**FLORIDA PUBLIC SERVICE COMMISSION**

 **Fletcher Building**

 **101 East Gaines Street**

 **Tallahassee, Florida 32399-0850**

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

 **May 6, 1993**

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

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

 **DIVISION OF LEGAL SERVICES (FEIL)**

**RE: UTILITY: GULF UTILITY COMPANY**

**DOCKET NO.: 930216-WS**

**COUNTY: LEE COUNTY**

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

**AGENDA: 5/18/93 - CONTROVERSIAL - PROPOSED AGENCY ACTION - PARTIES MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**RECOMMENDATION FILE NAME: I:\PSC\WAW\WP\930216.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. By Order No. PSC-92-0742-FOF-WS Gulf Utility Company (Gulf or Utility) was authorized to continue to gross-up CIAC for the related tax impact. A developer protested the continued authority to gross-up, and the matter has been set for hearing.

 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 on September 9, 1992, which included Attachment A which reflects the generic calculation form. No protests were filed, and the Order became final.

 Gulf is a Class A utility which provides water and wastewater service to customers in Lee County. According to their 1991 annual report, operating revenue of $1,484,296 for water and $660,570 for the wastewater system were reported. The utility reported net operating income of $44,650 for the water systems and $98,479 for the wastewater systems.

 **DISCUSSION OF ISSUES**

**ISSUE 1:** Should Gulf Utility Company be required to refund excess gross-up collections of $5,708 for 1987; $49,212 for 1988; $45,309 for 1989; $32,462 for 1990; and $120,447 for 1991, for a total of $253,138 plus accrued interest through the date of refund?

**RECOMMENDATION:** Yes, the utility should refund $5,708 for 1987; $49,212 for 1988; $45,309 for 1989; $32,462 for 1990; and $120,447 for 1991, for a total of $253,138, 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 the refund is to be completed. (MEADOR)

**STAFF ANALYSIS:** In compliance with Order No. 16971, Gulf filed its 1987 through 1991 annual CIAC reports regarding its collection of gross-up for each year. By letter dated April 10, 1991, Gulf filed amended CIAC reports for 1987, 1988 and 1989. In response to staff's preliminary calculations, which were sent to Gulf March 1, 1993, the utility submitted copies of a Special Report which calculated the utility's proposed refund calculation. In a letter dated April 7, 1993, Gulf stated that it filed revised 1987 through 1990 reports which broke out the actual tax return line items on an above the line and below the line basis on June 15, 1992. These schedules had not previously been received by the staff working on the gross-up refund calculation.

 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 separately reflected the first year's depreciation as a separate reduction to the taxable amount of CIAC only in the years where there was not an above-the-line loss. In those years with an above-the-line loss, the calculation states that the first year's depreciation is included in the losses. Staff believes the amount of the first year's depreciation associated with the collection of taxable CIAC should be separately reflected in order to determine the utility's taxable income/loss prior to consideration of taxable CIAC and its associated depreciation. 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 separately reflected the amount of first year's depreciation in our calculation of the net taxable amount of CIAC.

 It should be noted that staff's calculated Net Taxable CIAC amount for each year agrees with the company's amount of Net Taxable CIAC with the exception of 1988. The company states the above-the-line loss totals $76,885, however, this amount includes $99,700 in the first year's depreciation associated with the collection of taxable CIAC. The company would have an above-the-line income of $22,815 prior to inclusion of the first year's depreciation associated with taxable CIAC. Therefore, no reduction to the amount of taxable CIAC should be made in 1988 for an above-the-line loss prior to its collection of taxable CIAC.

**CALCULATION OF "EFFECTIVE TAX RATE"**

 The utility's special report filed on June 15, 1992 and again on April 7, 1993, states the Company's actual effective state and federal tax rates, based on the returns filed, were used to calculate the actual tax on CIAC. Staff has consistently used, and the refund calculation adopted in Order No. PSC-92-0961-FOF-WS used, the combined federal and state tax rates, and NOT the calculated effective tax rates. The effective federal and state tax rates calculated by the company are higher for each year (except 1987) than the combined federal and state tax rates. Staff believes that the net amount of taxable CIAC will in fact be taxed at the combined rates and not at the "effective federal and state tax rates" calculated by the utility. Therefore, we have used the combined federal and state taxes rates in effect for each year. It should be noted that for the first six months in 1987, the federal rate was 46%, while the tax rate was 34% for the last half of the year. Staff has calculated the average of the two combined federal and state rates due to the reduction of the federal rate for the last half of 1987. Staff's average combined federal and state tax rate is 43.3% while the company has used an "effective federal and state rate" of 42.10%.

 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.

 **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 amended gross-up reports filed each year are reflected on Schedule No. 1. A summary of each year's refund calculation follows.

 **1987**

 The utility calculated the refund to be $18,624 for 1987.

 Staff calculates a refund of $5,708 for 1987. The 1987 CIAC report indicates that a total of $275,502 of gross-up collections were received, with the first year's depreciation reported as $7,479. The utility had an above-the-line loss of $100,334 prior to consideration of taxable CIAC and its associated depreciation. A reduction to the amount of CIAC taxable was made to account for the amount of the above-the-line loss. Staff has used the 43.30% combined federal and state tax rates that were in effect during 1987 to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $5,708 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 the refund to be $26,658 for 1988.

 Staff calculates a refund of $49,212 for 1988. The 1988 CIAC report indicates that a total of $1,407,307 of gross-up collections were received, with the first year's depreciation reported as $99,700. Staff has used the 37.63% combined federal and state tax rates that were in effect during 1988 to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $49,212 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 the refund to be $37,670 for 1989.

 Staff calculates a refund of $45,309 for 1989. The 1989 CIAC report indicates that a total of $1,328,581 of gross-up collections were received, with the first year's depreciation reported as $39,437. Staff has used the 37.63% combined federal and state tax rates that were in effect during 1989 to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $45,309 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 the refund to be $25,677 for 1990.

 Staff calculates a refund of $32,462 for 1990. The 1990 CIAC report indicates that a total of $1,021,526 of gross-up collections were received, with the first year's depreciation reported as $60,146. Staff has used the 37.63% combined federal and state tax rates that were in effect during 1990 to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $32,462 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 calculated the refund to be $114,402 for 1991.

 Staff calculates a refund of $120,447 for 1991. The 1991 CIAC report indicates that a total of $665,291 of gross-up collections were received, with the first year's depreciation reported as $24,630. The utility had an above-the-line loss of $177,642 prior to consideration of taxable CIAC and its associated depreciation. A reduction to the amount of CIAC taxable was made to account for the amount of the above-the-line loss. Staff has used the 37.63% combined federal and state tax rates that were in effect during 1991 to calculate the tax effect. Based upon the foregoing, staff calculates a refund of $32,462 for 1991. This amount does not include the accrued interest which must also be refunded from December 31, 1991 to the date of refund.

 Based upon the foregoing, staff recommends that the utility be required to refund a total of $253,138 ($5,708 for 1987; $49,212 for 1988; $45,309 for 1989; $32,462 for 1990; and $120,447 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 the refund is to be completed.

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

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

**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.

GULF UTILITY 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) $ 633,346 $ 3,364,665 $ 3,482,926 $ 2,238,372 $ 1,092,219

 2 Less CIAC (Line 7) (461,100) (2,350,680) (2,166,402) (1,699,474) (1,105,326)

 3 Less Gross‑up collected (Line 19) (275,502) (1,407,307) (1,328,581) (1,021,526) (665,291)

 4 Add First Year's Depr on CIAC (Line 8) 7,479 99,700 39,437 60,146 24,630

 5 Add/Less Other Effects (Lines 20 & 21) (4,557) 316,437 165,322 542,774 476,126

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

 7 Adjusted Income Before CIAC and Gross‑up $ (100,334) $ 22,815 $ 192,702 $ 120,292 $ (177,642)

 8

 9 Taxable CIAC (Line 7) $ 461,100 $ 2,350,680 $ 2,166,402 $ 1,699,474 $ 1,105,326

10

11 Taxable CIAC Resulting in a Tax Liability $ 360,766 $ 2,350,680 $ 2,166,402 $ 1,699,474 $ 927,684

12 Less first years depr. (Line 8) (7,479) (99,700) (39,437) (60,146) (24,630)

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

14 Net Taxable CIAC $ 353,287 $ 2,250,980 $ 2,126,965 $ 1,639,328 $ 903,054

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

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

17 Net Income tax on CIAC $ 152,973 $ 847,044 $ 800,377 $ 616,879 $ 339,819

18 Less ITC Realized 0 0 0 0 0

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

20 Net Income Tax $ 152,973 $ 847,044 $ 800,377 $ 616,879 $ 339,819

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 $ 269,794 $ 1,358,095 $ 1,283,272 $ 989,064 $ 544,844

24 Less CIAC Gross‑up collected (Line 19) (275,502) (1,407,307) (1,328,581) (1,021,526) (665,291)

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26 PROPOSED REFUND (excluding interest) $ (5,708) $ (49,212) $ (45,309) $ (32,462) $ (120,447)

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29 TOTAL REFUND $ (253,138)

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