

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

MEMORANDUM RECEIVED

April 30, 1998

APR 30 1998

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO) 11:35 ds/Reporting

FROM: DIVISION OF WATER & WASTEWATER (GILCHRIST) 11:35
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (CAUSSEAU) 11:35
DIVISION OF LEGAL SERVICES (JAEGER) 11:35

RE: DOCKET NO. 980504-WS - DISPOSITION OF GROSS-UP FUNDS COLLECTED BY HYDRATECH UTILITIES, INC.
COUNTY: MARTIN

AGENDA: MAY 12, 1998 - REGULAR AGENDA - PROPOSED AGENCY ACTION-INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\980504.RCM

CASE BACKGROUND

Hydratech Utilities, Inc. (Hydratech or utility), is a Class A water and wastewater utility providing service to approximately 5,301 water and 4,499 wastewater customers in Martin County. According to its 1996 annual report, the utility reported gross operating revenues of \$1,330,262 and \$1,058,728 for water and wastewater, respectively, and net operating income of \$182,542 for water and net operating income of \$793 for wastewater.

As a result of the repeal of Section 118(b) of the Internal Revenue Code, effective January 1, 1987, contributions-in-aid-of-construction (CIAC) became gross income and were depreciable for federal tax purposes. Therefore, by 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 December 18, 1986 and October 1, 1990, respectively, 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

DOCUMENT NUMBER DATE

04845 APR 30 98

FPSC-RECORDS/REPORTING

DOCKET NO. 980504-WS
MAY 12, 1998

actual tax liability for the same year, should be refunded on a pro rata basis to those persons who contributed the taxes.

However, the Small Business Job Protection Act of 1996 (The Act), which became law on August 20, 1996, provided for the non-taxability of CIAC collected by water and wastewater utilities effective retroactively for amounts received after June 12, 1996.

The disposition of gross-up funds collected by the utility for 1995 was handled in Docket No. 970275-WS, Order No. PSC-97-0816-POF-WS, issued July 7, 1997. The purpose of this recommendation is to address the disposition of gross-up funds collected by the utility for 1996.

DISCUSSION OF ISSUES

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

RECOMMENDATION: No. The utility over collected CIAC gross-up in the amount of \$2,692; however, staff recommends that the Commission accept the utility's request to offset 50% of the legal and accounting fees incurred (\$3,457) against the refund amount of \$2,692. If the Commission approves staff's recommendation, only \$2,692 of the \$3,457 amount will be used to offset the refund of \$2,692. When the offset is made, no refund would be required for 1996. (GILCHRIST, CAUSSEAU)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Hydratech filed its 1996 annual CIAC report regarding its collection of gross-up. The utility calculated its above-the-line income to be \$888,384. Staff adjusted the utility's above-the-line income by \$20,236 to reflect first year's depreciation as above-the-line. Also, above-the-line income was adjusted by \$6,121 to reflect the net loss on a retired asset.

By letter dated January 13, 1998, staff submitted preliminary refund calculation numbers to the utility. By letter dated April 3, 1998, the utility stated that it disagreed with staff's decision to decrease above-the-line income by the loss resulting from the retirement of an asset. Further, the utility explained that while the loss on a retired asset was calculated for tax purposes, the utility indicated that for regulatory purposes, its books are kept in accordance with the NARUC system of accounts and retirements are accounted for in accordance with NARUC instruction 27B(2), which does not include recognition of gains or losses on disposal or retirement of assets. Staff agrees that the loss on the retired asset should remain below-the-line. As a result, staff calculated above-the-line income to be \$868,148. The utility states that although it does not agree with staff's methods, it agrees with staff's ultimate conclusion that none of the gross-up monies for 1996 are refundable.

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 1996 refund which is appropriate. Our calculations, taken from the information provided by the utility in its gross-up report filed for 1996, is reflected on Schedule No. 1.

The utility's 1996 CIAC report indicates that 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 \$528,355 in taxable CIAC was received, with \$20,236 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1996 CIAC Report to calculate the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$508,119 results in the income tax effect of \$191,205. 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 \$306,566. The utility collected \$309,258 of gross-up monies. Therefore, the utility collected \$2,692 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 \$6,914. 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 \$3,457; however, only, \$2,692 of this amount will be used to offset the refund of \$2,692 if the Commission approves staff's recommendation. When the legal and accounting fees of \$2,692 are offset against the refund amount of \$2,692, 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 Docket Nos. 961076-WS, and 970275-WS, by Order Nos. PSC-97-0657-AS-WS and PSC-97-0816-FOP-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.

DOCKET NO. 980504-WS
MAY 12, 1998

Staff believes that Orders Nos. 16971 and 23541 did not provide for or contemplate an offset as requested by the utility. 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. 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 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 Hydratech's request that it be allowed to offset 50% of the legal and accounting fees against the refund. The utility had legitimate legal and accounting fees of \$6,914. Fifty percent (50%) of this amount is \$3,457; however, only \$2,692 of this amount will be used to offset the over collection of \$2,692. When the legal and accounting fees of \$2,692 are offset against the over collection of \$2,692, there is nothing left to refund, thus no refund would be required for 1996.

DOCKET NO. 980504-WS
MAY 12, 1998

ISSUE 2: 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, if a timely protest is not received from a substantially affected person, the docket should be closed.

COMMISSION CALCULATED GROSS-UP REFUND

Hydratech Utilities, Inc.

SOURCE: (Line references are from CIAC Reports)

	1996
1 Form 1120, Line 30 (Line 15)	\$ 868,148
2 Less CIAC (Line 7)	(528,355)
3 Less Gross-up Collected (Line 10)	(309,258)
4 Add First Year's Depr on CIAC (Line 8)	20,236
5 Add/Less Other Effects (Lines 20 & 21)	
6	
7 Adjusted Income Before CIAC and Gross-up	\$ 50,771
8	
9 Taxable CIAC (Line 7)	\$ 528,355
10 Less first years depr. (Line 8)	\$ (20,236)
11	
12 Adjusted Income After CIAC	\$ 558,890
13 Less: NOL Carry Forward	\$ 0
14	
15 Net Taxable CIAC	\$ 508,119
16 Combined Marginal state & federal tax rates	37.63%
17	
18 Net Income tax on CIAC	\$ 191,205
19 Less ITC Realized	0
20	
21 Net Income Tax	\$ 191,205
22 Expansion Factor for gross-up taxes	1.6033349
23	
24 Gross-up Required to pay tax effect	\$ 306,566
25 Less CIAC Gross-up collected (Line 19)	(309,258)
26	
27 (OVER) OR UNDER COLLECTION	\$ (2,692)
28	
29 TOTAL YEARLY REFUND	\$ (2,692)
30 Offset of Legal and Accounting Fees	\$ 2,692
31	
32 PROPOSED REFUND (excluding interest)	\$ 0