



Public Service Commission

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RECORDS AND REPORTING

DATE: NOVEMBER 5, 1998

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

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

RE: DOCKET NO. 980943-WS - DISPOSITION OF GROSS-UP FUNDS
COLLECTED BY GULF UTILITY COMPANY
COUNTY: LEE

AGENDA: NOVEMBER 17, 1998 - REGULAR AGENDA - PROPOSED AGENCY
ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\WAW\WP\980943.RCM

CASE BACKGROUND

Gulf Utility Company (Gulf or utility), is a Class A utility providing service to approximately 7,282 water and 2,584 wastewater customers in Lee County. According to its 1997 annual report, the utility reported gross operating revenues of \$2,068,756 and \$1,556,271 for water and wastewater, respectively, and net operating income of \$108,751 for water and net operating income of \$278,885 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.

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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 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 1987-1991 were handled in Docket No. 930216-WS, Order No. PSC-95-0508-FOF-WS, issued April 25, 1995. The purpose of this recommendation is to address the disposition of gross-up funds collected by the utility for 1992-1996.

DISCUSSION OF ISSUES

ISSUE 1: Should Gulf Utility Company be required to refund excess gross-up collections for 1992-1996?

RECOMMENDATION: Yes, the utility should refund \$5,724 for 1992, \$11,643 for 1993, and \$23,102 for 1994, for a total of \$40,469 for excess gross-up collections, plus accrued interest through the date of refund. For 1995 and 1996, the utility does not owe any refunds.

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 canceled 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 the contributor and amount, and an explanation of the efforts made to make the refunds. (GILCHRIST, CAUSSEAUX)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Gulf filed its 1992-1996 annual CIAC reports regarding its collection of gross-up. By letter dated October 6, 1998, staff submitted preliminary refund calculation numbers to the utility. On October 21, 1998, the utility filed a response indicating that it agreed with staff's preliminary calculations, and that a refund of \$40,469 is appropriate for 1992-1996.

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 has calculated the amount of refunds which are appropriate for 1992-1996. Our calculations, taken from the information provided by the utility in its gross-up report is reflected on Schedule No. 1.

1992

The utility's 1992 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 \$528,301 in taxable CIAC was received, with \$4,886 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1992 CIAC Report to calculate the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$523,415 results in the income tax effect of \$196,961. 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 \$315,794. The utility collected \$321,518 of gross-up monies; therefore, staff calculates a refund of \$5,724. This amount does not include accrued interest which must be refunded from December 31, 1992 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 canceled 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.

1993

The utility's 1993 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 \$957,765 in taxable CIAC was received, with \$18,803 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1993 CIAC Report to calculate the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$938,962 results in the income tax effect of \$353,331. 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 \$566,508. The utility collected \$578,151 of gross-up monies; therefore, staff calculates a refund of \$11,643. This amount does not include accrued interest which must 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 canceled 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.

1994

The utility's 1994 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 \$1,469,031 in taxable CIAC was received, with \$38,301 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1994 CIAC Report to calculate the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$1,430,730 results in the income tax effect of \$538,384. 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 \$863,210. The utility collected \$886,312 of gross-up monies; therefore, staff calculates a refund of \$23,102. 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 canceled 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.

1995

The utility's 1995 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 \$1,110,304 in taxable CIAC was received, with \$35,635 being deducted for the first year's depreciation. Staff used the 37.63%

combined marginal federal and state tax rate as provided in the 1995 CIAC Report to calculate the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$1,074,669 results in the income tax effect of \$404,398. 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 \$648,385. The utility collected \$617,226 of gross-up monies; therefore, no refund is required for 1995.

1996

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 \$546,906 in taxable CIAC was received, with \$8,235 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 \$538,671 results in the income tax effect of \$202,702. 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 \$324,999. The utility collected \$320,647 of gross-up monies; therefore, no refund is required for 1996.

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ISSUE 2: Should this 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, and there are no unclaimed refunds. (JAEGER)

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, and there are no unclaimed refunds.

STAFF CALCULATED GROSS-UP REFUNDS

Gulf Utility Company

SOURCE: (Line references are from CIAC Reports)

	1992	1993	1994	1995	1996
1 Form 1120, Line 30 (Line 15)	\$ 992,548	\$ 1,678,566	\$ 2,503,601	\$ 1,742,258	\$ 921,854
2 Less CIAC (Line 7)	(528,301)	(957,765)	(1,469,031)	(1,110,304)	(546,906)
3 Less Gross-up Collected (Line 10)	(321,518)	(578,151)	(886,312)	(617,226)	(320,647)
4 Add First Year's Depr on CIAC (Line 8)	4,886	18,803	38,301	35,635	8,235
5 Add/Less Other Effects (Lines 20 & 21)	(2,347)	(4,984)	(4,348)	(2,650)	(1,645)
6					
7 Adjusted Income Before CIAC and Gross-up	\$ 145,268	\$ 156,469	\$ 182,211	\$ 47,713	\$ 60,891
8					
9 Taxable CIAC (Line 7)	\$ 528,301	\$ 957,765	\$ 1,469,031	\$ 1,110,304	\$ 546,906
10 Less first years depr. (Line 8)	\$ (4,886)	\$ (18,803)	\$ (38,301)	\$ (35,635)	\$ (8,235)
11					
12 Adjusted Income After CIAC	\$ 668,683	\$ 1,095,431	\$ 1,612,941	\$ 1,122,382	\$ 599,562
13 Less: NOL Carry Forward	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
14					
15 Net Taxable CIAC	\$ 523,415	\$ 938,962	\$ 1,430,730	\$ 1,074,669	\$ 538,671
16 Combined Marginal state & federal tax rates	37.63%	37.63%	37.63%	37.63%	37.63%
17					
18 Net Income tax on CIAC	\$ 196,961	\$ 353,331	\$ 538,384	\$ 404,398	\$ 202,702
19 Less ITC Realized	0	0	0	0	0
20					
21 Net Income Tax	\$ 196,961	\$ 353,331	\$ 538,384	\$ 404,398	\$ 202,702
22 Expansion Factor for gross-up taxes	1.6033349	1.6033349	1.6033349	1.6033349	1.6033349
23					
24 Gross-up Required to pay tax effect	\$ 315,794	\$ 566,508	\$ 863,210	\$ 648,385	\$ 324,999
25 Less CIAC Gross-up collected (Line 19)	(321,518)	(578,151)	(886,312)	(617,226)	(320,647)
26					
27 (OVER) OR UNDER COLLECTION	\$ (5,724)	\$ (11,643)	\$ (23,102)	\$ 31,159	\$ 4,352
28					
29 TOTAL YEARLY REFUND	\$ (5,724)	\$ (11,643)	\$ (23,102)	\$ 0	\$ 0
30					
31 PROPOSED REFUND (excluding interest)	\$ (40,469)				
32					