

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

M E M O R A N D U M

March 6, 1997

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

FROM: DIVISION OF WATER & WASTEWATER (GILCHRIST) *APC*
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (CAUSSEAU) *103*
DIVISION OF LEGAL SERVICES (CYRUS-WILLIAMS) *103*

RE: DOCKET NO. 970204-WS - DISPOSITION OF GROSS-UP FUNDS
COLLECTED BY ROLLING OAKS UTILITIES, INC.
COUNTY: CITRUS

AGENDA: MARCH 18, 1997 - REGULAR AGENDA - PROPOSED AGENCY ACTION-
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\970204.RCM

CASE BACKGROUND

As a result of the repeal of Section 118(b) of the Internal Revenue Code (I.R.C.), contributions-in-aid-of-construction (CIAC) became gross income and were 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.

Orders Nos. 16971 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 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.

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.

DOCUMENT NUMBER-DATE

02427 MAR-65

FPSC-RECORDS/REPORTING

DOCKET NO. 970204-WS
MARCH 6, 1997

Rolling Oaks (Rolling Oaks or utility) is a Class A water and wastewater utility providing service to approximately 5,661 water and 4,195 wastewater customers in Citrus County. According to its 1995 annual report, the utility reported gross operating revenues of \$750,793 for water and \$835,092 for wastewater and net operating income of \$20,240 and \$164,918 for water and wastewater, respectively. Rolling Oaks filed for authority to continue to gross-up on February 18, 1991. By Order No. PSC-92-0005-FOF-WS, issued March 3, 1992, Rolling Oaks 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 provision 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 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 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

DOCKET NO. 970204-WS
MARCH 6, 1997

cases are being processed pursuant to Order Nos. 16971 and 23541. The disposition of gross-up funds collected by the utility in 1993 and 1994 were handled in Docket No. 961072-WS and Order No. PSC-96-1353-FOF-WS was issued accordingly. The purpose of this recommendation is to address the disposition of gross-up funds collected by the utility in 1995.

DOCKET NO. 970204-WS
MARCH 6, 1997

DISCUSSION OF ISSUES

ISSUE 1: Should Rolling Oaks Utilities, Inc. be required to refund excess gross-up collections for 1995?

RECOMMENDATION: No, Rolling Oaks required more in gross-up to pay the tax impact than the utility collected; therefore, no refund is required for 1995. (GILCHRIST, CAUSSEAU)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Rolling Oaks filed its 1995 annual CIAC report regarding its collection of gross-up. 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. Based upon the foregoing, staff has calculated that a refund for 1995 is not appropriate. Our calculations, taken from the information provided by the utility in its gross-up report, are reflected on Schedule No. 1.

The utility's 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 \$50,537 in taxable CIAC was received, with \$950 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 the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$49,587 results in the income tax effect of \$18,660. 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 \$29,918. The utility collected \$29,552 of gross-up monies. The utility required more in gross-up to pay the tax impact than the utility collected, therefore, no refund is required for 1995.

DOCKET NO. 970204-WS
MARCH 6, 1997

ISSUE 2: Should the docket be closed?

RECOMMENDATION: Yes, upon expiration of the protest period, if a timely protest is not received from a substantially affected person, this docket should be closed. (CYRUS-WILLIAMS)

STAFF ANALYSIS: If a timely protest is not filed, upon expiration of the protest period, processing of this docket is complete and the docket should be closed.

STAFF CALCULATED GROSS-UP REFUND

Rolling Oaks, Utilities, Inc.

SOURCE: (Line references are from CIAC Reports)

| | 1995 |
|--|------------|
| 1 Form 1120, Line 30 (Line 15) | \$ 246,675 |
| 2 Less CIAC (Line 7) | (50,537) |
| 3 Less Gross-up collected (Line 19) | (29,552) |
| 4 Add First Year's Depr on CIAC (Line 8) | 950 |
| 5 Add/Less Other Effects (Lines 20 & 21) | (124) |
| 6 | |
| 7 Adjusted Income Before CIAC and Gross-up | \$ 167,412 |
| 8 | |
| 9 Taxable CIAC (Line 7) | \$ 50,537 |
| 10 Less first years depr. (Line 8) | \$ (950) |
| 11 | |
| 12 Adjusted Income After CIAC | \$ 216,999 |
| 13 Less: NOL Carry Forward | \$ 0 |
| 14 | |
| 15 Net Taxable CIAC | \$ 49,587 |
| 16 Combined Marginal state & federal tax rates | 37.63% |
| 17 | |
| 18 Net Income tax on CIAC | \$ 18,660 |
| 19 Less ITC Realized | 0 |
| 20 | |
| 21 Net Income Tax | \$ 18,660 |
| 22 Expansion Factor for gross-up taxes | 1.6033349 |
| 23 | |
| 24 Gross-up Required to pay tax effect | \$ 29,918 |
| 25 Less CIAC Gross-up collected (Line 19) | (29,552) |
| 26 | |
| 27 (OVER) OR UNDER COLLECTION | \$ 366 |
| 28 | |
| 29 | |
| 30 TOTAL YEARLY REFUND | \$ 0 |
| 31 | |
| 32 | |
| 33 PROPOSED REFUND (excluding interest) | 0 |
| 34 | |