

State of Florida



Public Service Commission

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COMMUNICATIONS DIVISION

**DATE:** JANUARY 7, 1999

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

**FROM:** DIVISION OF WATER AND WASTEWATER (GILCHRIST) *CSM*  
DIVISION OF LEGAL SERVICES (JAEFF) *JS*

**RE:** DOCKET NO. 981797-WS - DISPOSITION OF GROSS-UP FUNDS  
COLLECTED BY INDIANTOWN COMPANY, INC.  
COUNTY: MARTIN

**AGENDA:** JANUARY 19, 1999 - REGULAR AGENDA - PROPOSED AGENCY ACTION  
- INTERESTED PERSONS MAY PARTICIPATE

**CRITICAL DATES:** NONE

**SPECIAL INSTRUCTIONS:** NONE

**FILE NAME AND LOCATION:** S:\PSC\WAW\WP\981797.RCM

CASE BACKGROUND

Indiantown Company, Inc. (Indiantown or utility), is a Class B utility providing service to approximately 1,715 water and 1,582 wastewater customers in Martin County. According to its 1997 annual report, the utility reported gross operating revenues of \$457,745 and \$516,694 for water and wastewater, respectively, and net operating income of \$36,660 for water and a loss of \$6,266 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.

On October 16, 1990, Indiantown filed a petition for continued authority to gross-up CIAC. By Order No. 24303, issued March 29, 1991, the utility was granted interim authority to collect CIAC gross-up, pending further Commission investigation. By Order No. 25366, issued November 20, 1991, the utility was granted approval to continue its collection of CIAC gross-up. The purpose of this recommendation is to address the disposition of CIAC gross-up funds collected by the utility for 1991-1996.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should Indiantown Company, Inc. be required to refund excess CIAC gross-up collections for 1991-1996?

**RECOMMENDATION:** The utility does not owe any refunds for 1991-1994. However, the utility should be ordered to refund \$22,102 for 1995, and \$9,169 for 1996, for a total refund of \$31,271 for excess gross-up collections, plus accrued interest through the date of refund.

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)

**STAFF ANALYSIS:** In compliance with Orders Nos. 16971 and 23541, Indiantown filed its 1991-1996 annual CIAC reports regarding its collection of gross-up. By letter dated October 13, 1998, staff submitted preliminary refund calculation numbers to the utility. On November 30, 1998, the utility's attorney advised staff that the utility agrees with staff's preliminary refund calculations.

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 1991-1996. Our calculations, taken from the information provided by the utility in its gross-up report, are reflected on Schedule No. 1.

As mentioned above, By Order No. 25366, issued November 20, 1991, the utility was granted approval to continue its collection of CIAC gross-up. The Order revealed that the utility had not collected any gross-up as of the date of the Order. Also, the utility's CIAC reports for 1991 and 1992 showed that the utility

did not collect any CIAC gross-up in 1991 and 1992. Since there were no gross-up funds collected by the utility during those years, no refunds are required for 1991 and 1992.

### 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 \$291,000 in taxable CIAC was received, with \$1,645 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 \$289,355 results in the income tax effect of \$108,884. 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 \$174,578. The utility collected \$109,000 of gross-up monies; therefore, no refund is required for 1993.

### 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 \$88,591 in taxable CIAC was received, with \$1,594 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 \$86,997 results in the income tax effect of \$32,737. 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 \$52,488. The utility collected \$38,963 of gross-up monies; therefore, no refund is required for 1994.

### 1995

The utility's 1995 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 \$56,579 in taxable CIAC was received, with \$1,695 being deducted for the first year's depreciation, resulting in net taxable CIAC of \$54,884. When this amount is netted against the above-the-line loss of \$43,690, the amount of taxable CIAC resulting in a tax liability is \$11,194. 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 \$11,194 results in the income tax effect of \$4,212. 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 \$6,753. The utility collected \$28,855 of gross-up monies; therefore, staff calculates a refund of \$22,102. This amount does not include accrued interest which must be refunded from December 31, 1995 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.

#### 1996

The utility's 1996 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 \$51,615 in taxable CIAC was received, with \$908 being deducted for the first year's depreciation, resulting in net taxable CIAC of \$50,707. When this amount is netted against the above-the-line loss of \$102,882, the amount of taxable CIAC resulting in a tax liability is \$0. The utility collected \$9,169 of gross-up monies; therefore, staff calculates a refund of \$9,169. This amount does not include accrued interest which must be refunded from December 31, 1996 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

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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 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

Indiantown Utility Company  
 SOURCE: (Line references are from CIAC Reports)

	1993	1994	1995	1996
1 Form 1120, Line 30 (Line 15)	\$ 496,407	\$ 299,843	\$ 40,049	\$ (52,175)
2 Less CIAC (Line 7)	(291,000)	(88,591)	(56,579)	(51,615)
3 Less Gross-up collected (Line 19)	(109,000)	(38,963)	(28,855)	0
4 Add First Year's Depr on CIAC (Line 8)	*1,645	1,594	1,695	908
5 Add/Less Other Effects (Lines 20 & 21)	0	0	0	0
6				
7 Adjusted Income Before CIAC and Gross-up	\$ 98,052	\$ 173,883	\$ (43,690)	\$ (102,882)
8				
9 Taxable CIAC (Line 7)	\$ 291,000	\$ 88,591	\$ 56,579	\$ 51,615
10 Less first years depr. (Line 8)	\$ (1,645)	\$ (1,594)	\$ (1,695)	\$ (908)
11				
12 Adjusted Income After CIAC	\$ 387,407	\$ 260,880	\$ 11,194	\$ (52,175)
13 Less: NOL Carry Forward	\$ 0	\$ 0	\$ 0	\$ 0
14				
15 Net Taxable CIAC	\$ 289,355	\$ 86,997	\$ 11,194	\$ 0
16 Combined Marginal state & federal tax rates	37.63%	37.63%	37.63%	28.13%
17				
18 Net Income tax on CIAC	\$ 108,884	\$ 32,737	\$ 4,212	\$ 0
19 Less ITC Realized	0	0	0	0
20				
21 Net Income Tax	\$ 108,884	\$ 32,737	\$ 4,212	\$ 0
22 Expansion Factor for gross-up taxes	1.6033349	1.6033349	1.6033349	1.3914011
23				
24 Gross-up Required to pay tax effect	\$ 174,578	\$ 52,488	\$ 6,753	\$ 0
25 Less CIAC Gross-up collected (Line 19)	(109,000)	(38,963)	(28,855)	(9,169)
26				
27 (OVER) OR UNDER COLLECTION	\$ 65,578	\$ 13,525	\$ (22,102)	\$ (9,169)
28				
29				
30 TOTAL YEARLY REFUND	\$ 0	\$ 0	\$ (22,102)	\$ (9,169)
31				
32				
33 PROPOSED REFUND (excluding interest)	\$ (31,271)			
34				

\*1993 First Year's Depreciation - Estimated