KINGSLEY SERVICE COMPANY
782 FOXRIDGE CENTER DRIVE
ORANGE PARK, FLORIDA 32065
(904) 272-5999

April 26, 1991

Mr. Steve Tribble, Director
Division of Records & Reporting
Florida Public Service Commission
Fletcher Building
101 East Gaines Street
Tallahassee, Florida 32399-0870

910531-WS

Re: Transmittal of "Petition of Kingsley Service Company for Declaratory Statement related to appropriate treatment of taxes related to C.I.A.C.".

Dear Mr. Tribble:

We are enclosing herewith the original and 15 copies of our above referenced Petition. We would appreciate your processing this through the proper channels for Commission action at your earliest convenience.

Please feel free to call me at (904) 276-2301 if you have any questions or require any additional information in this regard.

Very truly yours,
KINGSLEY SERVICE COMPANY

Ray O. Avery

ROA/cb
Enclosures

cc: Marty Deterding
Jimmie R. Rodgers
Matthew W. Rodgers
Vaughn Mears
Ann Causseaux

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition of Kingsley Service Company for declaratory statement related to appropriate treatment of taxes related to CIAC.	)))))	DOCKET NO. 910531-WS

PETITION FOR DECLARATORY STATEMENT

Pursuant to Rule 25-22.020, Florida Administrative Code, Kingsley Service Company (hereinafter "Company") hereby petitions the Florida Public Service Commission (hereinafter the "Commission") to determine the rights and obligations of Kingsley Service Company and issue a declaratory statement as to the specific questions presented hereunder and under the provisions of the Commission Order Nos. 16971, 23541 and 23114, and in support thereof states:

1. The name and address of the Petitioner in this matter is:

Kingsley Service Company
782 Foxridge Center Drive
Orange Park, Florida 32065

Copies of all correspondence and other documents should be provided to:

Mr. Ray Avery
Kingsley Service Company
782 Foxridge Center Drive
Orange Park, Florida 32065

2. The name of the agency is the Florida Public Service Commission.

3. Company is a water and sewer utility company doing business in Clay County, Florida, under the jurisdiction of the Commission, pursuant to Chapter 367, Florida Statutes, with its principle place of business located at 782 Foxridge Center Drive, Orange Park, Florida, 32065.

4. Company is a Florida corporation and provides water and sewer utility services in Clay County pursuant to Certificates of Public Convenience and Necessity Number 44-W and 43-S issued by the Commission.

5. During 1986, much consideration was given by most investor owned water and sewer utilities in the United States to the threat that the Tax Reform Act of 1986 ("ACT") would delete the tax free status of Contributions in Aid of Construction to regulated water and sewer utilities. This tax free status at that time was allowed by Section 118(b) of the Internal Revenue Code for Contributions in Aid of Construction which met certain specific criteria.

6. The Florida Public Service Commission by Order No. 16971, dated December 18, 1986, authorized, but did not require, utilities subject to its jurisdiction to amend their service availability policies to meet the income tax impact on C.I.A.C. resulting from the passage of the ACT. The Order contained a formula ("gross-up formula") for calculating the income tax impact on C.I.A.C. collected by utilities. To take advantage of the gross-up formula, utilities were required to submit the appropriate tariff sheets for approval by the Commission prior to implementation of the new service availability policies, and Company did this at that time.

7. Prior to that time, Company, like many other utilities, gave much research and thought to ways to legally avoid and/or defer the effect of the loss of the nontaxable status of C.I.A.C.

Such attempts at avoidance or deferral were informally encouraged by the Commission and its Staff from the initiation of Commission Docket No. 860184-PU, and in fact such encouragement was specifically enumerated in Order No. 23541.

8. Much research was given by the Florida Home Builders Association, the Florida Waterworks Association, the National Association of Water Companies, the Florida Public Service Commission, and others to determine ways to avoid the income taxes resulting from the loss of the nontaxable status of C.I.A.C. We, as many others, concluded that the ACT, as well as the conference committee's written report, did an excellent job of closing the door on many innovative ways to get around the taxability of C.I.A.C. issue.

9. We had many requests from developers for consideration of ways to defer or avoid the income tax impact on C.I.A.C. In our research, we seized upon the fact that Section 118(b) allowed a two year expenditure period for the qualified expenditure of C.I.A.C. funds which were paid prior to December 31, 1986. We sought advice from our attorney as to what would be considered payment. He advised us that a cash payment would qualify as well as a note as long as the note document was unconditional and as long as it carried a fair rate of interest. He indicated that prior tax cases would support the conclusion that "for an accrual basis taxpayer the note would be considered equivalent to cash".

10. With this advice, we proceeded to enter into agreements with developers who expected to construct and complete developments during 1987 and 1988, and we allowed payment of the C.I.A.C. prior to December 31, 1986 by note. Interest was subsequently invoiced and collected on the outstanding balance from time to time.

11. Agreements, as recapped on Exhibit "A" covering Seven Million Four Hundred Sixty-One Thousand Seven Hundred Twenty-One and 17/100 ($7,461,721.17) Dollars of C.I.A.C. were entered into and were paid by note. Of this amount, Three Million Nine Hundred Sixty-Five Thousand Four Hundred Eighty-Nine and 94/100 ($3,965,489.94) Dollars was collected during 1987 and 1988 for projects completed under these agreements. Two Million Two Hundred Thirty-Eight Thousand One Hundred Sixty-Two and 60/100 ($2,238,162.60) Dollars was either (1) refunded under a Florida Public Service Commission Order because of an overcharge on plant and main line capacity which was not allowed, or (2) the developments never materialized, and therefore, the agreements and notes were recinded much the same as a refund would have been made if we had collected cash for the prepaid C.I.A.C. for the projects that never materialized. The balance of One Million Two Hundred Fifty-Eight Thousand Sixty-Eight and 63/100 ($1,258,068.63) Dollars was either paid subsequent to December 31, 1988 or is still on the books. In any event, Company spent more in the way of investment in the water and sewer system to serve these developments prior to December 31, 1988, than the net value of the notes after such recissions.

12. Company filed disclosure in its tax return of December 31, 1987 and December 31, 1988, of its treatment of the notes on C.I.A.C. The IRS has recently conducted an investigation and has issued a preliminary position and memorandum that challenges our treatment of the notes as valid payment of C.I.A.C. prior to December 31, 1986. (See Exhibit "B").

13. We included in our various water and sewer agreements a provision that basically stated that if the payment of the C.I.A.C. is not considered as valid payment and the result is that a tax liability is created by our having accepted C.I.A.C., then the developer is responsible to reimburse the cash impact of that liability to Company to the extent which it is allowed by the Florida Public Service Commission. (See language included in Exhibit "B").

14. Since many of the projects concerned herein are fully developed and in many cases have either been sold out by the developer or are in the process of being sold out by the developer, then our position of recovering these taxes from the developers, should we lose our debate with the Internal Revenue Service, becomes weaker every day. Therefore, it is important for us to be able to immediately establish the amount of income tax gross-up that we can seek from the developers in order to maximize our ability to collect the tax reimbursement.

15. At 12/31/86, Company was allowed an income tax gross-up rate of .595660 for C.I.A.C. collected after 12/31/86. Subsequently, Company petitioned the Florida Public Service Commission to reduce its gross-up rate on C.I.A.C. and the Commission issued an Order allowing

the reduced gross-up rate which, based on current State and Federal income tax rates is .2517. This is the rate that is in effect today.

16. The Company has not yet received the final notice of tax liability or assessment from the Internal Revenue Service, however, such notice is expected within the next few weeks. The Company will forward to the Commission such actual notice of tax liability or assessment as soon as received. It is, however, apparent from the memorandum from the IRS General Counsel to the District Director, dated April 10, 1991, that the IRS does intend to impose taxes on the "C.I.A.C. notes" received in December of 1986.

17. Company, has not, by any means, given up hope of pursuing and winning this case before the Internal Revenue Service. However, the potential sums involved are substantial and the impact as to whether the burden of payment is carried by the utility and the ultimate rate payer, or whether it is carried by the developers are severe.

18. Company believes that it did everything it could to properly document its position on the notes on C.I.A.C. so they would not be construed as taxable Contributions in Aid of Construction. Company believes that it was the desire of the Florida Public Service Commission at December 31, 1986, that all methods to avoid and/or delay the impact of the taxes on C.I.A.C. for the benefit of the rate payer should be pursued. Company believes that its position on the notes on C.I.A.C. was reasonable and it was backed up by the legal advice of its attorney. Company and its attorney believe that the position of the IRS is substantially in error. Nevertheless, should

Company's position be overturned by the IRS, Company cannot afford to pay the potential tax liability without (1) the ability to collect the reimbursement from the developer for all or a portion of the cash impact of such tax liability, and/or (2) be allowed Rate Base consideration for any remaining income taxes that Company may be out-of-pocket with regard to this transaction.

Company hereby respectfully requests that (1) the Florida Public Service Commission establish the appropriate tax gross-up percentage that Company can pursue for reimbursement from the developers with the understanding that such reimbursement cannot exceed more than 100% of the cash necessary for full gross-up to recover the entire cash impact of the income tax on C.I.A.C. which is assessed, should a settlement for less than the full amount of the taxes be achieved, and (2) in the event it is concluded by legal counsel that the taxes cannot reasonably and economically be recovered from the developer, the Company be allowed Rate Base treatment with regard to such amounts of income taxes resulting from these note transactions that Company has to expend and is not able to recover.

19. The Commission's interpretation of its Orders does affect the Company in its particular set of circumstances, in that the Company will have to make decisions with regard to:

(a) When and to what extent to pursue contests of the proposed taxation of the C.I.A.C. received as notes during December of 1986;

(b) In the event the IRS ultimately prevails in its position with regard to the taxability of this C.I.A.C., the Company will have

to determine to what extent to pursue collection of such monies from the appropriate developers; and

(c) To what extent "gross-up" C.I.A.C. is considered to be received by the IRS in previous years.

WHEREFORE, based upon all of the foregoing, the Company requests that the Florida Public Service Commission issue its declaratory statement interpreting the provisions of Order Nos. 16971, 23541 and 23114, and declare that:

1. Kingsley Service Company should pursue a contest of any proposed taxation of the C.I.A.C. received as notes during December of 1986.

2. Costs of contesting such action by taxation of the "C.I.A.C. notes" received in December of 1986 should be capitalized as intangible plant by the Utility.

3. To the extent the IRS ultimately prevails on its position that such C.I.A.C. received as notes is taxable to the Utility, the Company should pursue collection of such tax from the appropriate developers in accordance with its rights under the notes executed with those developers, to the extent management determines that such pursuit has a reasonable likelihood of success, based upon the likelihood of collection, the amount to be collected, and the cost of collection.

4. The gross-up percentage to be utilized in determining the amount of monies owed to the Utility by developers in the event the IRS ultimately prevails with regard to its proposed taxation of these C.I.A.C. notes should be based upon the gross-up percentage in effect at the time the IRS determines that such C.I.A.C. was received.

5. In the event it is concluded by legal counsel and management that the taxes cannot reasonably and economically be recovered from the developers, the Company should be allowed rate base treatment with regard to such amounts of income taxes which the Company is liable for as a result of this action by the IRS.

Respectfully submitted this 26th day of April, 1991, by:

KINGSLEY SERVICE COMPANY
782 Foxridge Center Drive
Orange Park, Florida 32065
(904) 276-2301

Jimmie R. Rodgers
President