

FLORIDA PUBLIC SERVICE COMMISSION
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MEMORANDUM

FEBRUARY 20, 1997

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

FROM: DIVISION OF WATER & WASTEWATER (GILCHRIST)
DIVISION OF AUDITING AND FINANCIAL ANALYSIS (CAUSSEAU)
DIVISION OF LEGAL SERVICES (JAEGER)

RE: DOCKET NO. 970121-SU - DISPOSITION OF GROSS-UP FUNDS
COLLECTED BY EAGLE RIDGE UTILITIES, INC.
COUNTY: LEE

AGENDA: MARCH 4, 1997 - REGULAR AGENDA - PROPOSED AGENCY ACTION -
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\970121.RCM

CASE BACKGROUND

Eagle Ridge is a Class B wastewater utility providing service to 606 customers in Lee County. According to its 1995 annual report, the utility reported operating revenues of \$338,486 and a net operating loss of \$53,052.

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 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, 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 collections 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.

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FPSC-RECORDS/REPORTING

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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. Eagle Ridge Utilities, Inc. (Eagle Ridge or utility), filed for authority to continue to gross-up on December 11, 1990. By Order No. 25436, issued December 4, 1991, Eagle Ridge was granted authority to continue to gross-up 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 which 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 (The Act) passed 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 Order Nos. 16971 and 23541. The disposition of gross-up funds collected by the utility in 1993 and 1994 were handled in Docket No. 961077-SU and Order No. PSC-96-

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1394-FOF-SU was issued accordingly. The purpose of this docket is to address the disposition of gross-up funds collected by the utility in 1995.

DISCUSSION OF ISSUES

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

RECOMMENDATION: Yes, the utility should refund \$1,131 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 canceled 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, CAUSSEAUX)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Eagle Ridge filed its 1995 annual CIAC report regarding its collection of gross-up. The utility proposes and staff agrees that a refund of \$1,131 plus accrued interest through the date of the refund is appropriate for 1995. In this docket, Eagle Ridge 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-FOF-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 was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC and gross-up. Therefore, all of the taxable CIAC received would be taxed. The report indicates a total of \$178,213 in taxable CIAC was received, with \$8,305 being deducted for the first year's depreciation. Staff used the 37.63% combined marginal federal and state tax rate as provided in the

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1995 CIAC Report to calculate the tax effect. The reported 37.63% combined marginal federal and state tax rate applied to the net \$169,908 results in the income tax effect of \$63,936. 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 \$102,511. The utility collected \$103,640 of gross-up monies; therefore, staff calculates a refund of \$1,131. The refund will be distributed to ten contributors and each contributor is entitled to a refund of \$113.10. This amount does not include accrued interest which must also be refunded from December 31, 1995 through the date of the refund.

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 canceled 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.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: No. Upon expiration of the protest period, 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. (JAEGER)

STAFF ANALYSIS: Upon expiration of the protest period, 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.

STAFF CALCULATED GROSS-UP REFUND

Eagle Ridge Utilities, Inc.

SOURCE: (Line references are from CIAC Reports)

	1995
1 Form 1120, Line 30 (Line 15)	\$ 285,493
2 Less CIAC (Line 7)	(178,213)
3 Less Gross-up collected (Line 19)	(103,640)
4 Add First Year's Depr on CIAC (Line 8)	8,305
5 Add/Less Other Effects (Lines 20 & 21)	(537)
6	-----
7 Adjusted Income Before CIAC and Gross-up	\$ 11,408
8	
9 Taxable CIAC (Line 7)	\$ 178,213
10 Less first years depr. (Line 8)	\$ (8,305)
11	-----
12 Adjusted Income After CIAC	\$ 181,316
13 Less: NOL Carry Forward	\$ 0
14	-----
15 Net Taxable CIAC	\$ 169,908
16 Combined Marginal state & federal tax rates	37.63%
17	-----
18 Net Income tax on CIAC	\$ 63,936
19 Less ITC Realized	0
20	-----
21 Net Income Tax	\$ 63,936
22 Expansion Factor for gross-up taxes	1.6033349
23	-----
24 Gross-up Required to pay tax effect	\$ 102,509
25 Less CIAC Gross-up collected (Line 19)	(103,640)
26	-----
27 (OVER) OR UNDER COLLECTION	\$ (1,131)
28	=====
29	
30 TOTAL YEARLY REFUND	\$ (1,131)
31	=====
32	
33 PROPOSED REFUND (excluding interest)	\$ (1,131)
34	=====