**FLORIDA PUBLIC SERVICE COMMISSION**

**Fletcher Building**

**101 East Gaines Street**

**Tallahassee, Florida 32399-0850**

**M E M O R A N D U M**

**February 11, 1993**

**TO : DIRECTOR, DIVISION OF RECORDS AND REPORTING**

**FROM : DIVISION OF WATER AND WASTEWATER (MEADOR)**

**DIVISION OF AUDITING AND FINANCIAL ANALYSIS (HOWARD)**

**DIVISION OF LEGAL SERVICES (JABER)**

**RE :UTILITY: FLORIDA CITIES WATER COMPANY**

**DOCKET NO.: 921240-WS**

**COUNTY: BREVARD, COLLIER AND LEE COUNTIES**

**CASE: DISPOSITION OF GROSS-UP FUNDS COLLECTED**

**AGENDA : 2/16/93 - CONTROVERSIAL - PROPOSED AGENCY ACTION - PARTIES MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**RECOMMENDATION FILE NAME: I:\PSC\WAW\WP\921240A.RCM**

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**CASE BACKGROUND**

The repeal of Section 118(b) of the Internal Revenue Code (I.R.C.) resulted in making contributions-in-aid-of-construction (CIAC) gross income and 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, 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, and whether a refund of the gross-up is appropriate for any given year for which gross-up was in effect. These orders also required that all gross-up amounts for a tax year which are in excess of a utility's actual tax liability for the same year resulting from its collection of CIAC should be refunded on a pro rata basis to those persons who contributed the taxes.

In Order No. 23541, the Commission determined that any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue collecting the gross-up, had to file a petition for approval with the Commission on or before October 29, 1990. Florida Cities Water Company (Florida Cities or Utility) did not request authority to continue to gross-up CIAC for the related tax impact. By Orders Nos. 24773, 24774, and 24775, all issued July 8, 1991, the Commission canceled the utility's authority to gross-up.

On September 9, 1992, this Commission issued PAA Order No. PSC-92-0961-FOF-WS, which clarified the provisions 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 with included Attachment A which reflects the generic calculation form. No protests were filed, and the Order became final.

Florida Cities is a Class A utility which provides water and wastewater service to customers in Brevard, Collier and Lee Counties. According to their 1991 annual report, operating revenue of $9,536,677 for water and $4,608,486 for the wastewater system were reported. The utility reported net operating income of $3,376,214 for the water systems and $609,351 for the wastewater systems.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should Florida Cities Water Company be required to refund excess gross-up collections of $30,478 for 1987; $95,341 for 1988; $86,097 for 1989; and $70,121 for 1990, for a total of $282,037 plus accrued interest through the date of refund?

**RECOMMENDATION:** Yes, the utility should refund $30,478 for 1987; $95,341 for 1988; $86,097 for 1989; and $70,121 for 1990, for a total of $282,037 plus accrued interest through the date of refund, for gross-up collected in excess of the tax liability resulting from the collection of CIAC. In accordance with Orders Nos. 16971 and 23541, all amounts should be refunded on a pro rata basis to those persons who contributed the taxes. The refund should be completed within 6 months. The utility should submit copies of canceled 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. (MEADOR, HOWARD)

**STAFF ANALYSIS:** In compliance with Order No. 16971, Florida Cities filed its 1987 through 1990 annual CIAC reports regarding its collection of gross-up for each year. Gross-up authority was cancelled as of January 1, 1991, therefore, no action is necessary for 1991. In response to staff's preliminary calculations, the utility submitted copies of Order No. 16971 and the approved tariffs for each of the systems. No comments or corrections to staff's proposed calculation were submitted; only a statement that the Utility's proposed calculation showed no refund was necessary. The Utility's refund calculation is reflected on Schedule No. 1. Staff has several theoretical concerns with the utility's calculations. These concerns will be discussed below.

**REDUCTION TO TAXABLE CIAC FOR THE FIRST YEAR'S DEPRECIATION ON CIAC**

In the utility's proposed calculation of the refund of gross-up funds collected, the utility failed to include the first year's depreciation as a reduction to the taxable amount of CIAC. The annual CIAC reports filed by the utility detail the amount of depreciation per year. Order No. 23541 states that the full gross-up formula takes into account the first year's depreciation using a half-year convention. The depreciation is an expense item which reduces the amount of CIAC which is taxable. Staff has included the first year's depreciation in our calculation of the net taxable amount of CIAC.

**COMPARISON OF ANNUAL WITHDRAWALS OF GROSS-UP COLLECTED WITH THE TAX LIABILITY RESULTING FROM ABOVE-THE-LINE OPERATIONS**

On May 12, 1992, the utility submitted a schedule showing the calculation of jurisdictional federal and state income taxes on CIAC and withdrawals from the escrow account used to pay the taxes. The utility stated in the response that annual withdrawals from the escrow account used to pay federal and state income tax on CIAC have not exceeded the tax liability. The threshold for a refund is not the amount of the withdrawal for payment of taxes. Orders Nos. 16971 and 23541, 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. Order No. 23541 specifically states 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. If gross-up collections exceed this determination of tax liability, a refund is required.

The utility calculated the tax liability based upon 100% of the CIAC and gross-up collected as if the total amount were taxable. The clarification to the refund calculation issued by this Commission in Order No. PSC-92-0961-FOF-WS, addressed this specific point. A utility's tax liability resulting from the collection of CIAC is in effect grossed-up to reflect the amount of gross-up required to pay the tax liability associated with the collection of taxable CIAC. Gross-up collected in excess of the gross-up required to pay the tax on the CIAC is to be refunded. Staff has compared the amount of gross-up taxes required to pay the tax liability to amount of gross-up collected, and determined the amount of refund due. 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 filed each year are reflected on Schedule No. 2. A summary of each year's refund calculation follows.

**1987**

The utility calculated Federal and State taxes to be $964,834 and withdrawals from the escrow account for payment of taxes equal $964,688. A rounding difference of $146 exists, and the utility states no refund is necessary.

Staff calculates a refund of $30,478 for 1987. The 1987 CIAC report indicates that a total of $961,547 of gross-up collections were received, with the first year's depreciation reported as $47,502. Staff has used the 43.30% combined federal and state tax rate as provided in the 1987 CIAC Report to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $30,478 for 1987. This amount does not include the accrued interest which must also be refunded from December 31, 1987 to the date of refund.

**1988**

The utility calculated Federal and State taxes to be $2,572,967 and withdrawals from the escrow account for payment of taxes equal $2,573,073. Because withdrawals exceeded the utility's calculated tax liability, no refund for 1988 gross-up collections was proposed.

Staff calculates a refund of $95,341 for 1988. The 1988 CIAC report indicates that a total of $2,572,243 of gross-up collections were received, with the first year's depreciation reported as $159,949. Staff has used the 37.63% combined federal and state tax rate as provided in the 1988 CIAC Report to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $95,341 for 1988. This amount does not include the accrued interest which must also be refunded from December 31, 1988 to the date of refund.

**1989**

The utility calculated Federal and State taxes to be $2,330,480 and withdrawals from the escrow account for payment of taxes equal $2,330,479. The utility states a rounding difference of $1 exists for 1989 gross-up collections, and that no refund is necessary.

Staff calculates a refund of $86,097 for 1989. The 1989 CIAC report indicates that a total of $2,329,660 of gross-up collections were received, with the first year's depreciation reported as $144,881. Staff has used the 37.63% combined federal and state tax rate as provided in the 1989 CIAC Report to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $86,097 for 1989. This amount does not include the accrued interest which must also be refunded from December 31, 1989 to the date of refund.

**1990**

The utility calculated Federal and State taxes and withdrawals from the escrow account for payment of taxes to be $1,894,495. Because no difference exists, the utility did not propose a refund for 1990 gross-up collections.

Staff calculates a refund of $70,121 for 1990. The 1990 CIAC report indicates that a total of $1,893,911 of gross-up collections were received, with the first year's depreciation reported as $117,773. Staff has used the 37.63% combined federal and state tax rate as provided in the 1990 CIAC Report to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $70,121 for 1990. This amount does not include the accrued interest which must also be refunded from December 31, 1990 to the date of refund.

**1991**

The utility did not collect gross-up during the year 1991. Therefore, no refund was proposed. Staff agrees that no further action is necessary for 1991.

The utility did not propose any refund of gross-up collections for 1987 through 1991. Based upon the foregoing, staff recommends that the utility be required to refund a total of $282,037 ($30,478 for 1987; $95,341 for 1988; $86,097 for 1989; $70,121 for 1990: and no refund for 1991), plus accrued interest through the date of refund, for gross-up collections, in excess of the actual tax liability resulting from the collection of CIAC. The refund should be completed within 6 months. The utility should submit copies of canceled checks, credits applied to monthly bills, or other evidence which verifies that the refunds have been made, within 30 days from the date of the refund.

**ISSUE 2:** Should the docket be closed?

**RECOMMENDATION:** Yes, the docket should be closed upon expiration of the protest period. (MEADOR, JABER)

**STAFF ANALYSIS:** Staff believes this docket should be closed if a timely protest is not filed. Staff will monitor the processing of the refunds separately.

Schedule 1 not available on network.

SCHEDULE NO. 2

FLORIDA CITIES WATER COMPANY STAFF CALCULATED GROSS‑UP REFUND

SOURCE: (Line references are from CIAC Reports)

1987 1988 1989 1990 1991

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1 Form 1120, Line 30 (Line 15) $ 3,793,099 $ 8,666,070 $ 6,901,695 $ 5,459,735 $ 0

2 Less CIAC (Line 7) (1,252,019) (4,265,300) (3,863,484) (3,140,623) 0

3 Less Gross‑up collected (Line 19) (961,547) (2,572,243) (2,329,660) (1,893,911) 0

4 Add First Year's Depr on CIAC (Line 8) 47,502 159,949 144,881 117,773 0

5 Add/Less Other Effects (Lines 20 & 21) 0 176,261 669,110 676,856 0

6 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

7 Adjusted Income Before CIAC and Gross‑up $ 1,612,346 $ 2,164,737 $ 1,522,542 $ 1,219,830 $ 0

8

9 Taxable CIAC (Line 7) $ 1,252,019 $ 4,265,300 $ 3,863,484 $ 3,140,623 $ 0

10

11 Taxable CIAC Resulting in a Tax Liability $ 1,252,019 $ 4,265,300 $ 3,863,484 $ 3,140,623 $ 0

12 Less first years depr. (Line 8) (47,502) (159,949) (144,881) (117,773) 0

13 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

14 Net Taxable CIAC $ 1,219,206 $ 4,105,351 $ 3,718,603 $ 3,022,850 $ 0

15 Effective state and federal tax rate 43.30% 37.63% 37.63% 37.63% 37.63%

16 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

17 Net Income tax on CIAC $ 527,916 $ 1,544,844 $ 1,399,310 $ 1,137,498 $ 0

18 Less ITC Realized 0 0 0 0 0

19 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

20 Net Income Tax $ 527,916 $ 1,544,844 $ 1,399,310 $ 1,137,498 $ 0

21 Expansion Factor for gross‑up taxes 1.76366843 1.603334937 1.603334937 1.603334937 1.603334937

22 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

23 Gross‑up Required to pay tax effect $ 931,069 $ 2,476,902 $ 2,243,563 $ 1,823,790 $ 0

24 Less CIAC Gross‑up collected (Line 19) (961,547) (2,572,243) (2,329,660) (1,893,911) 0

25 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

26 PROPOSED REFUND (excluding interest) $ (30,478) $ (95,341) $ (86,097) $ (70,121) $ 0

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28 No Gross‑up

29 TOTAL REFUND $ (282,037) Collected

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