

FLORIDA PUBLIC SERVICE COMMISSION
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Tallahassee, Florida 32399-0950

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MEMORANDUM

JANUARY 22, 1998

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10:00
FPSC - Records/Reporting

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

FROM: DIVISION OF WATER & WASTEWATER (JOHNSON)
DIVISION OF LEGAL SERVICES (JAEGER)

RE: DOCKET NO. 980077-WU DISPOSITION OF CONTRIBUTION IN AID
OF CONSTRUCTION BY LAKE HILLS UTILITIES, INC.
COUNTY: LAKE

AGENDA: FEBRUARY 3, 1998 - REGULAR AGENDA - PROPOSED AGENCY
ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\980077.RCM

CASE BACKGROUND

Lake Hills is a Class C water utility providing service to the public in Lake County. As of December 31, 1995, the Utility served 480 water customers. The Utility had gross operating revenues of \$53,850 for the water system. The Utility reported a net operating loss of \$95,567.

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 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 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.

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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 September 12, 1991, pursuant to Order No. 23541, Lake Hills Utilities, Inc. (Lake Hills or Utility) filed for authority to gross-up CIAC. The information as filed met the filing requirements of Order No. 23541. Order No. PSC-92-0253-FOF-WU, issued April 27, 1992, granted Lake Hills 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 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 which included Attachment A which reflects the generic calculation form. No protests were filed, and the Orders 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 Orders 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

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gross-up refund cases are being processed pursuant to Orders Nos. 16971 and 23541. The purpose of this recommendation is to address the disposition of CIAC refunds for the years 1989 through 1995.

On September 29, 1997, Lake Hills submitted its 1995 CIAC Gross-up Report. In that report, Lake Hills Utilities noted that no CIAC was collected in 1995 and therefore, no refund is due in 1995. The report indicated that all operating assets of the utility had been sold on May 4, 1995. In Docket No. 950421-WU, Lake Hills Utilities, Inc. was transferred to the City of Clermont, and the certificate was canceled.

This recommendation addresses the amount of CIAC gross-up funds that should be refunded for 1989 through 1995.

DISCUSSION OF ISSUES

ISSUE 1: Should Lake Hills Utilities be required to refund excess gross-up collections for 1989 through 1995?

RECOMMENDATION: Yes. The utility should be ordered to refund \$5,814 for 1989; \$23,032 for 1990; \$3,479 for 1991; \$18,483 for 1992; \$15,689 for 1993 and \$53,384 for 1994; for a total of \$119,563 plus accrued interest through the date of refund, for gross-up collected in excess of the tax liability resulting from the collection of CIAC. The utility did not collect CIAC during 1995; therefore, no refund is due. In addition to the refund amount, the utility should refund accrued interest through the date of refund, for gross-up of CIAC collected in excess of the tax liability. 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 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. Within 30 days from the date of refund, the utility also should file 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, Lake Hills filed its 1989 through 1995 annual CIAC report regarding its collection of gross-up for the year. By letter dated December 14, 1995, the utility responded to staff's preliminary refund calculation amounts. Staff and the utility have submitted and revised the preliminary refund calculation numbers several times due to the changing of staff on this docket, scheduling conflicts, the CIAC workshop and the amending for additional years. 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. The utility did not request recovery of consultants fees for accounting and legal services; therefore none were included.

ANNUAL GROSS-UP REFUND AMOUNTS

Based upon the foregoing, staff has calculated the amount of refund which is appropriate. Our calculations, taken from the information provided by the utility in its gross-up report and tax return are reflected on Schedule No. 1. A summary of the 1989 through 1995 refund calculation follows.

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1989

The utility proposes a refund of \$5,818 for 1989 excess gross-up collections. Staff calculates a refund of \$5,814 for 1989.

Based upon our review of the utility's 1989 filing, the utility incurred an above-the-line loss of \$8,788 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 \$8,788 must be netted with the taxable CIAC collected. The CIAC report indicates that the utility collected \$85,250 of taxable CIAC, with \$1,321 being deducted for the first year's depreciation. As a result, the amount of taxable CIAC is calculated to be \$75,141. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$28,276. 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 \$45,336. The utility collected \$51,150 in gross-up taxes. Based upon the foregoing, staff calculates the utility collected \$5,814 more in gross-up than was required to pay the taxes. This amount does not include the accrued interest as of December 31, 1989, which must also be refunded through the date of the refund.

1990

The utility proposes a refund of \$23,035 for 1990 excess gross-up collections. Staff calculates a refund of \$23,032 for 1989.

Based upon our review of the utility's 1990 filing, the utility incurred an above-the-line loss of \$35,865 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 \$35,865 must be netted with the taxable CIAC collected. The CIAC report indicates that the utility collected \$231,744 of taxable CIAC, with \$3,592 being deducted for the first year's depreciation. As a result, the amount of taxable CIAC is calculated to be \$192,287. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$72,358. 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 \$116,014. The utility collected \$139,046 in gross-up taxes. Based upon the foregoing, staff calculates the utility collected \$23,032 more in gross-up than was required to pay

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the taxes. This amount does not include the accrued interest as of December 31, 1990, which must also be refunded through the date of the refund.

1991

The utility proposes a refund of \$3,481 for 1991 excess gross-up collections. Staff calculates a refund of \$3,479 for 1991.

Based upon our review of the utility's 1991 filing, the utility incurred an above-the-line loss of \$4,623 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 \$4,623 must be netted with the taxable CIAC collected. The CIAC report indicates that the utility collected \$114,501 of taxable CIAC, with \$1,775 being deducted for the first year's depreciation. As a result, the amount of taxable CIAC is calculated to be \$108,103. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$40,679. 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 \$65,222. The utility collected \$68,701 in gross-up taxes. Based upon the foregoing, staff calculates the utility collected \$3,479 more in gross-up than was required to pay the taxes. This amount does not include the accrued interest as of December 31, 1991, which must also be refunded through the date of the refund.

1992

The utility proposes a refund of \$18,484 for 1992 excess gross-up collections. Staff calculates a refund of \$18,483 for 1992.

Based upon our review of the utility's 1992 filing, the utility was in a taxable position with \$7,760 in above-the-line income prior to the inclusion of taxable CIAC in income. The utility included a \$37,677 net operating loss carry backs from 1995. As a result, all of the CIAC collected would not be taxed. Order No. 23541 requires that losses be offset against CIAC income. Therefore, the \$37,677 net operating loss carry backs must be netted with the above-the-line income of \$7,760 and the taxable CIAC collected. The CIAC report indicates that the utility collected \$73,429 of taxable CIAC, with \$1,138 being deducted for the first year's depreciation. As a result, the amount of taxable CIAC is calculated to be \$42,374. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report

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to calculate the tax effect of \$15,945. 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 \$25,565. The utility collected \$44,048 in gross-up taxes. Based upon the foregoing, staff calculates the utility collected \$18,483 more in gross-up than was required to pay the taxes. This amount does not include the accrued interest as of December 31, 1992, which must also be refunded through the date of the refund.

1993

The utility proposes a refund of \$15,689 for 1993 excess gross-up collections. Staff agrees with the utility's proposed refund amount of \$15,689 for 1993.

Based upon our review of the utility's 1993 filing, the utility incurred an above-the-line loss of \$24,118 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 \$24,118 must be netted with the taxable CIAC collected. The CIAC report indicates that the utility collected \$170,644 of taxable CIAC, with \$2,830 being deducted for the first year's depreciation. As a result, the amount of taxable CIAC is calculated to be \$143,696. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$54,073. 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 \$86,697. The utility collected \$102,386 in gross-up taxes. Based upon the foregoing, staff calculates the utility collected \$15,689 more in gross-up than was required to pay the taxes. This amount does not include the accrued interest as of December 31, 1993, which must also be refunded through the date of the refund.

1994

The utility proposes a refund of \$53,385 for 1994 excess gross-up collections. Staff calculates a refund of \$53,384 for 1994.

Based upon our review of the utility's 1994 filing, the utility incurred an above-the-line loss of \$51,515 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 \$51,515 must be netted with the taxable CIAC

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collected. The CIAC report indicates that the utility collected \$115,200 of taxable CIAC, with \$2,131 being deducted for the first year's depreciation. As a result, the amount of taxable CIAC is calculated to be \$61,554. Staff has used the 20.36% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$12,532. 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 \$15,736. The utility collected \$69,120 in gross-up taxes. Based upon the foregoing, staff calculates the utility collected \$53,384 more in gross-up than was required to pay the taxes. This amount does not include the accrued interest as of December 31, 1994, which must also be refunded through the date of the refund.

1995

The utility proposes no refund is appropriate for 1995, because the utility did not collect CIAC in 1995. The utility was later sold in 1995. Therefore, staff agrees that no refund is appropriate.

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 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. Within 30 days from the date of refund, the utility also should file a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: No. Upon expiration of the 21-day 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. (JAEGER)

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.

STAFF CALCULATED GROSS-UP REFUND

	1989	1990	1991	1992	1993	1994
1 Form 1120, Line 30 (Line 15)	\$ 126,291	\$ 331,333	\$ 176,804	\$ 124,099	\$ 246,672	\$ 132,736
2 Less CIAC (Line 7)	(85,250)	(231,744)	(114,501)	(73,429)	(170,644)	(115,200)
3 Less Gross-up collected (Line 19)	(51,150)	(139,046)	(68,701)	(44,048)	(102,386)	(69,120)
4 Add First Year's Depr on CIAC (Line 8)	1,321	3,592	1,775	1,138	2,830	2,131
5				0		
6 Add/Less Other Effects (Lines 20 & 21)	0	0	0	0	(590)	(2,062)
7						
8 Adjusted Income Before CIAC and Gross-up	\$ (8,788)	\$ (35,865)	\$ (4,623)	\$ 7,760	\$ (24,118)	\$ (51,515)
9 Less: NOL Carryback				(37,677)		
10 Taxable CIAC (Line 7)	\$ 85,250	\$ 231,744	\$ 114,501	\$ 73,429	\$ 170,644	\$ 115,200
11 Less first years depr. (Line 8)	\$ (1,321)	\$ (3,592)	\$ (1,775)	\$ (1,138)	\$ (2,830)	\$ (2,131)
12						
13 Adjusted Income After CIAC	\$ 75,141	\$ 192,287	\$ 108,103	\$ 42,374	\$ 143,696	\$ 61,554
14	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
15						
16 Net Taxable CIAC	\$ 75,141	\$ 192,287	\$ 108,103	\$ 42,374	\$ 143,696	\$ 61,554
17 Combined Marginal state & federal tax rates	37.63%	37.63%	37.63%	37.63%	37.63%	20.36%
18						
19 Net Income tax on CIAC	\$ 28,276	\$ 72,358	\$ 40,679	\$ 15,945	\$ 54,073	\$ 12,532
20 Less ITC Realized	0	0	0	0	0	0
21						
22 Net Income Tax	\$ 28,276	\$ 72,358	\$ 40,679	\$ 15,945	\$ 54,073	\$ 12,532
23 Expansion Factor for gross-up taxes	1.603334937	1.603334937	1.603334937	1.603334937	1.603334937	1.25565
24						
25 Gross-up Required to pay tax effect	\$ 45,336	\$ 116,014	\$ 65,222	\$ 25,565	\$ 86,697	\$ 15,736
26 Less CIAC Gross-up collected (Line 19)	(51,150)	(139,046)	(68,701)	(44,048)	(102,386)	(69,120)
27						
28 (OVER) OR UNDER COLLECTION	\$ (5,814)	\$ (23,032)	\$ (3,479)	\$ (18,483)	\$ (15,689)	\$ (53,384)
29	=====	=====	=====	=====	=====	=====
30						
31 TOTAL YEARLY REFUND	\$ (5,814)	\$ (23,032)	\$ (3,479)	\$ (18,483)	\$ (15,689)	\$ (53,384)
32	=====	=====	=====	=====	=====	=====
33						
34 PROPOSED REFUND (excluding interest)	(119,881)					
35 REFUND.WK3	=====					