

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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|---------------------------------------|---|----------------------|
| In re: Petition for declaratory |) | DOCKET NO. 910531-WS |
| statement related to appropriate |) | |
| treatment of taxes related to |) | ORDER NO. 25271 |
| Contributions-In-Aid-of-Construction |) | |
| (CIAC) by Kingsley Service Company in |) | ISSUED: 10/30/91 |
| Clay County. |) | |
| |) | |
| |) | |

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD, Chairman
 SUSAN F. CLARK
 J. TERRY DEASON
 BETTY EASLEY
 MICHAEL MCK. WILSON

ORDER DENYING DECLARATORY STATEMENT

BY THE COMMISSION:

CASE BACKGROUND

Kingsley Service Company is a Florida water and sewer utility corporation operating in Clay County under Certificates of Public Convenience and Necessity Numbers 44-W and 43-S. The utility has petitioned the Commission for a declaratory statement regarding certain tax treatment of Contributions-in-Aid-of-Construction (CIAC).

On February 13, 1986, the Florida Waterworks Association requested that the Commission investigate a proposed amendment of Section 118(b), Internal Revenue Code (Code), under which certain contributions to the capital of a corporation were excluded from the calculation of federal taxable income or loss. Congress passed the proposed amendment to Section 118(b) of the Code and, effective January 1, 1987, all CIAC received after December 31, 1986 was included in the calculation of taxable income or loss in the year received. In addition, contributed plant became depreciable for federal tax purposes.

By Order No. 16971, issued December 18, 1986, on an emergency basis, this Commission authorized corporate utilities subject to its jurisdiction to amend their service availability policies to gross-up CIAC in order to meet the tax impact resulting from the inclusion of CIAC as gross income. On December 31, 1986, Kingsley received tariff approval for gross-up.

In its petition, the utility explains a method by which it attempted to avoid payment of taxes on CIAC. Because the Internal

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING

ORDER NO. 25271
DOCKET NO. 910531-WS
PAGE 2

Revenue Code allowed a two year expenditure period for CIAC funds paid prior to December 31, 1986, the utility accepted notes as payment of CIAC in the total amount of \$7,461,721.17. The utility, an accrual basis taxpayer, thus treated the notes as CIAC received in 1986, before CIAC became taxable. According to the utility, \$3,965,489.94 of this amount was collected during 1987 and 1988 for projects completed under the agreements, \$2,238,162.60 was subsequently refunded or the notes were rescinded because the developments never materialized, and the balance of \$1,258,068.63 was either paid after December 31, 1988, or is still on the books.

In its petition, the utility states that it included a provision in its water and sewer agreements which "basically stated that if the payment of the CIAC is not considered as valid payment and the result is that a tax liability is created . . . then the developer is responsible to reimburse the cash impact of that liability to [the utility] to the extent which it is allowed by the Florida Public Service Commission." Recently, the utility's position has been challenged by the Internal Revenue Service, which has assessed the utility taxes in the approximate amount of \$1.5 million, plus penalty and interest. The utility contested the assessment and petitioned the Commission for a declaratory statement regarding aspects of the utility's handling of the tax issue.

DISCUSSION

Section 120.565, Florida Statutes, provides that the purpose of a declaratory statement is to "set out the agency's opinion as to the applicability of a specified statutory provision or of any rule or order of the agency as it applies to the petitioner in his particular set of circumstances only." Rule 25-22.021, Florida Administrative Code, which implements the statute, specifies that a declaratory statement is a means for resolving controversy or confusion:

A declaratory statement is a means for resolving a controversy or answering questions or doubts concerning the applicability of any statutory provision, rule or order as it does, or may, apply to petitioner in his or her particular circumstances only. The potential impact upon petitioner's interests must be alleged in order for petitioner to show the existence of a controversy, question or doubt.

Although we find that the utility's petition contains one issue which meets the threshold requirements for a declaratory statement found in section 120.565, Florida Statutes and Rule 25-22.021, Florida Administrative Code, we find it is unnecessary to

ORDER NO. 25271
DOCKET NO. 910531-WS
PAGE 3

issue a declaratory statement at this time.

Contest of proposed taxation

Kingsley Service Company requested the Commission declare to declare that the utility should pursue a contest of any proposed taxation of the CIAC received as notes during December of 1986. We decline to issue a declaratory statement to this effect.

There is no controversy, question, or doubt raised by the application of any statutory provision, rule or order which gives rise to this request. In its petition, the utility cites Commission Orders Nos. 16971, 23541 and 23114, which do not appear to raise any questions as applied to the utility. Rather, the utility seeks a determination by the Commission of a matter that falls into the category of management decision-making.

Proposed Agency Action Order No. 16971 was issued on December 18, 1986 in Docket No. 860184-PU (In Re: Request by Florida Waterworks Association for investigation of proposed repeal of Section 118(b), Internal Revenue Code (Contributions in Aid of Construction)). In that order, the Commission granted an application by Florida Waterworks Association to allow water and wastewater utilities to gross-up CIAC in order to recover taxes imposed by the Tax Reform Act of 1986 on formerly nontaxable CIAC. Kingsley Service Company's petition does not claim, and we do not find, that the application of this order gives rise to any controversy, question, or doubt as to whether Kingsley Service Company should pursue a contest of any proposed taxation of the CIAC received as notes during December of 1986. Rather, the utility seeks a predetermination of the prudence or reasonableness of a management decision.

Order No. 23541 was issued in Docket No. 860184-PU on October 1, 1990. The order retained the CIAC gross-up and, among other things, specified accounting procedures and required utilities to file a petition for approval to continue or begin collecting the gross-up. The order also contains a discussion on avoidance of taxes on CIAC at page 4, which concludes: "Accordingly, we hereby encourage the water and wastewater industry to continue to search for viable methods" to avoid taxes on CIAC. (Reconsideration of this order was denied and clarification was granted in Order No. 24413, issued on April 22, 1991. However, the clarification does not affect this issue.) Kingsley Service Company's petition does not claim, and we do not find, that the application of Order No. 23541 gives rise to any controversy, question, or doubt as to whether the utility should pursue a contest of a tax assessment of the CIAC received as notes during December of 1986. The utility has not alleged that this order has any possible impact upon its

ORDER NO. 25271
DOCKET NO. 910531-WS
PAGE 4

interests which gives rise to a proper petition for declaratory statement. Instead, the decision whether or not to contest proposed taxes is the type of management decision which the utility is best suited to make. Such decisions are typically reviewed by the Commission at a later date rather than pre-approved in a declaratory statement:

Generally, we do not insert ourselves into the day-to-day decision-making processes of a utility. In fact, we normally do not review the management decisions of a utility unless it has applied for a rate increase or we have initiated an overearnings investigation.

(Order No. 23541 at 9)

Order No. 23114 was issued in Docket No. 891316-WS (In Re: Application of Kingsley Service Company in Clay County for approval to increase service availability charges, pay taxes on CIAC rather than pass them on to developer, and approve inclusion of its investment in income taxes in rate base) on June 25, 1990. The Commission granted the utility's amended petition to reduce its CIAC gross-up percentage and for authorization to include net prepaid CIAC taxes in rate base. Again, this order has no impact upon the utility's management decision on whether or not to contest proposed taxes.

In its petition, which the utility was given ample opportunity to amend, the utility states that, in developing its note-as-payment of CIAC procedure, it "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.", and that "[s]uch 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 encouragement was specifically enumerated in Order No. 23541." (petition at 3) The petition also states that "[t]he 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" related to the tax issues discussed in its petition. However, the petition fails to point to any provision in the orders cited which impacts its interests with regard to contesting taxes. With regard to this issue, the petition does not meet the threshold requirements for a declaratory statement. We therefore decline to issue the declaratory statement as requested.

Capitalization of costs

The utility asked the Commission to declare that costs of contesting taxation of CIAC received as notes during December, 1986 should be capitalized as intangible plant by Kingsley Service

ORDER NO. 25271
DOCKET NO. 910531-WS
PAGE 5

Company. However, nothing in the orders cited by the utility impacts the capitalization decision. The utility has shown no controversy, question or doubt arising from the cited orders as to whether it should capitalize the as yet unascertained costs of contesting taxation of CIAC. Therefore, the petition does not meet the threshold requirements for a declaratory statement.

Collection of tax reimbursement

The utility also asked the Commission to declare that, to the extent the IRS ultimately prevails on its position that the CIAC received as notes during December, 1986 is taxable to the Kingsley Service Company, the utility should pursue collection of such tax from the appropriate developers in accordance with its rights under the notes executed with the developers, to the extent utility 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.

The utility seeks our pre-approval for a series of management decisions the utility must make. Nothing in the orders cited by the utility impact this decision. The utility has shown no controversy, question or doubt arising from the cited orders as to whether and to what extent it should pursue collection of taxes from developers. Therefore, the petition does not meet the threshold requirements for a declaratory statement.

Appropriate gross-up percentage

The utility asked the Commission to declare that the gross-up percentage to be utilized in determining the amount of monies owed to Kingsley Service Company by developers in the event the IRS ultimately prevails with regard to its proposed taxation of the CIAC notes should be based upon the gross-up percentage in effect at the time the IRS determines that such CIAC was received. Although our review of the applicable orders indicates that this issue meets the threshold requirements for a declaratory statement, we decline to issue the statement as requested by the utility.

Order No. 16971 allowed utilities to gross-up in order to recover taxes on formerly untaxable CIAC. The order was issued on December 18, 1986. Pursuant to that order, Kingsley Service Company received tariff approval of a service availability policy which included a CIAC gross-up of 59.566 percent for CIAC collected after December 31, 1986. On June 25, 1990, by the terms of Order No. 23114, the utility received permission to decrease the gross-up to 25.17 percent.

According to the petition, the utility included a provision in

ORDER NO. 25271
DOCKET NO. 910531-WS
PAGE 6

its water and sewer agreements with developers which specified that if payment of CIAC notes resulted in a tax liability for the utility, the developer must reimburse the utility for the cash impact of the liability to the extent allowed by the Commission. The utility seeks a determination of the appropriate percentage to use in actions to collect CIAC gross-up from developers.

If the utility collects CIAC gross-up from developers, it will receive the funds while the decreased (25.17 percent) gross-up is in effect. However, the IRS treated the CIAC as taxable income received by the utility when collected from developers. Kingsley collected most, if not all, of the CIAC which gives rise to the tax liability between December 31, 1986 and June 25, 1990, when the 59.566 percent gross-up rate was in effect.

We believe it is unnecessary to issue a declaratory statement as to the appropriate gross-up percentage at this time. The IRS has assessed the amount of taxes it believes to be due on CIAC received by the utility. Under the circumstances, it is not necessary for Kingsley Service Company to receive a declaratory statement from the Commission in order to pursue collection of the assessed taxes from developers. If a developer believes that Kingsley is attempting to collect an improper amount of tax reimbursement, the dispute can be resolved if and when it arises.

Rate base treatment of taxes

The utility asked the Commission to declare that in the event it is concluded by the utility's legal counsel and management that taxes cannot reasonably and economically be recovered from developers, the utility should be allowed rate base treatment with regard to such amounts of income tax for which the utility is liable as a result of the IRS action. We decline to issue this statement.

The rate base treatment requested by the utility rests upon a management decision. That is, the utility seeks rate base treatment of an unspecified amount "in the event it is concluded" that the funds in question "cannot reasonably and economically be recovered". The issue of rate base treatment is therefore premature. The decision whether it is reasonable and economical to pursue collection of the funds is inappropriate for a declaratory statement. Nothing in the orders cited by the utility impacts these decisions.

There is no conflict or controversy as to whether CIAC debit deferred taxes, once offset against credit deferred taxes, may be properly included in rate base. This has been the policy of the Commission, and is clearly set forth in Order No. 23514 and in the

ORDER NO. 25271
DOCKET NO. 910531-WS
PAGE 7

clarification of that order (Order No. 24413). Additionally, in Order No. 23114, Kingsley Service Company was granted permission to record net CIAC debit deferred taxes in rate base. The utility has cited no conflicting order, rule or statutory provision giving rise to uncertainty on its part. Therefore, it appears that this is actually another way of asking about the prudence of the decision to pursue reimbursement from developers. We will not issue a declaratory statement which would have the effect of pre-approving the reasonableness or prudence of the utility's collection efforts.

According to the terms of Order No. 23114, the utility may record net CIAC debit deferred taxes in rate base. However, amounts included in rate base pursuant to the terms of Order No. 23114 will remain subject to Commission scrutiny, as always.

It is therefore

ORDERED by the Florida Public Service Commission that for the reasons stated in the body of this order, the petition for a declaratory statement is denied. It is further

ORDERED that this docket should be closed.

By ORDER of the Florida Public Service Commission, this 30th
day of OCTOBER, 1991.

STEVE TRIBBLE, Director
Division of Records and Reporting

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by: Kay Flynn
Chief, Bureau of Records

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

ORDER NO. 25271
DOCKET NO. 910531-WS
PAGE 8

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.