

State of Florida



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Public Service Commission

January 19, 1990

Mr. Steve Tribble
Director of Records and
Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32399-0850

Re: Docket No. 891278-PU - Revision of Rule 25-14.003, F.A.C.,
Corporate Income Tax Expense Adjustment Rule; Midpoint and
Additional Changes.

Dear Mr. Tribble:

Please find enclosed for filing the original and seven copies
of Florida Public Service Commission staff's comments for filing
in the above referenced matter.

Service has been made as indicated on the Certificate of
Service.

- ACK _____
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Sincerely,

Cynthia B. Miller
Associate General Counsel

CBM:prl
Enclosures
cc: Parties of Record
3666G

DOCUMENT NUMBER-DATE
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FPSC-RECORDS/REPORTING

STAFF COMMENTS

**DOCKET NO. 891278-PU - REVISION OF RULE 25-14.003,
F.A.C., CORPORATE INCOME TAX EXPENSE ADJUSTMENTS RULE:
MIDPOINT AND OTHER ADDITIONAL CHANGES**

Several changes have been proposed to Rule 25-14.003, Corporate Income Tax Expense Adjustments, Florida Administrative Code, (the Rule.)

Throughout the Rule, "regulated company" is added to clarify the coverage of the Rule.

The "associated revenues" definition in subsection (1)(c) is clarified to state that the tax rate to be used in calculating the revenue expansion factor shall reflect the tax rate at which the utility or regulated company recognizes the effect of the refund, collection, or other adjustment in its tax return.

References to "show cause" proceedings are deleted throughout the Rule and replaced with "earnings review" proceedings.

The "midpoint" definition in subsection (1)(f) is changed to "the midpoint of the range of return calculated as the weighted average cost of capital for the period of time covered by the tax adjustment report required in subsection (4)." In turn, the "weighted average cost of capital" shall be calculated using the current embedded cost of fixed rate capital, the actual cost of short-term debt,

zero cost for all investment tax credits, the cost of common equity and the actual cost of other sources of capital. The capital structure used shall be the company's actual capital structure adjusted to reflect all regulatory adjustments. The language deleted established the midpoint in relation to the midpoint of the range of return approved by the Commission in the utility's last rate case, adjusted for the cost of any debt issued subsequent to the rate case and prior to the commencement of a tax savings refund or tax deficiency collection.

Throughout the Rule, the language "or other adjustments approved by the Commission" is added to allow the Commission explicit, additional flexibility beyond that of authorizing refunds or collections.

The reporting requirements are clarified in subsection (4) and the form used by the Commission in relation to the Rule is incorporated by reference. Language is added which allows a reporting date on or before 15 days after the due date, including authorized extensions, of the Annual Report.

The procedures subsection, (5)(c), is clarified to state that "For years subsequent to the year in which the tax change became effective, tax savings or tax deficiencies shall be calculated for the entire calendar year or for the portion of the calendar year prior to the effective date of the next tax change."

The role of the Commission to "review and evaluate" the company's petition containing a calculation of and the

method for refunding, collecting or otherwise disposing of any tax saving or deficiency is clarified.

Refunds shall be made in accordance with Rules 25-4.114, 25-6.109, and 25-7.109.

Language is added that the date of overcollection or underpayment shall be the later of the date the tax rate change was effective or the first of the year for which the report is being filed. If a tax rate change was phased in over a period of time, then the date of overcollection or underpayment shall be the earlier of the date when the tax rate change was effective or the date the effect of the tax rate change was recognized as such by use of a blended tax rate. If the utility or regulated company is unable to show when overcollection or underpayment occurred, then the tax savings or tax deficiency shall be assumed to have occurred evenly over the twelve months covered by the tax adjustment report. Interest on refunds, collections, or other Commission approved adjustments shall be calculated in accordance with interest calculations provided in the Commission rules. Interest shall not accrue on franchise fees, utility taxes, sales taxes, or excise taxes.

In paragraph (5)(f), the customer's share of refund or collection should be determined on a basis that fairly and equitably reflects the income taxes embodied in rates for that company's various customer classes, or on any other fair and reasonable basis approved by the Commission.

When a tax rate change occurs, its effects shall be addressed in the course of rate cases and earnings review proceedings that are pending when the tax rate change became law. If such a proceeding is initiated in the year in which the change became effective, the effects of the change shall be addressed in such proceedings.

A tax savings refund, tax deficiency collection, or other adjustment already in progress shall be completed.

Subsection (7) states that the Rule revisions shall not negate any agreements already approved by the Commission prior to the Rule's effective date.

These amendments to the Rule were proposed for the following reasons:

1. To ease the burden of the Rule;
2. To make administration of the Rule more effective and more equitable;
3. To allow more explicit flexibility in application of the Rule;
4. To clarify the Rule; and,
5. To change the calculation of the **self-imposed limitation** on the amount of tax savings or deficiency that is considered under the Rule. This would be accomplished by changing the equity return used for the calculation and by assigning a cost rate of zero to the investment tax credits (ITC) used in the calculation.

Staff's further comments will be directed toward the cost rate to be assigned to ITC.

Congress provided ITC for economic reasons. To assure itself that the ITC would be used for those reasons in a regulated environment, Congress established limitations on the treatment of the ITC in the ratemaking process. If the limitations are not observed, the ITC are forfeited both prospectively and retroactively: new ITC cannot be taken in the future and old ITC must be repaid.

The Tax Reform Act of 1986 phased in repeal of the ITC by allowing, in limited circumstances, some unused ITC to be carried forward and some new ITC to be generated. The limitations on the ratemaking treatment of the ITC were retained.

Section 46(f) of the Code and section 1.46-6 of the Regulations deal with the limitations on the ratemaking treatment of the ITC. The limitations affect both the rate base and cost of service treatment of the ITC and are dictated by the election the utility made under section 46(f) of the Code.

The unamortized balance of the ITC of a utility making an election under section 46(f)(1) of the Code may reduce the rate base of the utility if the amount of the rate base reduction is decreased in a given manner. The rate base reduction must be decreased no less rapidly than ratably. Essentially this means that the rate base reduction must be decreased over the book depreciable life of the asset that

created the ITC. As an alternative to rate base reduction, the unamortized balance of ITC may be included in the capital structure of the utility and may be assigned a zero cost rate. The amount of zero cost ITC in the capital structure must be reduced in the same manner as a rate base reduction must be reduced.

The amortization of ITC reducing the rate base or assigned a zero cost rate in capital structure may not affect the calculation of net operating income by reducing the utility's cost of service and revenue requirements.

The unamortized balance of the ITC of a utility making an election under section 46(f)(2) of the Code may be included in the capital structure of the utility. If it is included in the capital structure, it must be assigned a cost rate that is equal to the cost of the investor capital it has replaced. The ITC may not reduce rate base or be assigned a cost rate of zero.

The amortization of these ITC may affect the calculation of net operating income thereby reducing the utility's cost of service and revenue requirements if the amortization is not more rapid than ratable. Again, "ratable" is measured by the book depreciable life of the asset that created the ITC.

Methods that indirectly arrive at the same result as a direct method that is not permitted will also result in violations of the Code and underlying Regulations.

Comments that have been filed by parties affected by the Rule suggest that the proposed change in the **self-imposed limitation** in the amount of tax savings or deficiencies to be addressed under the Rule would violate the provisions of the Code and underlying Regulations. Staff does not believe that to be so.

It is in relation to utilities making elections under section 46(f)(2) that the proposal might appear to violate the provisions of the Code through the assignment of a zero cost rate to the unamortized ITC balance.

When this Commission adopted the Rule, it could have chosen to order that an adjustment be made for the full amount of tax savings or deficiency, for one-half of the tax savings or deficiency, for one-fourth of the tax savings or deficiency or for any other portion of the tax savings or deficiency. This Commission could have chosen to order that only the amounts of tax savings or deficiencies outside of a specified range, above or below a specified floor, or above or below a specified ceiling be addressed.

This Commission chose to require that only a portion of the tax savings be addressed under the Rule. In order to measure the limited amount of tax savings or deficiencies to be addressed, the Commission chose a specific midpoint as the measure. It now proposes to change the calculation of the midpoint to be used.

The return of the entire amount of tax savings would be no different than the return of the entire amount of a

reduction in any other expense of a utility. The collection of the entire amount of a tax deficiency would be no different than the collection of the entire amount of the increase in any other expense of a utility. It might not be viewed by some in certain circumstances as good regulation but it would not be a violation of the Code or underlying Regulations.

The Commission does not propose a change in the treatment of unamortized balances of ITC included in the capital structure nor does it propose a change in the treatment of the amortization of those balances to cost of service. The Commission proposes a change in a tool or benchmark. That benchmark does not affect the calculation of the tax savings or tax deficiency. Neither does it affect the determination, review or evaluation of the utility's earnings. It merely imposes a limitation on the amount of the tax savings or tax deficiency that will be addressed.

Because the Commission can order the return of the entire amount of tax savings or order the collection of the entire amount of tax deficiency but chooses not to do so, the use of a **self-imposed limitation** or benchmark cannot cause a violation of the provisions of the Code and underlying Regulations. The use of an earnings test--however the earnings are calculated--as the vehicle for the **self-imposed limitation** cannot convert an otherwise permissible adjustment into an impermissible one.

Staff believes the calculation of and disposal of a tax savings or tax deficiency is a specialized treatment for a specific purpose and that the thought process behind the treatment of ITC is not unlike that in regard to the treatment of ITC for purposes of calculating the allowance for funds used during construction.

Staff does not believe that the calculation of and disposition of tax savings or tax deficiencies meet the definition of "ratemaking" as contemplated by the Code and underlying Regulations. If the calculation of and disposition of tax savings or deficiencies do not meet the definition of "ratemaking" under the Code and underlying Regulations, then there can be no direct or indirect violation of the Code and underlying Regulations.

CERTIFICATE OF SERVICE

DOCKET NO. 891278-PU

I HEREBY CERTIFY that a copy of Florida Public Service Commission staff's comments in Docket No. 891278-PU has been furnished by United States mail this 19th day of January, 1990, to:

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