

FLORIDA PUBLIC SERVICE COMMISSION  
Capital Circle Office Center • 2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399-0850

MEMORANDUM

DECEMBER 5, 1996

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF WATER & WASTEWATER (GILCHRIST) *CGA*  
DIVISION OF LEGAL SERVICES (CYRUS-WILLIAMS) *WJL*

RE: DOCKET NO. 951415-WB - DISPOSITION OF GROSS-UP FUNDS  
COLLECTED BY LAKE GROVES UTILITIES, INC. -  
COUNTY: LAKE

AGENDA: DECEMBER 17, 1996 - REGULAR AGENDA - PROPOSED AGENCY  
ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\951415.RCM

CASE BACKGROUND

As a result of the repeal of Section 118(b) of the Internal Revenue Code (I.R.C.), contributions-in-aid-of-construction (CIAC) became gross income and were 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.

Order No. 16971 and Order No. 23541, issued October 1, 1990, require that utilities annually file information which would be used to determine the actual state and federal income tax liability directly attributable to the CIAC. The information would also determine whether refunds of gross-up would be appropriate. These orders also required that all gross-up collections for a tax year, which are in excess of a utility's actual tax liability for the same year, should be refunded on a pro rata basis to those persons who contributed the taxes.

In Order No. 23541, the Commission required any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue, to file a petition for approval with the Commission on or before October 29, 1990.

Lake Groves Utilities, Inc. (Lake Groves or utility) is a Class C utility providing services to 342 water and 341 wastewater

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customers in Lake County. According to its 1995 annual report, the utility reported operating revenues of \$92,747 for water and \$77,129 for wastewater and net operating income of \$77,032 and \$69,139 for water and wastewater, respectively. By Order No. PSC-93-0291-FOF-WS, issued February 23, 1993, Lake Groves was granted authority to gross-up using the full gross-up formula.

On September 9, 1992, this Commission issued Proposed Agency Action Order No. PSC-92-0961-FOF-WS, which clarified the provision of Orders Nos. 16971 and 23541 for the calculation of refunds of gross-up of CIAC. On September 14, 1992, Order No. PSC-92-0962-A-FOF-WS was issued. This order included Attachment A which reflects the generic calculation form. No protests were filed, and the Order became final.

On March 29, 1996, Docket No. 960397-WS was opened to review the Commission's policy concerning the collection and refund of CIAC gross-up. Workshops were held and comments and proposals were received from the industry and other interested parties. By Order No. PSC-96-0686-FOF-WS, issued May 24, 1996, staff was directed to continue processing CIAC gross-up and refund cases pursuant to Order Nos. 16971 and 23541; however, staff was also directed to make a recommendation to the Commission concerning whether the Commission's policy regarding the collection and refund of CIAC should be changed upon staff's completion of its review of the proposals and comments offered by the workshop participants. In addition, staff was directed to consider ways to simplify the process and determine whether there were viable alternatives to the gross-up.

However, on August 1, 1996, the Small Business Job Protection Act of 1996 (The Act) passed Congress and was signed into law by President Clinton on August 20, 1996. The Act provided for the non-taxability of CIAC collected by water and wastewater utilities effective retroactively for amounts received after June 12, 1996. As a result, on September 20, 1996, in Docket No. 960965-WS, Order No. PSC-96-1180-FOF-WS was issued to revoke the authority of utilities to collect gross-up of CIAC and to cancel the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. Since there was no longer a need to review the Commission's policy on the gross-up of CIAC, on October 8, 1996, Order No. PSC-96-1253-FOF-WS was issued, closing Docket No. 960397-WS. However, as established in Order No. PSC-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Order Nos. 16971 and 23541. The purpose of this recommendation is to address the disposition of gross-up funds collected by the utility in 1993 and 1994.



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### DISCUSSION OF ISSUES

**ISSUE 1:** Should Lake Groves Utilities, Inc. be required to refund excess gross-up collections for 1993 and 1994?

**RECOMMENDATION:** Yes, the utility should refund \$3,023 for 1993 and \$21,596 for 1994 plus accrued interest through the date of refund, for gross-up collected in excess of the above-the-line tax liability resulting from the collection of taxable CIAC. According to Orders Nos. 16971 and 23541, all amounts should be refunded on a pro rata basis to those persons who contributed the taxes. The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of cancelled checks, credits applied to monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility also should provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds. (GILCHRIST)

**STAFF ANALYSIS:** In compliance with Orders Nos. 16971 and 23541, Lake Groves filed its 1993 and 1994 annual CIAC reports regarding its collection of gross-up for each year. By letter dated February 20, 1996, staff submitted preliminary refund calculation numbers to the utility. On October 28, 1996, Lake Groves filed amended CIAC reports for 1993 and 1994. On November 25, 1996, staff sent new refund calculation numbers to the utility based on the information contained in the amended CIAC reports.

Staff has calculated the gross-up required to pay the tax liability resulting from the collection of taxable CIAC by grossing-up the net taxable CIAC amount, in accordance with the method adopted in Order No. PSC-92-0961-POF-WS.

### ANNUAL GROSS-UP REFUND AMOUNTS

Based upon the foregoing, staff has calculated the amount of refund per year which is appropriate. Our calculations, taken from the information provided by the utility in its gross-up reports filed each year are reflected on Schedule No. 1. A summary of each year's refund calculation follows.

1993

The utility proposes and staff agrees that a refund of \$3,023 is appropriate for 1993.

The utility's 1993 CIAC report indicates that the utility had an above-the-line-loss before the inclusion of taxable CIAC in income. Order No. 23541 requires that CIAC income be netted against the above-the-line-loss; therefore, not all of the CIAC collected would create a tax liability. The utility's CIAC report indicates a total of \$108,790 in taxable CIAC was received, with \$2,124 being deducted for the first year's depreciation, resulting in net taxable CIAC of \$106,666. When this amount is netted against the above-the-line-loss of \$3,487, the amount of taxable CIAC resulting in a tax liability is \$103,179. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1993 CIAC Report to calculate net income taxes of \$38,826 on the taxable CIAC. When this amount is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect on the CIAC is calculated to be \$62,251. The utility collected \$65,274 of gross-up monies; therefore, staff calculates a refund of \$3,023. This amount does not include accrued interest which must also be refunded from December 31, 1993 through the date of the refund.

The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of cancelled checks, credits applied to monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility also should provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds.

1994

The utility proposes that a refund of \$5,576 is appropriate for 1994. Staff believes that a refund of \$21,596 is appropriate.

In its filing, the utility classified \$20,770 of its expenses as above-the-line and \$84,306 as below-the-line operating expenses. Staff classified \$102,944 of the utility's expenses as above-the-line operating expenses. The utility's annual report for 1994 shows operating expenses to be \$102,944; therefore, the utility's operating expenses has been adjusted accordingly. When staff reviewed the utility's annual report to determine whether it was overearning, operating expenses in the amount of \$102,944 were



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considered to be utility related and used and useful. Further, for annual report review purposes, these expenses were included and considered when determining the utility's net income; therefore, staff believes expenses in the amount of \$102,944, should be included as above-the-line operating expenses in calculating the utility's taxable income.

Staff's adjustment to the utility's operating expenses changed the utility's reported above-the-line taxable loss before the inclusion of CIAC in income from \$1,715 to \$28,215. Order No. 23541 requires that CIAC income be netted against the above-the-line loss; therefore, not all of the CIAC collected would create a tax liability. The utility's CIAC report indicates a total of \$627,581 in taxable CIAC was received, with \$12,254 being deducted for the first year's depreciation, resulting in net taxable CIAC of \$615,327. When this amount is netted against staff's above-the-line loss of \$28,265, the amount of taxable CIAC resulting in a tax liability is \$587,062 instead of \$613,612 as calculated by the utility. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1994 CIAC Report to calculate net income taxes of \$220,911 on the taxable CIAC. When this amount is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect on the CIAC is calculated to be \$354,194. The utility collected \$375,790 of gross-up monies; therefore, staff calculates a refund of \$21,596. This amount does not include accrued interest which must be refunded from December 31, 1994 through the date of the refund.

The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of cancelled checks, credits applied to monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility also should provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refund.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: No. Upon expiration of the protest period, this docket should remain open pending staff's verification of refunds. Staff should be given administrative authority to close the docket upon verification that the refunds have been completed. (CYRUS-WILLIAMS)

STAFF ANALYSIS: Upon expiration of the protest period, if a timely protest is not received from a substantially affected person, this docket should remain open pending completion and verification of the refunds. Staff recommends that administrative authority be granted to staff to close the docket upon verification that the refunds have been made.



Lake Groves Utilities, Inc. STAFF CALCULATED GROSS-UP REFUND  
 SOURCE: (Line references are from CIAC Reports)

	1993	1994
1 Form 1120, Line 30 (Line 15)	\$ 168,465	\$ 964,250
2 Less CIAC (Line 7)	(108,790)	(627,581)
3 Less Gross-up collected (Line 19)	(65,274)	(375,790)
4 Add First Year's Depr on CIAC (Line 8)	2,124	12,254
5 Add/Less Other Effects (Lines 20 & 21)	(12)	(1,398)
6		
7 Adjusted Income Before CIAC and Gross-up	\$ (3,487)	\$ (28,265)
8		
9 Taxable CIAC (Line 7)	\$ 108,790	\$ 627,581
10 Less first years depr. (Line 8)	\$ (2,124)	\$ (12,254)
11		
12 Adjusted Income After CIAC	\$ 103,179	\$ 587,062
13 Less: NOL Carry Forward	\$ 0	\$ 0
14		
15 Net Taxable CIAC	\$ 103,179	\$ 587,062
16 Combined Marginal state & federal tax rates	37.63%	37.63%
17		
18 Net Income tax on CIAC	\$ 38,826	\$ 220,911
19 Less ITC Realized	0	0
20		
21 Net Income Tax	\$ 38,826	\$ 220,911
22 Expansion Factor for gross-up taxes	1.6033349	1.6033349
23		
24 Gross-up Required to pay tax effect	\$ 62,251	\$ 354,194
25 Less CIAC Gross-up collected (Line 19)	(65,274)	(375,790)
26		
27 (OVER) OR UNDER COLLECTION	\$ (3,023)	\$ (21,596)
28		
29		
30 TOTAL YEARLY REFUND	\$ (3,023)	\$ (21,596)
31		
32		
33 PROPOSED REFUND (excluding interest)	(24,619)	
34		