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4/13/98

Decision 98-04-015 April 9, 1998

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Taxability of Contributions in Aid of Construction and Advances in Aid of Construction for California Corporate Franchise Tax Purposes.	Application No. 91-12-009 (Petition for Modification filed December 6, 1991)
Requested by:	
Pacific Gas & Electric Company's	Advice Letter 1643-G/1352-E (Filed April 10, 1991)
San Diego Gas & Electric Company's	Advice Letter 809-G/750-E (Filed April 8, 1991)
Sierra Pacific Power Company's	Advice Letter 216-E (Filed May 28, 1991)
Southern California Edison Company's	Advice Letter 901-E (Filed April 19, 1991)
Southern California Gas Company's	Advice Letter 20 (Filed May 23, 1991)
Southwest Gas Corporation's	Advice Letter 429 (Filed April 8, 1991)
San Jose Water Company's	Advice Letter 235 (Filed May 30, 1991)
and Related Matter.	I.86-11-019

O P I N I O N

Summary of Decision

This Decision denies Utility Design, Inc. (UDI) modification of Resolution (Res.) E-3243 requested in its Application (A.) 91-12-009 (Application). A.91-12-009 is misplaced and procedurally defective.

Notice of the filing of the Application appeared on the Commission's Daily Calendar of December 23, 1991. Several protests and responses were received by the Commission.

UDI requests that Res. E-3243 be modified to: (1) provide a more clear definition of the basis upon which both the federal and state taxes on Contributions in Aid of Construction (CIAC) and Advances in Aid of Construction (AIC) shall be applied, (2) order all utilities named respondents to Investigation (I.) 86-11-019 that utilize Method #5 of Decision (D.) 87-09-026 for CIAC and AIC tax calculations to exempt the refundable portion of Applicant Installed Facilities (AIF), the cost to relocate existing facilities, the cost of repairs to existing facilities, and the cost of temporary facilities from its application base for state and federal taxes on CIAC and AIC, and (3) require all respondent utilities to refund all amounts previously collected as tax on CIAC or AIC for the above-listed exempted facilities to the contributor, inclusive of interest, within 90 days of the effective date of the requested modification of Res. E-3243.

Due partly to re-organization/movement of personnel and by unintentional omission, no decision has been rendered until now and the Application remained outstanding.

Pursuant to a telephone conversation of February 27, 1998, UDI indicated to staff that the matter is moot. However, UDI does not want to submit a letter withdrawing the Application but prefers that the Commission act on the matter.

Background

In 1976 Congress enacted Internal Revenue Code (IRC) § 118(b) which defined contributions as contributions to capital. Such contributions were deemed not taxable for federal purposes and were also not included in the taxpayer's rate base for ratemaking purposes.

In October of 1986, the Tax Reform Act was signed into law which repealed the provisions of IRC § 118(b) and defined contributions to capital as specifically excluding CIAC received

by a regulated public utility. IRC § 118(b) provides that the term "contribution to capital of the taxpayer" does not include any CIAC or any other contribution from a customer or potential customer. Payments and property are to be treated as a CIAC if they are contributed to provide or encourage the provision of services to or for the benefit of the person making a contribution. CIAC includes any item or amount contributed to a regulated public utility to the extent that the purpose of the contribution is to provide for the expansion, improvement, or replacement of the utility's facilities. Specifically excluded from the definition of a CIAC are customer connection fees. Customer connection fees include any payment made to the utility for the cost of installing a connection from the utility's main line to the customer's line as well as any amount paid as a service charge for stopping or starting service.

Internal Revenue Service (IRS) Notice 87-82 provides additional guidance for the treatment of CIAC by stating that a payment received by a utility that does not reasonably relate to the provision of services by the utility or for the benefit of the person making the payment, but rather relates to the public at large, is not a CIAC. An example given in the Notice of a payment benefiting the public is a relocation payment received by a utility under a government program. In that situation, the relocation is undertaken for either reasons of community aesthetics or in the interest of public safety and does not directly benefit particular customers.

D.87-09-026 dated September 10, 1987, in I.86-11-019 authorized the methods by which the utilities may recover the tax and associated gross-up on contributions. In general, it placed the burden of the tax on the contributor or advancer, and was based on the premise that the person who causes the tax must pay the tax.

Method 5 placed the tax burden on the contributor but mitigated the burden by requiring, in addition to the plant contribution, only the present value of the future tax burden. Method 2 provided for complete gross-up by the contributor at the

utility's incremental federal tax rate. The Maryland Method required sharing of tax between the contributor and the utility's shareholders.

Finding of Fact Number 9 of D.87-09-026 declared in part that "No methods were introduced that showed by clear and convincing evidence that the IRS would not impose a tax on a particular transaction, except that contributions resulting from condemnation or the threat or imminence thereof or which are for a public benefit appears to be exempt from tax. It would be imprudent for this Commission to find that one form of transaction or another would avoid the tax. That decision is for the IRS and the courts. Individual utilities, however, may make that decision but should their decision be wrong, the ratepayer may not be charged with back taxes, penalties, or interest." (D.87-09-026, 25 CPUC2d 299, 335-336.)

Ordering Paragraph No. 6 stated in part, "Contributions-in-aid-of-construction and refundable advances made after the date the California tax is enacted shall be collected by each respondent in the same manner as it collects the federal tax." (25 CPUC2d at 337.)

Ordering Paragraph No. 8 required all respondents to make refunds: "a. For those respondents who elect Method 2, all collections in excess of the 67% tax gross-up shall be refunded to the contributor with interest from the date of collection to the date of refund. b. For those respondents who elect Method 5 or the Maryland Method, the difference between the amount collected and the amount computed by the use of Method 5 or the Maryland Method shall be refunded to the contributor with interest from the date of collection to the date of refund. c. Refunds shall be completed within 120 days after the effective date of this order. d. Respondents shall report to the Evaluation and Compliance Division within 140 days after the effective date of this order a summary of all collections of CIAC, the gross-up portion of the collection, if any, and the refunds made, with dates and amounts. e. Interest shall be computed at the average three month commercial paper rate as

published in the Federal Reserve Bulletin." (25 CPUC2d at 337-338.)

The Commission indicated in D.87-09-026 that the methods to treat CIAC and AIC authorized by the decision are not perfect, but workable. Specifically, Method 5 gross-up is only an approximation. All the methods have the same problem of valuation, of tax changes, of new accounting systems, of IRS inquiries.

On May 21, 1991, The California Franchise Tax Board (FTB) issued Notice 91-2 which stated that CIAC and Advances in Aid of Construction must be included in the gross income of a recipient regulated public utility (conforming with that adopted by the federal government in the Tax Reform Act).

Following the FTB's Notice 91-2, the Commission on September 25, 1991 issued Res. E-3243, which confirmed the taxability of CIAC and Advances, and authorized all utilities to apply the same method they choose for the federal tax gross-up for California taxes.

Modification Sought

Pursuant to Rule 47 (previously Rule 43) of the Commission's Rules of Practice and Procedure, UDI seeks modification of Res. E-3243 in order to (1) clarify the basis upon which both the federal and state taxes on CIAC and AIC shall be applied, (2) require all utilities named respondent to I.86-11-019 that utilize Method 5 of D.87-09-026 for CIAC and AIC tax calculations exempt the refundable portion of AIF, the cost to relocate existing facilities, the cost of repairs to existing facilities, and the cost of temporary facilities from their application bases for state and federal taxes on CIAC and AIC, and (3) require these respondent utilities to refund all amounts previously collected as tax on CIAC or AIC for the foregoing listed exempted facilities to the contributor, inclusive of interest within a prescribed period of time.

UDI states in the Application that it is clear that a taxable advance or contribution occurs when a utility receives

cash payments for utility-installed line extensions or when nonrefundable AIF are purchased by the utility. However, it is far less straightforward to determine the taxable occurrence of refundable AIF, relocations of existing facilities, repairs to existing facilities, or installations of temporary facilities. Some utility companies have taken the conservative approach of charging the contributor tax on all of these items.

It is UDI's opinion that this conservative approach of applying tax on CIAC and AIC is inappropriate and exceeds the intent of D.87-09-026. UDI contends that if a utility company is allowed to collect taxes on AIF in advance of their purchase, the contributor is not only paying for the cost of these facilities, but it is also providing working capital on a non-interest bearing basis to the utility in excess of that amount authorized by rates. In the case of relocations, repairs and temporary facilities, the utility company is charging the contributor tax on work that is either being done to maintain the status quo or is specifically not intended to be an advance or a contribution. In each of these situations, the utility company's actions may very well leave the ratepayers indifferent to this tax, but the new homebuyer will most certainly bear this added cost in the form of increased housing prices.

Protests & Responses

On December 27, 1991, Pacific Gas and Electric Company (PG&E) filed its Response to UDI's Application. PG&E states that UDI's Application is defective in that the relief UDI is requesting has nothing to do with Res. E-3242. Even if UDI's request were to be considered on its substantive merits, it should be rejected. In D.87-09-026 the Commission held that with exceptions not relevant here, "all contributions [and refundable advances] should be considered taxable until the IRS rules otherwise." PG&E states that since UDI did not cite any IRS authority holding that the contributions in question are non-taxable, the Application should be rejected.

On January 3, 1992, Southern California Edison Company (SoCal Edison) filed a protest to the Application. SoCal Edison believes that a modification of Res. E-3243 is not only unwarranted, but would amount to a complete policy change from D.87-09-026, which has already established a clear policy as to who bears the burden of taxes on CIAC and AIC. And since no IRS ruling has been issued which would provide a basis for reexamining the Commission's policy, UDI's Application to modify Res. E-3243 should be denied. There is no record of any reply from UDI to SoCal Edison's protest.

On January 8, 1992, Southern California Gas Company (SoCal Gas) filed its Late-File Response to the Application. SoCal Gas points out that UDI should seek remedy from the IRS and not from the Commission to determine the "taxable occurrence" under federal tax law.

On January 9, 1992, Sierra Pacific Power Company (Sierra) filed a Motion to Dismiss UDI's requested modification of Res. E-3243. Sierra states that UDI's Application seeks a major change to Res. E-3243 and that the issues discussed in the Application were not even considered in Res. E-3243. That proceeding authorized the expansion of the tax gross-up calculation to include state tax liability.

DISCUSSION

It is evident from the foregoing that UDI's request for modification of Res. E-3243 is a fundamental departure from established policy with respect to the taxability of CIAC and AIC (that all contributions should be presumed taxable until the IRS rules otherwise) and would be tantamount to a policy change of D.87-09-026. The issues raised by UDI in its Application have nothing to do with Res. E-3243. The resolution did not in any way address the matter of the taxability of different types of CIAC. It primarily addressed California tax issues.

We will therefore deny UDI's Application on the grounds that the matter is procedurally defective. Even if the Application were to be considered on its substantive merits, it

is the IRS who should make a determination as to which items are taxable. It would be imprudent for the Commission to do so.

We note herein that if UDI believes it has a good case to exclude its contribution from taxable CIAC treatment and the utility does not agree, it should take its case to the IRS.

Findings of Fact

1. The issues raised by UDI in A.91-12-009 and the modifications proposed therein have nothing to do with Res. E-3243.

2. Res. E-3243 confirmed the taxability of CIAC and authorized all utilities to use the same method to compute the California tax gross-up that they apply to compute the federal tax gross-up.

3. Res. E-3243 did not address the matter of the taxability of CIAC.

4. D.87-09-026 authorized the methods by which the utilities may recover the tax and associated gross-up on contributions. It placed the burden of the tax on the contributor or advancer, and was based on the premise that the person who causes the tax must pay the tax.

5. UDI has not provided any indication in the Application that the IRS has issued a ruling that would provide a basis for reopening CIAC issues.

6. D.87-09-026 provided the refund and interest-on-refund mechanism associated with CIAC.

7. The response of PG&E to UDI's A.91-12-009 is meritorious.

8. The protest of SoCal Edison to UDI's Application is valid.

9. Sierra's motion to dismiss and deny the relief requested in UDI's Application is reasonable.

10. SoCal Gas' late-filed response is meritorious.

Conclusions of Law

1. A public hearing is not necessary.

2. A.91-12-009 addresses tax matters not covered by Res. E-3243.

3. The Application should be rejected as being procedurally defective.

4. This order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. Application (A.) 91-12-009 filed by Utility Design, Inc. is denied.

2. A.91-12-009 is closed.

This order is effective today.

Dated April 9, 1998, at San Francisco, California.

RICHARD A. BILAS
President
J. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners