

FLORIDA PUBLIC SERVICE COMMISSION
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Tallahassee, Florida 32399-0850

MEMORANDUM

JANUARY 23, 1997

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

FROM: DIVISION OF WATER & WASTEWATER (JOHNSON) *WJ*
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (CAUSSEAU) *CA*
DIVISION OF LEGAL SERVICES (CYRUS-WILLIAMS) *WJ*

RE: DOCKET NO. ~~92000~~-SU - DISPOSITION OF CONTRIBUTION IN AID
OF CONSTRUCTION BY HUDSON UTILITIES, INC. D/B/A HUDSON
BAY COMPANY
COUNTY: PASCO

AGENDA: FEBRUARY 4, 1997 - REGULAR AGENDA - PROPOSED AGENCY
ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP ~~XXXXXXXXXX~~

CASE BACKGROUND

As a result the repeal of Section 118(b) of the Internal Revenue Code (I.R.C.), contributions-in-aid-of-construction (CIAC) became gross income and are 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 Nos. 16971, issued December 18, 1986, and 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 require 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. On November 30, 1992,

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pursuant to Order No. 23541, Hudson Utilities, Inc. (Hudson or Utility) filed for initial authority to gross-up CIAC. The information as filed met the filing requirements of Order No. 23541. By order No. PSC-93-0206-FOF-SU, issued February 9, 1993, the Commission allowed the utility's proposed tariff to become effective by operation of law on an interim basis for gross-up on CIAC. Order No. PSC-93-0962-FOF-SU, issued June 28, 1993, granted Hudson Utilities authority to gross-up.

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 October 12, 1994, Order No. PSC-94-1265-FOF-WS revised the full gross-up formula. 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 to determine any changes. 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 96-0686-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 CIAC refunds for the years 1993 and 1994.

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Hudson is a Class B wastewater utility providing service to the public in Pasco County. As of December 31, 1995, the Utility served 1,172 wastewater customers. The Utility had gross operating revenues of \$629,192 for the wastewater system. The Utility reported a net operating income of \$17,394 for the wastewater system.

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DISCUSSION OF ISSUES

ISSUE 1: Should Hudson Utilities, Inc. be required to refund excess gross-up collections plus accrued interest for the years 1993 and 1994?

RECOMMENDATION: Yes, the utility should refund \$1,817 for 1993, and \$47,051.94 for 1994, for a total of \$48,868.94 plus accrued interest through the date of refund, for gross-up of CIAC collected in excess of the tax liability. For 1994, the utility should be required to refund \$139.62 to each of the 337 customers who paid the gross-up in full. In addition, the utility should collect only \$460.38 from the 59 customers who paid the gross-up in installments. To the extent that the utility has collected more than \$460.38 from those customers using the installment plan, the utility should be required to refund the difference in the \$460.38 that should have been collected and the amount actually collected in installments. In accordance with Orders Nos. 16971 and 23541, all refunds should be made on a pro rata basis to those persons who contributed the taxes. The refunds should be completed within six months. The utility should submit copies of cancelled checks, credits applied to monthly bills or other evidence which verifies that the refunds have been made, within 30 days from the date of refund. Within 30 days from the date of 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. (JOHNSON)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Hudson filed its 1993 and 1994 annual CIAC reports regarding its collection of gross-up for each year. By correspondence dated February 29, 1996, staff submitted their preliminary refund calculation to the utility. By letter dated March 28, 1996 the utility amended its proposed refunds for 1993 and 1994 to include the costs associated with filing refund reports. The cost incurred for filing the CIAC reports was netted with the proposed refund amount. However, Orders No. 16971 and 23541 does not provide for the netting of costs incurred with filing refund reports with the excess gross-up collections. Those orders specifically state:

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"that all gross-up amounts in excess of a utility's actual tax liability resulting from its collection of CIAC should be refunded on a pro rata basis to those persons who contributed the taxes."

Further, staff does not believe that the contributors should be held responsible for the accounting costs incurred to determine the amount of each customer's refund. Staff acknowledges that these costs were incurred to satisfy regulatory requirements, but a reduction of the contributors refund amount is not the appropriate place to seek recovery of accounting charges. The utility may seek recovery of these expenses in a rate case proceeding. Therefore, staff has removed the cost for preparing the refund reports from the utility's proposed refund amount. In addition, it has been Commission practice that in no instance should maintenance and administrative costs associated with any refund be borne by the customers. Those costs are the responsibility of, and should be borne by, the utility.

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-FOF-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 and tax returns filed each year are reflected on Schedule No. 1. A summary of each year's refund calculation follows.

1993

The utility proposes a refund of \$1,818 and the recovery of \$5,030 in cost for preparing the refund report in 1993. Inclusion of the refund report preparation costs in the refund calculation resulted in the preparation costs exceeding the refund by \$3,212. Therefore, the utility proposes that no refund is appropriate for 1993. Staff believes that a refund of \$1,817 for excess gross up collections for 1993 is appropriate, and as previously stated, staff has excluded the accounting costs for preparing the refund report from the refund calculation. Further, by netting the \$5,030 against the \$1,818, the utility is mixing pre-tax expenses with post-tax results.

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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 in income; therefore, all taxable CIAC received would be taxed. The CIAC reports also indicates that a total of \$87,000 in taxable CIAC was received, with \$3,491 being deducted for the first year's depreciation. As a result, net taxable CIAC was calculated to be \$83,509. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$31,424. When \$31,424 is multiplied by the expansion factor for gross-up taxes, the amount of gross-up required to pay the tax effect of the CIAC is calculated to be \$50,383. The utility collected \$52,200 of gross-up monies; therefore, staff calculates that the utility collected \$1,817 more in gross-up than is required to pay the tax impact. Therefore, staff recommends that the utility be required to refund \$1,817. This amount does not include the accrued interest which also must be refunded from December 31, 1993 to the date of refund.

The gross-up funds were collected from 87 separate individuals or entities during 1993. Based on the total refund amount, each contributor would receive \$20.89.

1994

The utility calculated a refund of \$43,008 using the generic refund calculation form established in Order No. PSC-92-0961A-FOF-WS, issued September 14, 1992. The utility reduced its calculated refund by \$6,476 to reflect recovery of the cost for preparing the refund report for 1994. As a result, the utility proposes a refund of \$36,532 for 1994.

Staff calculates a refund of \$47,051.94, instead of the \$36,532 proposed by the utility. Staff's calculated refund differs from the utility's proposed refund amount because staff's calculation excludes the \$6,476 in cost for preparing the refund report for 1994. Staff does not believe that the contributors should be held responsible for the legal and accounting costs incurred to determine whether they overpaid the gross-up taxes and are, therefore, entitled to a refund. Staff acknowledges that these are costs which were incurred to satisfy regulatory requirements, but a reduction in the amount of refund the customer is entitled to receive as a result of his overpayment of gross-up

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taxes is not appropriate. The utility may seek recovery of these amounts in a rate case proceeding. Again, the company has mixed pre-tax and post-tax amounts. Therefore, staff has excluded the cost for preparing the 1994 CIAC report from its refund calculation. In addition, as discussed previously, it is Commission practice that in no instance should maintenance and administrative costs associated with any refund be borne by the customers. Those costs are the responsibility of, and should be borne by, the utility.

In addition, staff has not used the generic refund calculation form to calculate its proposed refund because staff's calculated refund recognizes the fact that some customers paid the gross-up in full, while others paid the gross-up in installments. Therefore, as a result of collecting some of the gross-up in installments, the utility did not collect all of the gross-up that should have been collected in 1994. The utility's refund calculation, which was calculated based on the generic refund calculation form, does not recognize that all of the gross-up that should have been collected was not collected. As a result, the utility's calculated refund is understated by the amount of CIAC that should have been collected in 1994, but was not collected because the contributor was allowed to pay the gross-up in installments. Therefore, in order to calculate the appropriate refund, staff calculated the amount of gross-up taxes that each contributor should have paid based on the amount of taxable CIAC, and compared it to the amount of gross-up the utility actually collected from or charged each customer. The difference in the amount that should have been paid and the amount that was actually paid represents the amount of refund due to the contributor.

Order No. PSC-95-0052-SU, issued March 2, 1995, gave the utility authority to provide customers the option of paying the CIAC and the gross-up charge in installment payments. The installment payment plan allowed the contributor to pay the service availability charge of \$1,000 plus the gross-up taxes of \$600 in 24 monthly installment payments. In 1994 the utility collected CIAC and gross-up from 396 customers. Three hundred and thirty seven (337) customers paid the CIAC and gross-up in full and the remaining 59 customers signed notes to pay the CIAC and gross-up on the installment plan. For federal income tax purposes for 1994, the utility reported all of the CIAC as income whether or not it was paid in full or in installments. However, in reporting the gross-up, the utility only reported the actual amount of gross-up collected as income on its tax return. Therefore, for 1994, the utility reported \$396,000 of CIAC income on its tax return (396 customers x \$1,000 service availability charge). Of this amount, \$337,000 was collected from customers who paid the CIAC charge in full, and \$59,000 (\$1,000 x 59) was reported for those customers

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who paid the CIAC charge using the installment plan. In addition, the utility reported \$216,200 of gross-up collections as income on its tax return. Of this amount, \$202,200 ($\600×337) was collected from customers who paid the gross-up in full, and \$14,000 was collected from customers who paid the gross-up in installments.

The 1994 CIAC report indicates that the utility had an above-the-line loss of \$75,488 prior to the inclusion of taxable CIAC in income. As a result, all of the CIAC collected would not be taxed. Order No. 23541 requires that above-the-line losses be offset against CIAC income. Therefore, the above-the-line loss of \$75,488 must be netted with the taxable CIAC collected. The CIAC report indicates that the utility collected \$396,000 of taxable CIAC, with \$18,338 being deducted for the first year's depreciation. As a result, the amount of taxable CIAC is calculated to be \$377,662. When this amount is offset with the above-the-line loss of \$75,488, net taxable CIAC is calculated to be \$302,174. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$113,708. 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 \$182,312. Based on this amount, the utility should have collected \$460.38 ($\$182,312/396$) of gross-up from each customer instead of \$600.

As previously stated, the utility collected \$202,200 ($\600×337) of gross-up from the customers who paid the gross-up in full. However, based on the amount of gross-up required to pay the taxes on the CIAC, the utility should have only collected \$155,148.06 ($\460.38×337) from those customers. Therefore, the customers who paid the gross-up in full are due a refund of \$47,051.94 or \$139.62 per customer. Because of the installment payment plan, the utility only collected \$14,000 of gross-up in 1994 from the customers who paid the gross-up in installments. However, the utility is due a total of \$27,162.42 ($\460.38×59) from those customers. The utility should, therefore, be allowed to collect the balance of the \$460.38 from those customers who paid the gross-up using the installment plan. To the extent that the utility has collected more than \$460.38 from each of those customers, the utility should be required to refund the difference between the \$460.38 that should have been collected and the amount that was actually collected in installments.

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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 verification of the refunds. Staff should be given administrative authority to close the docket upon verification that the refunds have been completed. (JOHNSON, CYRUS-WILLIAMS)

STAFF ANALYSIS: Upon expiration of the protest period, if a timely protest is not filed by 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.

BREAK DOWN BASED ON CUSTOMERS & CIAC (2)

HUDSON UTILITIES, INC.

		1994		
		NOTES	PAID IN FULL	TOTAL
1 Taxable CIAC Resulting in a Tax Liability	\$	45,024	257,150	302,174
2 Less: NOL Carryforward		0	0	0
3				
4 Net Taxable CIAC	\$	45,024	257,150	302,174
5 Effective state and federal tax rate		37.63%	37.63%	37.63%
6				
7 Net Income tax on CIAC	\$	16,943	96,766	113,709
8 Less ITC Realized				
9				
10 Net Income Tax	\$	16,943	96,766	113,709
11 Expansion Factor for gross-up taxes		1.603334937	1.603334937	3
12				
13 Gross-up Required to pay tax effect	\$	27,165	155,148	182,313
14 Less CIAC Gross-up collected (Line 19)		(14,000)	(202,200)	(216,200)
15				
16 (OVER) OR UNDER COLLECTION	\$	13,165	(47,052)	(33,887)
17		=====	=====	=====
18				
19 TOTAL YEARLY REFUND	\$	13,165	(47,052)	(33,887)
20		=====	=====	=====
21				
22 PROPOSED REFUND (excluding interest)	\$	(47,052)		
23		=====		