

FLORIDA PUBLIC SERVICE COMMISSION  
Capital Circle Office Center • 2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399-0850

MEMORANDUM

March 20, 1997

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYON) *mk*  
FROM: DIVISION OF WATER & WASTEWATER (GILCHRIST) *GH*  
DIVISION OF LEGAL SERVICES (CYRUS-WILLIAMS) *WJS*  
RE: DOCKET NO. ~~REDACTED~~-WS - DISPOSITION OF GROSS-UP FUNDS *OW*  
COLLECTED BY HYDRATECH UTILITIES, INC. *AS*  
COUNTY: MARTIN  
AGENDA: APRIL 1, 1997 - REGULAR AGENDA - PROPOSED AGENCY ACTION -  
INTERESTED PERSONS MAY PARTICIPATE  
CRITICAL DATES: NONE  
SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\~~REDACTED~~

CASE BACKGROUND

Hydratech Utilities, Inc. (Hydratech or utility) is a Class A water and wastewater utility providing service to approximately 5,169 water and 4,389 wastewater customers in Martin County. According to its 1995 annual report, the utility reported gross operating revenues of \$1,210,078 and \$963,550 for water and wastewater, respectively, and net operating income of \$119,558 for water and a net operating loss of \$14,873 for wastewater.

As a result of the repeal of Section 118(b) of the Internal Revenue Code, 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 October 1, 1990, require that utilities annually file information 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 also required 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.

DOCUMENT NUMBER DATE

0257 MAR 20 97

FPSC-RECORDS/REPORTING

**DOCKET NO. 970275-WS**  
**MARCH 20, 1997**

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. Hydratech filed for authority to gross-up on May 22, 1991. By Order No. 25515, issued December 20, 1991, Hydratech was granted authority to gross-up CIAC using the full gross-up formula.

On September 9, 1992, this Commission issued Proposed Agency Action Order No. PSC-92-0961-FOF-WS, which clarified the provision 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. This order included Attachment A which reflects the generic calculation form. No protests were filed, and the Order 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 Order 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 was passed by Congress and was signed 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. Based on the above, there was no longer a need to review the Commission's policy to determine any changes and 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-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Orders Nos. 16971 and 23541. The disposition of gross-up funds collected by the utility from 1991 through 1994 was handled in Docket No. 970121-SU and Order No. PSC-96-1352-FOF-WS was issued accordingly. The purpose of this

**DOCKET NO. 970275-WB**  
**MARCH 20, 1997**

recommendation is to address the disposition of gross-up funds collected by the utility in 1995.

DOCKET NO. 970275-WS  
MARCH 20, 1997

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should Hydratech Utilities, Inc. be required to refund excess gross-up collections for 1995?

**RECOMMENDATION:** Yes, the utility should refund \$71,902 for 1995, plus accrued interest through the date of refund, for gross-up collected in excess of the above-the-line tax liability resulting from the collection of taxable CIAC. According to Orders Nos. 16971 and 23541, all amounts should be refunded on a pro rata basis to those persons who contributed the taxes. The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of cancelled checks, credits applied to monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility also should provide a list of unclaimed refunds detailing the contributor and the amount, and an explanation of the efforts made to make the refunds. (GILCHRIST, CAUSSEAU)

**STAFF ANALYSIS:** In compliance with Orders Nos. 16971 and 23541, Hydratech filed its 1995 annual CIAC report regarding its collection of gross-up. The utility proposes and staff agrees that a refund of \$71,902 plus accrued interest through the date of the refund is appropriate for 1995. In this docket, Hydratech is not requesting that the accounting and legal costs associated with preparing the CIAC gross-up report for 1995 be deducted from the refund amount.

Staff 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-POF-WS.

Based upon the foregoing, staff calculated the amount of refund which is appropriate. Our calculations, taken from the information provided by the utility in its gross-up report are reflected on Schedule No. 1.

The utility's 1995 CIAC report indicates that the utility had an above-the-line loss before the inclusion of taxable CIAC and gross-up. Order No. 23541 requires that CIAC income be netted against the above-the-line loss; therefore, not all of the CIAC collected would create a tax liability. The utility's CIAC report indicates a total of \$645,578 in taxable CIAC was received, with \$10,814 being deducted for the first year's depreciation, resulting in net taxable CIAC of \$634,764. When this amount is netted against the above-the-line-loss of \$127,973, the amount of taxable

**DOCKET NO. 970275-WB**  
**MARCH 20, 1997**

CIAC resulting in a tax liability is \$506,791. Staff used the 37.63% combined marginal federal and state tax rate as provided in the 1995 CIAC Report to calculate the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$506,791 results in the income tax effect of \$190,705. 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 \$305,757. The utility collected \$377,659 of gross-up monies; therefore, staff calculates a refund of \$71,902. This amount does not include accrued interest as of December 31, 1995 which must also be refunded through the date of the refund. The refund will be distributed to 179 water and 225 wastewater customers.

The refunds should be completed within 6 months of the effective date of the order. Within 30 days from the date of the refund, the utility should submit copies of cancelled checks, credits applied to monthly bills or other evidence that verifies that the utility has made the refunds. Within 30 days from the date of the refund, the utility should also provide a list of unclaimed refunds detailing the contributor and the amount, and an explanation of the efforts made to make the refunds.

DOCKET NO. 970275-WB  
MARCH 20, 1997

ISSUE 2: Should the docket be closed?

RECOMMENDATION: No. Upon expiration of the protest period, if a timely protest is not received from a substantially affected person, the 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. (CYRUS-WILLIAMS)

STAFF ANALYSIS: Upon expiration of the protest period, if a timely protest is not received from a substantially affected person, the 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.

SCHEDULE NO. 1

STAFF CALCULATED GROSS-UP REFUND

Hydratech Utilities, Inc.

SOURCE: (Line references are from CIAC Reports)

	1995
1 Form 1120, Line 80 (Line 15)	\$ 887,110
2 Less CIAC (Line 7)	(645,578)
3 Less Gross-up Collected (Line 10)	(377,659)
4 Add First Year's Depr on CIAC (Line 8)	10,814
5 Add/Less Other Effects (Lines 20 & 21)	(2,660)
6	-----
7 Adjusted Income Before CIAC and Gross-up	\$ (127,973)
8	
9 Taxable CIAC (Line 7)	\$ 645,578
10 Less first years depr. (Line 8)	\$ (10,814)
11	-----
12 Adjusted Income After CIAC	\$ 506,791
18 Less: NOL Carry Forward	\$ 0
14	-----
15 Net Taxable CIAC	\$ 506,791
16 Combined Marginal state & federal tax rates	37.63%
17	-----
18 Net Income tax on CIAC	\$ 190,705
19 Less ITC Realized	0
20	-----
21 Net Income Tax	\$ 190,705
22 Expansion Factor for gross-up taxes	1.6088349
23	-----
24 Gross-up Required to pay tax effect	\$ 305,757
25 Less CIAC Gross-up collected (Line 19)	(377,659)
26	-----
27 (OVER) OR UNDER COLLECTION	\$ (71,902)
28	=====
29	
30 TOTAL YEARLY REFUND	\$ (71,902)
31	=====
32	
33 PROPOSED REFUND (excluding interest)	(71,902)
34	=====