**FLORIDA PUBLIC SERVICE COMMISSION**

 **Fletcher Building**

 **101 East Gaines Street**

 **Tallahassee, Florida 32399-0850**

 **M E M O R A N D U M**

 **October 22, 1992**

**TO : DIRECTOR, DIVISION OF RECORDS AND REPORTING**

**FROM : DIVISION OF WATER AND WASTEWATER (MEADOR)**

 **DIVISION OF LEGAL SERVICES (KNOWLES)**

**RE :UTILITY: SOUTHERN STATES UTILITIES SERVICES**

**DOCKET NO.: 920634-WS**

**COUNTY: CLAY, CITRUS, DUVAL, LAKE, MARION, MARTIN, ORANGE,**

 **OSCEOLA, PUTNAM AND SEMINOLE COUNTIES**

**CASE: DISPOSITION OF GROSS-UP FUNDS COLLECTED**

**AGENDA : NOVEMBER 3, 1992 - CONTROVERSIAL - PROPOSED AGENCY ACTION - PARTIES MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**RECOMMENDATION FILE NAME: I:\PSC\WAW\WP\W920634A.REC WAW**

 **CASE BACKGROUND**

 The repeal of Section 118(b) of the Internal Revenue Code (I.R.C.) resulted in making contributions-in-aid-of-construction (CIAC) gross income and depreciable for federal tax purposes. In Order No. 16971, issued December 18, 1986, the Commission authorized corporate utilities to collect the gross-up on CIAC in order to meet the tax impact resulting from the inclusion of CIAC as gross income.

 Orders Nos. 16971 and 23541, require that utilities annually file information which would be used to determine the actual state and federal income tax expense directly attributable to the CIAC, and whether a refund of the gross-up is appropriate for any given year for which gross-up was in effect. These orders also required that all gross-up amounts for a tax year which are in excess of a utility's actual tax liability for the same year resulting from its collection of CIAC should be refunded on a pro rata basis to those persons who contributed the taxes.

 In Order No. 23541, issued October 1, 1990, the Commission determined that any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue collecting the gross-up, had to file a petition for approval with the Commission on or before October 29, 1990. Southern States Utilities Services (SSU or utility) did not request authority to continue to gross-up CIAC for the related tax impact. By Order No. 24791, issued July 10, 1991, the Commission canceled the utility's authority to gross-up.

 By Order No. PSC-92-0961-FOF-WS, issued on September 9, 1992, the Commission clarified the procedure to be used to calculate the amount of gross-up refunds. The calculations used by staff in this recommendation are consistent with that order.

 SSU is a Class A utility which provides water and wastewater service to water customers and wastewater customers in sixteen (16) Counties. According to their 1991 annual report, operating revenue of $4,912,789 for water and $3,931,643 for the wastewater system were reported. The utility reported net operating income of $274,918 for the water system and a net operating loss of $277,432 for the wastewater system.

 **DISCUSSION OF ISSUES**

**ISSUE 1:** Should Southern States Utilities Services be required to refund excess gross-up collections plus accrued interest through the date of refund?

**RECOMMENDATION:** Yes, the utility should refund $153,491 for 1987; $73,823 for 1988; $410,210 for 1989; $794,359 for 1990 and no refund for 1991, for a total of $1,431,883 plus accrued interest through the date of refund, for gross-up collected in excess of the tax liability resulting from the collection of CIAC. In accordance with Orders Nos. 16971 and 23541, all amounts should be refunded on a pro rata basis to those persons who contributed the taxes. The refund should be completed within 6 months. The utility should submit copies of canceled checks, credits applied to monthly bills or other evidence which verifies that the refunds have been made, within 30 days from the date of refund. (MEADOR)

**STAFF ANALYSIS:** In compliance with Order No. 16971, SSU filed its 1987 through 1991 annual CIAC reports regarding its collection of gross-up for each year. Staff has a theoretical concern with the utility's calculations. This concern will be discussed below.

**COMPARISON OF ANNUAL GROSS-UP COLLECTED WITH THE TAX LIABILITY**

**RESULTING FROM ABOVE-THE-LINE OPERATIONS**

 The utility provided its proposed refund calculations on May 27, 1992. It appears that the utility calculates the above-the-line tax liability based upon the total taxable income at its federal and state tax rates. This above-the-line tax liability is then compared to the amount of gross-up collected for the year to determine the amount of gross-up refund, if any.

 Staff has several problems with this method of refund calculation. First, Orders Nos. 16971 and 23541, require that utilities annually file information which would be used to determine the actual state and federal income tax expense directly attributable to the CIAC. The utility has in fact calculated the amount of above-the-line tax liability resulting from its overall operations. With the exception of taxable CIAC, federal and state income taxes due on above-the-line operations are recovered through service rates charged to the general body of ratepayers. Therefore, if a utility has an above-the-line loss, the amount of taxable CIAC collected for the year should be netted against the above-the-line loss to determine the net amount of taxable CIAC and taxes which the gross-up was collected to pay. If a utility has above-the-line income, the total amount of CIAC collected which is taxable because of the Amendment to Section 118(b), I.R.C., should be used to calculate the tax liability.

 Second, if the tax liability resulting from the collection of taxable CIAC is not looked at in isolation, the effect is that the developer or individual customer who pays gross-up is paying for the income taxes associated with the utility's overall operations, which is recoverable through service rates. Staff believes it is appropriate to use the total amount of taxable CIAC to calculate the actual tax liability attributable to the CIAC when a utility has an above-the-line taxable income and the amount of taxable CIAC should be reduced by the amount of the above-the-line loss when an above-the-line loss exists.

 **ANNUAL GROSS-UP REFUND AMOUNTS**

 Based upon the foregoing, staff has calculated the amount of refund per year which is appropriate. Our calculations are reflected on Schedule No. 1, attached to the recommendation. A summary of each year's refund calculation follows.

 **1987**

 The utility proposes a refund of $113,078 plus accrued interest for 1987 excess gross-up collections.

 Staff calculates a refund of $153,491 for 1987. The 1987 CIAC report indicates that a total of $153,491 of gross-up collections were received. Based upon our review of the utility's 1987 filing, the utility incurred an above-the-line loss prior to inclusion of the taxable CIAC. The loss is almost as much as the amount of CIAC collected. Staff has made a reduction to the amount of taxable CIAC to reflect the loss. Staff has used the 43.30% combined federal and state tax rate as provided in the 1987 CIAC Report. Based upon the foregoing, staff calculates a refund of $153,491 for 1987. This amount does not include the accrued interest which must also be refunded from December 31, 1987 to the date of refund.

 **1988**

 The utility did not propose a refund for 1988 excess gross-up collections.

 Staff calculated a refund of $73,823 for 1988. The 1988 CIAC report indicates that a total of $307,294 of gross-up collections were received. Based upon our review of the utility's 1988 filing, the utility had above-the-line income prior to inclusion of the taxable CIAC. Staff therefore, has not made a reduction to the amount of taxable CIAC. Staff has used the 37.63% combined federal and state tax rate as provided in the 1988 CIAC Report. Based upon the foregoing, staff calculates a refund of $73,823 for 1988. This amount does not include the accrued interest which must also be refunded from December 31, 1988 to the date of refund.

 **1989**

 The utility proposes a refund of $345,252 plus accrued interest for 1989 excess gross-up collections.

 Staff calculated a refund of $410,210 for 1989. The 1989 CIAC report indicates that a total of $410,210 of gross-up collections were received. Based upon our review of the utility's 1989 filing, the utility incurred an above-the-line loss prior to inclusion of the taxable CIAC. The loss is greater than the amount of CIAC collected. Staff has made a reduction to the amount of taxable CIAC to reflect the loss. Staff has used the 37.63% combined federal and state tax rate as provided in the 1989 CIAC Report. Based upon the foregoing, staff calculates a refund of $410,210 for 1989. This amount does not include the accrued interest which must also be refunded from December 31, 1989 to the date of refund.

 **1990**

 The utility proposes a refund of $794,359 plus accrued interest for 1990 excess gross-up collections.

 The 1990 CIAC report indicates that a total of $794,359 of gross-up collections were received. Based upon our review of the utility's 1990 filing, the utility incurred an above-the-line loss prior to inclusion of the taxable CIAC. The loss is greater than the amount of CIAC collected. Staff has used the 37.63% combined

federal and state tax rate as provided in the 1990 CIAC Report. Based upon the foregoing, staff calculates a refund of $794,359 for 1990. This amount does not include the accrued interest which must also be refunded from December 31, 1990 to the date of refund.

 **1991**

 The utility did not collect gross-up during the year 1991. Therefore, no refund was proposed. Staff agrees that no further action is necessary for 1991.

 The utility proposes a total refund of $1,252,689 for the years 1987 through 1991. Based upon the foregoing, staff recommends that the utility be required to refund a total of $1,431,883 ($153,491 for 1987; $73,823 for 1988; $410,210 for 1989; $794,359 for 1990: and no refund for 1991), plus accrued interest through the date of refund, for gross-up collections, in excess of the actual tax liability resulting from the collection of CIAC. The refund should be completed within 6 months. The utility should submit copies of canceled checks, credits applied to monthly bills, or other evidence which verifies that the refunds have been made, within 30 days from the date of the refund.

**ISSUE 2:** Should the docket be closed?

**RECOMMENDATION:** Yes the docket should be closed upon expiration of the protest period. (MEADOR, KNOWLES)

**STAFF ANALYSIS:** Staff believes this docket should be closed if a timely protest is not filed. Staff will monitor the processing of the refund separately.

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SOUTHERN STATES UTILITIES, INC. STAFF CALCULATED GROSS‑UP REFUND

SOURCE: (Line references are from CIAC Reports)

 1987 1988 1989 1990 1991

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 1 Form 1120, Line 30 (Line 15) $ 157,770 $ 858,921 $ 80,871 $ (900,457) $ 0

 2 Less CIAC (Line 7) (253,377) (512,551) (885,897) (1,208,006) 0

 3 Less Gross‑up collected (Line 19) (153,491) (307,294) (410,210) (794,359) 0

 4 Add First Year's Depr on CIAC (Line 8) 9,502 19,221 33,221 45,300 0

 5 Add/Less Other Effects (Lines 20 & 21) (1,907) (1,877) (4,126) (30,258) 0

 6 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

 7 Adjusted Income Before CIAC and Gross‑up $ (241,503) $ 56,420 $ (1,186,141) $ (2,887,780) $ 0

 8

 9 Taxable CIAC (Line 7) $ 253,377 $ 512,551 $ 885,897 $ 1,208,006 $ 0

10

11 Taxable CIAC Resulting in a Tax Liability $ 11,874 $ 512,551 $ 0 $ 0 $ 0

12 Less first years depr. (Line 8) (9,502) (19,221) (33,221) (45,300) 0

13 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

14 Net Taxable CIAC $ 2,372 $ 493,330 $ (33,221) $ (45,300) $ 0

15 Effective state and federal tax rate 43.30% 37.63% 37.63% 37.63% 37.63%

16 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

17 Net Income tax on CIAC $ 1,027 $ 185,640 $ (12,501) $ (17,046) $ 0

18 Less ITC Realized (47,331) (40,024) 0 0 0

19 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

20 Net Income Tax $ (46,304) $ 145,616 $ (12,501) $ (17,046) $ 0

21 Expansion Factor for gross‑up taxes 1.76366843 1.603334937 1.603334937 1.603334937 1.603334937

22 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

23 Gross‑up Required to pay tax effect $ (81,665) $ 233,471 $ (20,043) $ (27,330) $ 0

24 Less CIAC Gross‑up collected (Line 19) (153,491) (307,294) (410,210) (794,359) 0

25 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

26 PROPOSED REFUND (excluding interest) $ (153,491) $ (73,823) $ (410,210) $ (794,359) $ 0

27 ============ ============ ============ ============ ============

28 NO GROSS‑UP

29 TOTAL REFUND $ (1,431,883) COLLECTED

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