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

February 26, 1998

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

FROM: DIVISION OF WATER & WASTEWATER (IWENJIORA) *EW*  
DIVISION OF AUDITING & FINANCIAL ANALYSIS (C. FROMIG) *CF*  
DIVISION OF LEGAL SERVICES (JAEGER) *JA*

RE: DOCKET NO. 931141-WS - PARKLAND UTILITIES, INC. -  
PETITION TO GROSS-UP CONTRIBUTIONS IN AID OF CONSTRUCTION  
(CIAC) FOR RELATED TAX IMPACT AND DISPOSITION OF GROSS-UP  
COLLECTIONS

COUNTY: BROWARD

AGENDA: 03/10/98 - REGULAR AGENDA - PROPOSED AGENCY ACTION -  
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\931141.RCM

**CASE BACKGROUND**

By Order No. 16971, issued December 18, 1986, the Commission granted approval for water and wastewater utilities to amend their service availability policies to meet the tax impact of contributions in aid of construction (CIAC) resulting from the amendment of Section 118(b) of the Internal Revenue Code. Order No. 23541, issued October 1, 1990, ordered utilities currently grossing up CIAC to file a petition for continued authority to gross-up and also ordered that no utility may gross-up CIAC without first obtaining the approval of this Commission. Orders Nos. 16971 and 23541 also prescribe the accounting and regulatory treatments for the gross-up and require refunds of certain gross-up amounts collected.

On November 24, 1993, pursuant to Order No. 23541, Parkland Utilities, Inc. (Parkland or utility) filed its petition for

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authority to gross up CIAC. The information as filed met the filing requirements of Order No. 23541; however, numerous questions resulted from our review of the filing such that staff was unable to determine with any degree of certainty that a tax liability would be created by the collection of taxable CIAC. In an effort to complete our review and analysis, staff requested additional information and clarification. As a result of staff's requests, the utility submitted additional information and several revisions to its initial application. However, based on the additional information received, staff still could not conclude that gross-up authority should be granted.

Consequently, by Order No. PSC-94-0653-FOF-WS, issued May 31, 1994, the Commission allowed the full gross-up tariff authority to become effective on an interim basis, subject to refund with interest, in accordance with the provisions of Orders Nos. 16971 and 23541. Additionally, the May 31, 1994 Commission order included a restriction regarding the gross-up funds collected. That order maintained that no monies be withdrawn from the escrow account until a final determination of the utility's authority to collect CIAC gross-up was made. Further, pursuant to Rule 25-30.360 (6), Florida Administrative Code, the utility was required to provide a report by the 20th of each month indicating the monthly and total CIAC gross-up (revenue) collected subject to refund.

At the May 30, 1995 Agenda Conference, the Commission considered staff's recommendations regarding whether to grant Parkland authority to collect CIAC gross-up and also the disposition of CIAC gross-up funds that had been collected by Canal Utilities, Inc. (Docket No. 941083-WS). In its recommendation regarding Parkland's "final" CIAC gross-up authority, staff recommended that the utility be denied gross-up authority. Following much discussion, this item was deferred to clarify the wording of the recommendation and to verify the amount of available net operating losses (NOLs). Regarding staff's recommendation relating to Canal Utilities, Inc.'s CIAC gross-up disposition, questions were raised as to whether or not staff's method of calculating the gross-up refunds was contrary to the requirement of Order No. 23541 and the Commission's current practice. Also at issue, among others, was the appropriate level of review necessary to grant authority or process a refund, and the offsetting of above-the-line NOLs and investment tax credits (ITCs) with CIAC and taxes. As a result of these issues, among others, staff was directed to hold workshops to discuss viable alternatives. Staff also was directed to consider the need, if any, to change the Commission's current policy. In addition, processing of CIAC gross-up dockets was held in abeyance pending resolution of those

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issues.

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 Orders 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 into law 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. Parkland's interim gross-up authority was revoked and the tariff was canceled as of October 20, 1996.

Since there was no longer a need to review the Commission's policy on the gross-up of CIAC, 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-96-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Orders Nos. 16971 and 23541.

Staff's recommendation regarding this docket was scheduled to be heard at the November 4, 1997 Agenda Conference; however, on October 29, 1997, the utility's representative, F. Marshall Deterding, requested a deferral to allow the utility and its representatives opportunity to research the issues underlying staff's positions and to meet with the staff after accumulation of data in an attempt to resolve the differences. The Commission granted the utility's request for a deferral of the case. On December 5, 1997, the utility filed additional information and reiterated its request to set up a meeting with staff. The utility met with staff on January 7, 1998 and provided additional

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information.

Nevertheless, because of the current non-taxability of CIAC collected by water and wastewater utilities, the issue of final authority is moot. Therefore, the sole purpose of this recommendation is to address the disposition of gross-up funds collected for the period May 31, 1994 through December 31 1995.

Parkland is a Class B water and wastewater utility providing service to the public in Broward County. A review of the utility's 1996 annual report reflected approximately 635 water and 633 wastewater customers as of December 31, 1996. Gross annual operating revenues were \$231,433 and \$401,501 for the water and wastewater systems, respectively. The utility reported a net operating loss of \$23,908 for water and a net operating profit of \$57,964 for the wastewater system.

DISCUSSION OF ISSUES

ISSUE 1: Should Parkland Utilities, Inc. be required to refund excess gross-up collections for the tax periods, March 1 through December 31, 1994 and January 1 through December 31, 1995?

RECOMMENDATION: No. For the tax period, March 1 through December 31, 1994, the utility overcollected CIAC gross-up in the amount of \$12,421; however in accordance with the settlement allowed in previously approved refund cases, staff recommends that the Commission accept Parkland's request that 50 percent (\$14,538) of the legal, accounting and management fees incurred for the preparation of the gross-up disposition report be offset against the overcollected amount of \$12,421. Because 50 percent of the legal, accounting and management fees for 1994 (\$14,538) is greater than the overcollection, if the Commission accepts the utility's proposal, no refunds are appropriate for 1994. Further, no refund is appropriate for the year 1995 due to its immateriality. (IWENJIORA, C. ROMIG)

STAFF ANALYSIS: Parkland was wholly owned by the developer of the property, Narcco Realty, Inc. According to the consolidated 1992 Federal Income Tax return of Narco Realty, Inc. and Subsidiaries for the fiscal tax year ended February 28, 1993, Parkland's share of NOL carry forwards was \$1,091,336 at February 28, 1993. However, during the fiscal year ended February 28, 1994, Parkland was spun off from the consolidated group and now files a stand alone return. Parkland filed its own 1993 Federal Income Tax return for the fiscal period beginning on March 1, 1993 and ending on February 28, 1994. Parkland's stand-alone return includes NOLs at March 1, 1993 of \$607,725 instead of \$1,091,336 as reflected on the consolidated return; a difference of \$483,611. Staff noted the difference between the \$1,091,336 NOL carry forward attributed to Parkland at February 28, 1993 on the consolidated return and the \$607,725 NOL carry forward at the same date on Parkland's stand alone "spun-off" return and requested that the utility reconcile the difference. According to a representative of the CPA firm that prepared its tax returns, some of the Parkland NOLs were utilized in that year and prior years to offset taxable income of other subsidiaries and the parent within the consolidated group. Adding the Parkland loss of \$364,223 for 1993 (fiscal period March 1, 1993 through February 28, 1994) to the NOL carry forward of \$607,725 results in a NOL carry forward of \$971,948 at February 28, 1994 and is reflected as such on the 1993 return.

In 1994, Parkland began filing its Federal Income Tax (FIT) returns on a calendar year basis. For the short tax year beginning

on March 1, 1994 and ending on December 31, 1994, Parkland's reported \$971,948 NOL carry forward from March 1, 1993 was offset against taxable income of \$979,251. The \$979,251 was comprised of a \$1,226,510 gain from forgiveness of indebtedness income; \$139,380 in contributions-in-aid-of-construction; and a net loss of \$386,639 for other revenues and expenses. The taxable income was, therefore, \$979,251 prior to the NOL carry forward of \$971,948 and \$7,303 after taking into consideration the NOL carry forward.

Although not specifically addressed in its original early submissions and correspondence, the year that the utility was spun off from its parent, Parkland owed Narco Realty, Inc. (the parent) \$2,393,917 in debt. At that point, Parkland's gross rate base was \$1,167,407. Narco Realty "forgave" the debt in excess of the rate base (\$1,226,510), resulting in Parkland's receiving a \$1,226,510 gain from forgiveness of indebtedness. On page two of his letter dated August 21, 1997, Mr. Deterding argues that,

. . . the gain on forgiveness of debt is clearly an above the line item since the debt forgiven was that in excess of plant, and was incurred to fund losses from operations in prior years, which the Commission would surely consider above-the-line. In other words, if the losses from operations were above-the-line, the debt incurred was above-the-line, and the gain from the forgiveness of such debt should be considered above-the-line. At the very least, the loss NOLs and the gain on forgiveness of debt are directly related and must be considered together.

While staff does not believe that funds can be traced, a review of the utility's annual report indicates that the amount of debt from the parent exceeded the utility's investment in all plant facilities. Further, the annual reports indicate that the utility was in a continuous loss position. Therefore, staff believes it is reasonable to conclude that the excess debt from the parent funded losses from operations in prior years. Staff believes that the utility has made a valid argument and has therefore classified the gain on forgiveness of indebtedness above the line for gross-up disposition purposes.

As previously stated, according to the consolidated 1992 Federal Income Tax return of Narco Realty, Inc. and Subsidiaries for the fiscal tax year ended February 28, 1993, Parkland's share of NOL carry forwards was \$1,091,336 at February 28, 1993. The utility has not provided a calculation and/or schedule that

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demonstrates how the \$483,611 of NOLs were utilized by Parkland (\$1,091,336 less \$607,725). However, according to a representative of the CPA firm that prepared their tax returns, some of the Parkland NOLs were utilized in that year and prior years to offset taxable income of other subsidiaries and the parent within the consolidated group. Although staff believes that this form of tax strategy is acceptable and widely used, staff believes that in the case of a regulated entity, the NOL carry forwards of Parkland should be attributed to Parkland. In other words, the gross accumulated NOLs generated by Parkland should be used to offset the taxable CIAC for gross-up disposition purposes.

With the belief in mind that Parkland's NOLs should be used by Parkland, staff examined the 1990 through 1995 FIT returns in its possession. Staff also took into consideration the data provided to staff at the January 7, 1998 meeting. One of the utility handouts reflected additional Parkland NOL carry forwards of \$50,912 at March 1, 1988 and \$356,546 of NOLs for the period March 1, 1988 through February 28, 1989, or additional NOL carry forwards of \$407,458 at March 1, 1989. Further, in each year where a consolidated return was filed, staff was able to locate the consolidating schedule and determine the net operating loss attributed to Parkland Utilities, Inc. for that year. The losses and accumulated losses taken from FIT returns and supporting schedules, where applicable, follow:

<u>Tax Year</u>	<u>Consolidated (C) Stand Alone (SA)</u>	<u>NOL</u>	<u>Accumulated NOLS</u>
1987	C	\$ 50,912	\$ 50,912
1988	C	356,546	407,458
1989	C	303,797	711,255
1990	C	386,534	1,097,789
1991	C	355,527	1,458,316
1992	C	252,198	1,705,514
1993	SA	364,223	2,069,737

Staff interprets the above to mean that as of February 28, 1994, Parkland's accumulated NOLs were \$2,069,737, but that \$1,097,789 (\$2,069,737 less \$971,948) had been utilized by other entities within the consolidated group. Further, the utility's annual report reflects that the utility was formed in 1975 and began serving customers in 1981. However, our files contain FIT returns from 1989 forward and information on the NOLs for 1987 and 1988, only. Therefore, it is very likely that Parkland incurred additional losses for the six years prior to 1987 that might also be considered in addition to the \$2,069,737 reflected above.

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However, these returns were not provided and it was represented to staff that they were probably not easily obtainable at this point because of the time that had passed.

Prior to the January 7, 1998 meeting, the utility had not provided staff with an above-the-line/below-the-line breakdown of the NOL carry forwards at March 1, 1994, as they did not believe it was necessary in light of the substantial gain on forgiveness of indebtedness. However, at the January 7, 1998 meeting, that was attended by the utility, the utility consultants and staff, the utility provided staff with a breakdown of the above-the-line and below-the-line NOLs for the years 1989 through 1993. Additionally, subsequent to the meeting, the utility provided staff with a breakdown of the above-the-line and below-the-line NOLs for 1987 and 1988. Staff reviewed the breakdown and support provided, and believes the utility's breakdown to be reasonable. Based on the foregoing, Parkland's accumulated above-the line NOLs as of February 28, 1994 are \$1,205,126, as follows:

<u>Year</u>	<u>Above-the-Line NOL</u>	<u>Above-the-Line NOL Carry Forward</u>
1987	0	0
1988	228,153	228,153
1989	204,771	432,924
1990	217,942	650,866
1991	246,464	897,330
1992	143,962	1,041,292
1993	163,834	1,205,126

As stated earlier, the gain on forgiveness of indebtedness in 1994 was \$1,226,510, which exceeds the calculated above-the-line NOL carry forward at the approximate same date. Staff believes that the amount of gain on forgiveness of indebtedness should be limited to the above-the-line NOL carry forward. The utility has stated that the debt that was forgiven was accumulated as a result of Narco Realty's funding Parkland's above-the-line losses. In its August 21, 1997 letter, the utility stated,

In other words, if the losses from operations were above-the-line, the debt incurred was above-the-line and the gain from the forgiveness of such debt should be considered above-the-line. At the very least, the loss NOLs and the gain on forgiveness of debt are directly related and must be considered together. . . . since these above-the-line

losses at whatever level relate directly to the debt forgiven which was originally incurred to fund such losses, the two must offset one another.

Staff is willing to accept this treatment of the gain on forgiveness of indebtedness in this particular CIAC gross-up disposition proceeding. Regardless, we do not believe that this treatment should prohibit the Commission from reexamination of the issue in a rate proceeding, nor should it be construed as precedent setting in other gross-up disposition proceedings. Further, if the NOLs are changed or diminished in any manner because of NOLs being attributed to other entities within the consolidated group, then staff believes that reexamination of the above-the-line treatment of the gain is also appropriate. Staff also believes that the amount of NOLs used to offset that gain should be the gross above-the-line NOLs that were generated by Parkland, not those NOLs that remain after a portion of them has been utilized by other members of the consolidated group.

**STAFF ADJUSTMENTS:**

Staff's calculations reflect an offset of CIAC with Parkland's gross above-the-line NOLs of \$1,205,126 and also reflect the inclusion of \$1,205,126 of the \$1,226,510 gain on forgiveness of indebtedness above-the-line. Staff's adjustments follow.

(a) **Connection Fees** - The utility included initial connection fees of \$4,140 in its calculation of 1995 above-the-line taxable income. Staff believes that connection fees, tap-in fees, meter fees and similar CIAC charges that were taxable prior to the 1986 amendment of Section 118(b) of the Internal Revenue Code should be excluded from above-the-line income because they were taxable prior to 1986. The exclusion of these revenues is consistent with Commission practice. For this reason, staff decreased the utility's 1995 taxable income by \$4,140.

(b) **Depreciation** - In its above-the-line calculation of depreciation expense for 1994 and 1995, the utility reduced above-the-line depreciation expense to reflect the amount attributed to non-used and useful plant. Staff concurs. However, in addition, Parkland removed the entire amount of depreciation on contributed plant. Staff disagrees with the reclassification of the entire amount of depreciation on contributed plant to below-the-line. Consistent with Commission policy and Order No. 23541, the first year's depreciation on contributed assets should be reflected above-the-line for gross-up disposition purposes. Consequently,

staff decreased the utility's taxable income by \$1,160 for 1994 and by \$11,787 for 1995, the respective amounts of first year's depreciation on contributed assets for those years.

(c) Other deductions/O&M expenses - In 1994 and 1995, Parkland reduced the above-the-line operating expenses from the amounts in its annual reports to reflect the level of operating expenses approved in its last rate case, adjusted for inflation and customer growth. In 1994, Parkland also made an adjustment to convert the twelve months of data to ten months to "match" the FIT return period. On the other hand, staff used the amount in the FIT return as the more objective measure in this instance.

The utility defended its approach to the break out of above and below-the-line operating expense. Parkland believes that absent customer growth it is appropriate to adjust the level of operation and maintenance expenses to the level approved in its last rate case because to the extent that actual expenses during these years exceeded those approved, the shortfall would not be realized through service revenues. Further, the utility believes that the shortfall was funded by the utility's stockholders. Thus, the excess of actual expenses over those embedded in the utility's rates should appropriately be classified as below-the-line expenses.

Staff disagrees with the utility's adjustment. Staff believes that all operating expenses except non-utility expenses should be included above-the-line. Staff notes that those expenses are utility related and are used in determining whether the utility is exceeding its authorized rate of return for earnings surveillance purposes. Therefore, they should be included above-the-line. The fact that the utility may not be earning within its authorized range should not determine the level of above-the-line expenses for gross-up purposes. The utility has the opportunity to request compensatory rates whenever its revenues fall short of covering its expenses.

Further, staff believes that unless there is evidence that the amounts in the annual reports are unreasonable or an annual report for the tax year does not exist, the above-the-line amounts for CIAC gross-up authority, should reasonably mirror the tax return amounts and the amounts reflected in the utility's annual reports for those years. Staff believes the annual reports and the tax returns to be an objective measure of expenses for gross-up disposition purposes and that they should not be altered, based on a utility's level of earnings. Further, the utilities' annual reports contain the financial information that the Commission relies upon to determine the utility's achieved rate of return.

Staff's position is consistent with the Commission's decisions in the CIAC gross-up refund case for Eagle Ridge Utilities, Inc. (Docket No. 961077-SU, Orders Nos. PSC-96-1394-FOF-SU and PSC-97-0647-FOF-SU) wherein the Commission used the management fees in the utility's annual report and not the management fees proposed by the utility. The management fees proposed by the utility were management fees upon which rates were set in 1985, adjusted for customer growth and the change in the Consumer Price Index.

Additionally, in Forest Utilities, Inc., another CIAC gross-up disposition case (Docket No. 961237-SU, Orders Nos. PSC-97-0007-FOF-SU and PSC-97-0648-FOF-SU), the Commission also used the entire amount of officers' salaries included in its annual report. In both cases, the Commission determined that because the level of expenses in the annual report was used to determine earnings, that level also should be used for CIAC gross-up disposition purposes and reflected as an above-the-line expense. Finally, staff's method of determining above-the-line operating expenses is consistent with Commission practice in determining above-the-line expenses for regulatory purposes. Therefore, based on the above, staff has reduced the utility's above-the-line income by \$81,330 for 1994 and \$44,898 for 1995, to reflect the amount of expense reported in the utility's 1994 and 1995 federal income tax returns.

(d) Gain on Forgiveness of Indebtedness - As explained earlier, the utility stated that the debt that was forgiven was accumulated as a result of Narco Realty's funding Parkland's above-the-line losses. Therefore, staff believes it appropriate to limit the gain on forgiveness of indebtedness to the above-the-line NOL carry forward. Because the above-the-line NOL carry forward is calculated to be \$1,205,126 and the gain on forgiveness of indebtedness included above-the-line by the utility is \$1,226,510, an adjustment of \$21,384 is necessary.

(e) Legal, Accounting & Management Fees - The utility requested that it be allowed to offset 50 percent of legal, accounting and management costs incurred in preparing the refund reports with the contributors' refunds. The utility has documented legal, accounting and management costs in the amount of \$80,529. Staff notes that the Commission has considered on several occasions, the question of whether an offset should be allowed pursuant to the orders governing CIAC gross-up. (See, Order No. PSC-97-0647-FOF-SU, issued June 7, 1997, in Docket No. 961077-SU; Order No. PSC-97-0657-AS-WS, issued June 9, 1997, in Docket No. 961076-WS; and Order No. PSC-97-0816-FOF-WS, issued July 7, 1977, in Docket No. 970275-WS.) In these orders, the Commission accepted the utility's settlement proposals that 50 percent of the legal and accounting costs be offset against the refund amount. However, it

should be noted that Orders Nos. 16971 and 23541 do not provide for the netting of costs incurred with filing gross-up refund reports with the excess gross-up collection's refund. Those Orders specifically state,

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.

Therefore, staff believes that once the contributors have paid the gross-up taxes on the CIAC, the contributors have fulfilled their obligation under Orders Nos. 16971 and 23541. Further, since those orders also provide that gross-up in excess of the utility's actual tax liability be refunded on a pro rata basis to those persons who contributed the taxes, staff believes that once the tax liability is determined, it is the responsibility of the Commission to ensure that excess payments of CIAC taxes are refunded in compliance with those orders. Therefore, staff does not believe that a reduction in the amount of refund a contributor is entitled to receive as a result of his overpayment of gross-up taxes is appropriate. Staff acknowledges that those costs were incurred to satisfy regulatory requirements; however, staff does not believe that the contributors should be held responsible for the legal and accounting costs incurred to determine whether they are entitled to a refund. Staff views those costs as a necessary cost of doing business, and as such, staff believes it is appropriate for the utility to seek recovery of those amounts in a rate proceeding. Finally, staff believes that this situation is similar to when a utility files for an increase in service availability charges. The costs of processing the utility's service availability case are borne by the general body of ratepayers, although the charges are set for future customers only.

However, as in the other cases referenced above, staff recognizes in this case that acceptance of the utility's request would avoid the substantial cost associated with a hearing, which may in fact exceed the amount of the legal and accounting costs to be recovered. Staff further notes that the actual costs associated with making the refunds have not been included in these calculations and will be absorbed by the utility. Moreover, staff believes that the utility's request is a reasonable "middle ground." Therefore, staff recommends that while not adopting the utility's position, the Commission accept Parkland's request that it be allowed to offset 50 percent of the legal and accounting fees against the refund.

Staff's refund calculations are based on the method adopted in Order No. PSC-92-0961-FOF-WS. The adjustments were based on information provided by the utility in its gross-up reports, supplemental information, federal income tax returns on file, annual reports and recent Commission decisions. The adjustments have been explained in the body of this recommendation and are reflected on Schedule No. 1. A summary of each year's refund calculation follows.

ANNUAL GROSS-UP REFUND AMOUNTS

1994

The utility proposes no refund in 1994. Staff has calculated an overcollection of \$12,421 prior to consideration of 50 percent of legal and accounting costs. However, after consideration of the legal and accounting costs, no refund is appropriate.

Based on the utility's position as reflected in its August 27, 1997 letter, that the \$1,226,510 gain on forgiveness of indebtedness should be above-the-line, staff calculates that the utility's proposed above-the-line income is \$1,286,967 for the tax period, March 1 through December 31, 1994, before the inclusion and effect of taxable CIAC. However, as a result of the adjustments discussed above, staff calculated above-the-line income of \$1,184,253 before the inclusion and effect of taxable CIAC for the same period and before consideration of staff's NOL carry forward of \$1,205,126. Order No. 23541, issued October 1, 1990, requires that CIAC income be netted against the above-the-line losses and that first year's depreciation on contributed assets be netted against taxable CIAC. When the NOL carry forward was netted against the adjusted income before CIAC and its effects, the utility has \$20,873 of NOLs remaining to offset against CIAC and its effects. The utility collected \$133,400 of taxable CIAC that was reduced by first year's depreciation of \$1,160. Therefore CIAC receipts of \$11,367 (\$133,400 less \$1,160 less \$20,873) are taxable for 1994. Based on the above, staff calculates that Parkland has a taxable income resulting from the collection of CIAC. Applying the statutory tax rate of 37.63% results in income tax expense of \$41,907 and a required gross-up of \$67,191. The utility collected \$79,612 of gross-up. Therefore, staff calculates the overcollection to be \$12,421, before the offset for 50 percent of the requested legal and accounting fees.

As previously discussed, staff recommends that the utility be allowed to offset 50 percent of the legal and accounting fees against the overcollection. For 1994, the utility provided documentation for the combined legal and accounting fees of \$25,491

for services rendered by Robert Nixon of Cronin, Jackson, Nixon & Wilson and F. Marshall Deterding of Rose, Sundstrom & Bentley. In addition, the utility provided documentation for management fees of \$43,526 for services rendered by East Coast Equity Management Corporation which were outside of its regular management contract. Some of the legal and accounting costs requested by the utility related to cost incurred to prepare the utility's Petition to Continue Gross-up Authority. However, since these costs were not directly related to preparing the refund reports, consistent with past Commission decisions, those costs have been excluded in determining the allowable legal and accounting costs to be recovered for purposes of the disposition of CIAC gross-up.

Staff was, however, able to use some of the information provided in the petition to gross-up to calculate the 1994 and 1995 refunds. Therefore, staff allocated the cost incurred to file the petition to continue to gross-up the refund calculation for 1994 and 1995. Staff adjusted the legal and accounting expenses by allowing only 1/3 of those invoiced costs that directly related to initial petition for gross-up authority in 1994; staff disallowed costs associated with the CIAC workshop, cancellation of gross up tariff, etc. As a result of these adjustments, staff determined that \$13,274 of the legal and accounting fees requested appeared to be directly associated with preparing the required report and calculating the tax effect, and, thus, are considered to be legitimate expenses. Fifty percent of this amount is \$6,637. Further, staff determined that \$15,801 of the management fees should be considered. Fifty percent of this amount is \$7,901. Therefore, staff recommends that the utility be allowed to offset \$14,538 of legal and accounting costs incurred to prepare the gross-up refund reports, against any overcollection. Staff calculated an overcollection of \$12,421 for 1994; therefore, \$12,421 of the allowable legal, accounting, and management expenses has been offset against the 1994 overcollection of \$12,421 and no refund is necessary.

#### 1995

For 1995, the utility calculated a refund of \$12, but proposes no refund because of the immateriality. Staff calculated an \$3 refund and concurs that no refund should be required because of the immateriality. Legal and accounting costs were not examined for this year because staff recommends that no refund is appropriate.

Parkland calculates that the above-the-line income is \$60,450 for 1995, before the inclusion and effect of taxable CIAC. However, as a result of the adjustments discussed above, staff calculates above-the-line income of \$11,412 before the inclusion.

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and effect of taxable CIAC for the same period. Because both the utility and staff calculate above-the-line income before the inclusion and effects of taxable CIAC, the utility and staff are in agreement that all CIAC (reduced by first year's depreciation) is taxable. The utility's CIAC report indicates a total of \$457,588 in taxable CIAC was received, with \$11,787 being deducted for first year's depreciation, resulting in taxable CIAC of \$445,801. Staff used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$167,755 and gross-up needed of \$268,966. The utility collected \$268,974 of gross-up monies. Therefore, staff calculates the overcollection to be \$8.

Staff recommends that no refund is appropriate because of the immateriality.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: Yes. Upon expiration of the protest period, if a timely protest is not filed by a substantially affected person, this docket should be closed. (JAEGER, IWENJIORA)

STAFF ANALYSIS: Upon expiration of the protest period, if a timely protest is not filed by a substantially affected person, this docket should be closed.

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EXHIBIT 1

FARMLAND UTILITIES, INC.  
 STAFF CALCULATED GROSS-UP REFUND

	1994	1995
1 A-T-L TAXABLE INCOME PER UTILITY BEFORE CIAC	\$1,286,967	\$80,450
2 Plus taxable CIAC	133,400	457,588
3 A-T-L TAXABLE INCOME PER UTILITY	<u>\$1,420,367</u>	<u>\$437,938</u>
4		
5 <u>STAFF ADJUSTMENTS:</u>		
6 (a) Remove initial connection fees		76,100
7 (b) First year's depreciation on contributed assets	(1,180)	(11,787)
8 (c) Adjust O&M expenses to amounts on FIT returns	181,330	146,090
9 (d) Adjust gain on forgiveness of indebtedness	(21,300)	
10		
11 <u>TOTAL STAFF ADJUSTMENTS</u>	<u>(107,850)</u>	<u>(10,697)</u>
12		
13 A-T-L TAXABLE INCOME PER STAFF	\$1,312,517	\$427,241
14 Less CIAC	(133,400)	1457,588
15 Plus first year's depreciation on CIAC	1,180	11,787
16		
17 <u>A-T-L TAXABLE INCOME PER STAFF BEFORE CIAC</u>	<u>\$1,180,297</u>	<u>\$440,616</u>
18		
19 Less NOL carryforward	(81,205,126)	\$0
20		
21 <u>NOL remaining to offset against CIAC</u>	<u>(81,205,126)</u>	<u>\$0</u>
22		
23 Post 1986 CIAC	133,400	457,588
24 Less first year's depreciation on CIAC	(1,180)	(11,787)
25		
26 <u>Post 1986 CIAC subject to gross-up</u>	<u>132,220</u>	<u>445,801</u>
27		
28		
29 <u>Adjusted income incl. CIAC &amp; NOL</u>	<u>\$111,167</u>	<u>\$445,801</u>
30		
31		
32		
33 <u>Net Post 1986 CIAC</u>	<u>\$132,220</u>	<u>\$445,801</u>
34		
35 <u>Taxable CIAC resulting in a tax liability</u>	<u>\$132,527</u>	<u>\$457,588</u>
36 Less first year's depreciation	(1,180)	(11,787)
37		
38 <u>Net taxable CIAC</u>	<u>\$131,347</u>	<u>\$445,801</u>
39 <u>Combined marginal state &amp; federal tax rate</u>	<u>37.63%</u>	<u>37.63%</u>
40		
41 <u>Net income tax on CIAC</u>	<u>\$49,907</u>	<u>\$167,755</u>
42 Less ITC realized	0	0
43		
44 <u>Net income tax</u>	<u>\$49,907</u>	<u>\$167,755</u>
45 <u>Expansion factor to gross up taxes</u>	<u>1.40333</u>	<u>1.40333</u>
46		
47 <u>Gross-up required to pay tax effect</u>	<u>\$67,191</u>	<u>\$268,966</u>
48 <u>Gross-up collected to pay tax effect</u>	<u>(9,832)</u>	<u>(268,974)</u>
49		
50 <u>(OVER) OR UNDERCOLLECTION</u>	<u>(812,421)</u>	<u>(80)</u>
51		
52		
53 (d) Less 50 percent of legal and accounting fees	912,421	n/a
54		
55		
56 <u>PROPOSED REFUND</u>	<u>\$0</u>	<u>\$0</u>
57		