

DOCKET NO. 971529-WS
JANUARY 22, 1998

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. Aloha filed for authority to continue to gross-up on December 28, 1990. By Order No. 25526, issued December 24, 1991, Aloha was granted authority to continue 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 provisions of Orders Nos. 16971 and 23541 for the calculation of refunds of gross-up of CIAC. On September 14, 1992, Order No. PSC-92-0961A-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 Orders 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, the Small Business Job Protection Act of 1996 (The Act) 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. Based on the above, there was no longer a need to review the Commission's policy to determine any changes and 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

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to Orders Nos. 16971 and 23541. The disposition of gross-up funds collected by the utility in 1990-1992 were handled in Docket No. 940156-WS and Order No. PSC-94-0444-FOF-WS was issued accordingly. The purpose of this docket is to address the disposition of gross up funds collected by the utility from 1993 to 1996, and to address the utility's proposal that 50% of its legal and accounting costs be offset against the refund amount.

DISCUSSION OF ISSUES

ISSUE 1: Should Aloha Utilities, Inc. be required to refund excess gross-up collections for 1993-1996?

RECOMMENDATION: No, the utility does not owe refunds for 1993-1995. For 1996, the utility over collected CIAC gross-up in the amount of \$2,859; however, staff recommends that the Commission accept Aloha's request to offset 50% of the legal and accounting fees incurred (\$3,050) against the refund amount of \$2,859. Although the utility is entitled to offset \$3,050; only, \$2,859 of this amount will be used to offset the refund of \$2,859. When the offset is made, no refund is required for 1996. (GILCHRIST, CAUSSEAUX)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Aloha filed its 1993 through 1996 annual CIAC reports regarding its collection of gross-up for each year. By letter dated November 14, 1997, staff submitted preliminary refund calculation numbers to the utility. By letter dated December 22, 1997, the utility stated that while they do not agree with staff's above the line classification of officers' salaries, they accept the staff's refund calculations for 1993-1996.

Staff 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-FOF-WS.

ANNUAL GROSS-UP REFUND AMOUNTS

Based upon the foregoing, staff 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 that no refund is appropriate. Staff agrees that a refund of gross-up collections for 1993 is not appropriate.

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The 1993 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC and gross-up. Therefore, all of the taxable CIAC received would be taxed. The report indicates a total of \$553,643 in taxable CIAC was received, with \$7,651 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rates as provided in the 1993 CIAC Report to calculate net income taxes of \$205,457. 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 \$329,416. In December, 1992, Aloha received and booked \$24,010 of property CIAC from Heritage Lake Development. Such CIAC was included as income on the 1992 tax return and the 1992 gross-up refund report filed with the Commission. However, the related gross-up of \$13,927 was not received and booked until January, 1993. Therefore, the gross-up amount collected in 1993 has been adjusted to properly match 1993 CIAC with the related 1993 gross-up collections. As a result, the amount of gross-up collected by the utility in 1993 is \$327,570. The utility required more in gross-up to pay the tax impact than the utility collected; therefore, no refund is necessary.

1994

The utility proposes that no refund is appropriate. Staff agrees that a refund of gross-up collections for 1994 is not appropriate.

The 1994 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC and gross-up. Therefore, all of the taxable CIAC received would be taxed. The report indicates a total of \$1,301,370 in taxable CIAC was received, with \$15,192 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rates as provided in the 1994 CIAC Report to calculate net income taxes of \$483,989. 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 \$775,996. The utility collected \$762,413 of gross-up monies. The utility required more in gross-up to pay the tax impact than the utility collected; therefore, no refund is necessary.

1995

The utility proposes that no refund is appropriate. Staff agrees that a refund of gross-up collections for 1995 is not appropriate.

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The 1995 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC and gross-up. Therefore, all of the taxable CIAC received would be taxed. The report indicates a total of \$401,761 in taxable CIAC was received, with \$7,043 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rates as provided in the 1995 CIAC Report to calculate net income taxes of \$148,532. 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 \$238,147. The utility collected \$235,421 of gross-up monies. The utility required more in gross-up to pay the tax impact than the utility collected; therefore, no refund is necessary.

1996

The utility proposes that no refund is appropriate. For 1996, the utility over collected CIAC gross-up in the amount of \$2,859; however, staff recommends that the Commission accept Aloha's request to offset 50% of the legal and accounting fees incurred (\$3,050) against the refund amount of \$2,859. Although the utility is entitled to offset \$3,050; only, \$2,859 of this amount will be used to offset the refund of \$2,859. When this offset is made, no refund is required for 1996.

The 1996 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC and gross-up. Therefore, all of the taxable CIAC received would be taxed. The report indicates a total of \$454,632 in taxable CIAC was received, with \$17,065 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rates as provided in the 1996 CIAC Report to calculate net income taxes of \$164,656. 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 \$263,999. The utility collected \$266,858 of gross-up monies. Therefore, the utility collected \$2,859 more in gross-up than was required to pay the tax impact; however, staff recommends that no refund be required.

The utility provided documentation requesting legal and accounting fees of \$6,100. Staff reviewed these costs and determined that all of the legal and accounting fees submitted by the utility are directly associated with preparing the required reports and calculating the tax effect, and, thus, are considered to be legitimate expenses. Fifty percent (50%) of this amount is \$3,050. Although the utility is entitled to offset \$3,050; only,

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\$2,859 of this amount will be used to offset the refund of \$2,859. When the legal and accounting fees of \$2,859 is offset against the refund amount of \$2,859, there is nothing left to refund, thus no refund would be required for 1996.

Staff notes that the Commission has considered on several occasions, the question of whether an offset should be allowed pursuant to the orders governing CIAC gross-up. In Dockets Nos. 961076-WS, and 970275-WS, by Orders Nos. PSC-97-0657-AS-WS and PSC-97-0816-FOF-WS, respectively, the Commission accepted the utility's settlement proposals that 50% of the legal and accounting costs be offset against the refund amount. In general, the utility argues that the legal and accounting costs should be deducted from the amount of the contributors' refund, as the contributors are the cost-causers and as such, those costs should be recovered from the cost-causers.

Staff notes that it was the change in the tax laws and not the contributors that imposed a new cost on the utilities associated with CIAC. Further, staff believes that once the contributors have paid the gross-up taxes on the CIAC, the contributors have fulfilled their obligation under Orders Nos. 16971 and 23541. Since those orders also provide that gross-up in excess of the utility's actual tax liability should be refunded on a pro rata basis to those persons who contributed the taxes, staff believes that once the tax liability is determined, it is the responsibility of the Commission to ensure that excess payments of CIAC taxes are refunded in compliance with those Orders. Therefore, staff does not believe that a reduction in the amount of refund a contributor is entitled to receive as a result of his overpayment of gross-up taxes is appropriate. Staff acknowledges that those costs were incurred to satisfy regulatory requirements; however, staff does not believe that the contributors should be held responsible for the legal and accounting costs incurred to determine whether they are entitled to a refund. Staff views those costs as a necessary cost of doing business, and as such, staff believes it is appropriate for the utility to seek recovery of those amounts in a rate case proceeding. Finally, staff believes that this situation is similar to when a utility files for an increase in service availability charges. The costs of processing the utility's service availability case is borne by the general body of ratepayers, although the charges are set for future customers, only.

However, as in the other cases referenced herein, staff recognizes in this case that acceptance of the utility's request would avoid the substantial cost associated with a hearing, which may in fact exceed the amount of the legal and accounting cost to be recovered. Staff further notes that the actual costs associated

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with implementing the refunds have not been included in these calculations and will be absorbed by the utility. Moreover, staff believes the utility's request is a reasonable "middle ground". Therefore, staff recommends that while not adopting the utility's position, the Commission grant Aloha's request that it be allowed to offset 50% of the legal and accounting fees against the refund. For 1996, the utility had legitimate legal and accounting fees of \$6,100. Fifty percent (50%) of this amount is \$3,050. Although the utility is entitled to offset \$3,050; only, \$2,859 of this amount will be used to offset the refund of \$2,859. When the legal and accounting fees of \$2,859 is offset against the refund amount of \$2,859, there is nothing left to refund, thus no refund would be required for 1996.

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ISSUE 3: Should the docket be closed?

RECOMMENDATION: Yes, this docket should be closed upon the expiration of the protest period. (JAEGER)

STAFF ANALYSIS: If the Commission approves staff's recommendation, no further action in this docket would be required. Therefore, upon the expiration of the protest period, the docket should be closed.

COMMISSION CALCULATED GROSS-UP REFUND

Aloha Utilities, Inc.

SOURCE: (Line references are from CIAC Reports)

	1993	1994	1995	1996
1 Form 1120, Line 30 (Line 15)	\$ 1,117,308	\$ 2,130,594	\$ 869,363	\$ 1,530,948
2 Less CIAC (Line 7)	(553,643)	(1,301,370)	(401,761)	(454,632)
3 Less Gross-up Collected (Line 10)	(341,497)	(762,413)	(235,421)	(266,858)
4 Add First Year's Depr on CIAC (Line 8)	7,651	15,192	7,043	17,065
5 Add/Less Other Effects (Lines 20 & 21)	(1,779)	(1,455)	(968)	(1,055)
6				
7 Adjusted Income Before CIAC and Gross-up	\$ 228,040	\$ 80,548	\$ 238,256	\$ 825,468
8				
9 Taxable CIAC (Line 7)	\$ 553,643	\$ 1,301,370	\$ 401,761	454,632
10 Less first years depr. (Line 8)	\$ (7,651)	\$ (15,192)	\$ (7,043)	(17,065)
11				
12 Adjusted Income After CIAC	\$ 774,032	\$ 1,366,726	\$ 632,974	\$ 1,263,035
13 Less: NOL Carry Forward	\$ 0	\$ 0	\$ 0	0
14				
15 Net Taxable CIAC	\$ 545,992	\$ 1,286,178	\$ 394,718	\$ 437,567
16 Combined Marginal state & federal tax rates	37.63%	37.63%	37.63%	37.63%
17				
18 Net Income tax on CIAC	\$ 205,457	\$ 483,989	\$ 148,532	\$ 164,656
19 Less ITC Realized	0	0	0	0
20				
21 Net Income Tax	\$ 205,457	\$ 483,989	\$ 148,532	\$ 164,656
22 Expansion Factor for gross-up taxes	1.6033349	1.6033349	1.6033349	1.6033349
23				
24 Gross-up Required to pay tax effect	\$ 329,416	\$ 775,996	\$ 238,147	\$ 263,999
25 Less CIAC Gross-up Collected (Line 19)	(341,497)	(762,413)	(235,421)	(266,858)
Less 1992 Gross-up Collected in 1993	13,927			
Adjusted 1993 Gross-up Collected	(327,570)			
26				
27 (OVER) OR UNDER COLLECTION	\$ 1,846	\$ 13,583	\$ 2,726	\$ (2,859)
28				
29 TOTAL YEARLY REFUND	\$ 0	\$ 0	\$ 0	\$ (2,859)
30 Offset of Legal and Accounting Fees				\$ 2,859
31				
32 PROPOSED REFUND (excluding interest)	\$ 0	\$ 0	\$ 0	\$ 0