

## PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION & COMPLIANCE DIVISION  
Energy Branch

RESOLUTION G-2714  
February 11, 1987

## RESOLUTION

ORDER AUTHORIZING SOUTHERN CALIFORNIA GAS COMPANY'S (SOCAL GAS) REQUEST TO ADD AN INCOME TAX COMPONENT TO IT'S GAS EXTENSION RULES PURSUANT TO THE FEDERAL TAX REFORM ACT OF 1986 (TAX ACT).

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RECOMMENDATION

The Commission should adopt Resolution G-2714 which will authorize SoCal Gas' request to collect the additional Federal Income Tax which it must pay on Contributions in Aid of Construction (CIAC) in 1987.

BACKGROUND

By Advice Letter No. 1678, filed January 8, 1987, SoCal Gas requests authority to add an income tax component to tariff Rules 20 and 21. This change is requested because the Tax Reform Act of 1986 (Tax Act) defines contributions to the capital of a corporation, including Contributions in Aid of Construction (CIAC), as taxable income effective January 1, 1987. Previously CIAC were excluded from taxable income.

1. SoCal Gas states that the Commission issued OII No. 86-11-019 on November 14, 1986 to investigate the impacts of the Tax Act as it affects the rules of California utilities. SoCal Gas has added taxes to its rates in effect as of January 1, 1987 subject to refund pending the final determinations made by the Commission in the OII.
2. SoCal Gas further states that this Advice Letter is being filed consistent with a letter dated December 10, 1986 from the Commission's Evaluation & Compliance Division that identifies a risk to the Company for failure to collect CIAC on a gross of tax basis pending final determination of the issue by the Commission.
3. SoCal Gas does not support the options outlined in the December 10, 1986 letter from the Commission's Evaluation and Compliance Division, however, to avoid the potential penalty implied in the letter, SoCal Gas requests approval of this Advice Letter.

4. Pending a final policy determination by the Commission in OII, 86-11-019 SoCal Gas proposes to collect all contributions from parties at a rate that will be a gross of federal and state income taxes. SoCal Gas has determined that the factor required to convert to a gross of income tax is 1.8437.

5. In accordance with Sections 489 and 491 of the Public Utilities Code, SoCal Gas hereby filed a revision to Section 3.A.(1), B.3.(2) and D. of Rule 20, Gas Main Extensions and Section 3.a. of Rule 21, Gas Service Extensions.

6. These Rules have been modified by SoCal Gas to show the tax change component to be added to the unit cost for CIAC. This same tax component will be collected subject to refund in accordance with the refund provisions of the extensions rules, and will be collected subject to further refund pending further determination by the Commission in Order Instituting Investigation 86-11-019.

7. This filing will not increase or decrease any filed rate or charge, other than by the tax component, cause the withdrawal of service, nor conflict with other schedules or rules.

8. SoCal Gas requests under the provisions of Sections 489 and 491 of the California Public Utilities Code that this filing be made effective on less than statutory notice for the reason that the potential income tax liability for CIAC is effective January 1, 1987.

9. Public notification of this filing has been made by mailing copies of the Advice Letter to other utilities, governmental agencies, and to all interested parties who requested a copy.

#### PROTESTS:

1. The Commission has received numerous protests to this Advice Letter and related Advice Letters of other utilities regarding the inclusion of a tax component in the line extension rates and charges. Most of the protests have been from housing and industrial tract developers and builders associations. In addition, a protest has been received from the U.S. Navy.

2. The staff of the Evaluation and Compliance Division is of the opinion that although the protestors may have grounds for their protest, that this revision will substantially increase line extension and other utility costs affecting their developments, nonetheless, this is a tax component that must be paid by the utility. SoCal Gas estimates that it will incur about \$11.5 million in Federal Income Taxes on contributions from developers received in 1987. If the developers do not pay these taxes as part of their Costs of Construction, these taxes will be borne by SoCal Gas' ratepayers. Therefore, the customers and the utility will be best served by collecting the tax component as soon as practicable, subject to refunds with interest.

## DISCUSSION

1. While the Federal tax law changes become effective January 1, 1987, no concurrent California tax law changes have been made effective as of this date, although AB-33 is pending with a proposed effective date of January 1, 1987.
2. Because California law does not yet allow collection of California Corporation Franchise Tax (CCFT ) on CIAC, SoCal Gas should not be permitted to collect any CCFT in anticipation of such state tax changes.
3. This resolution cannot be approved retroactively, therefore SoCal Gas cannot be authorized to collect Federal Income Tax on any developer's advances received under Extension Rules 20 and 21 for the period of January 1, 1987 to 11:59 p.m. on February 10, 1987. We therefore will require that SoCal Gas refund with interest any amounts so collected.

## CONFLICT WITH STATE LAW

1. Section 783 of the Public Utilities Code places restrictions on the Commission's ability to modify the extension rules of gas corporations. These restrictions apply except for the periodic review provisions of the extension rules. The periodic review provision allows the utility to revise its charges for excess footage (unit costs). This is the only change allowed without the extensive review provisions of Section 783 of the Public Utility Code.
2. SoCal Gas Company's filing includes substantial text modifications to the extension rule. The modifications describe the tax factor to be collected, and refund provisions, and cites the Commission's Order Instituting Investigation 86-11-019 (regarding the Tax Act). Such extensive revisions would appear to conflict with Public Utilities Code Section 783.
3. In addition, the changes may be more far reaching, and therefore, more appropriately placed in the utility's Preliminary Statement.

## FINDINGS

1. Failure of utilities to collect the required Federal Income tax with developers advances for Contributions in Aid of Construction or to provide for subsequent payment of the permanent short-fall for all contributions entered into subsequent to January 1, 1987, and prior to the issuance of a final decision by this Commission, in OII 86-11-019, would leave this burden to be borne by all taxpayers of Southern California Gas Company.

2. The line extension modifications requested by Southern California Gas Company would violate Code Section 783.

3. A factor of 1.667 reflects the maximum increase in revenues required to allow utilities to recoup tax liabilities on contributions incurred under the current Federal Tax Act.

4. The tax component of contributions collected gross of Federal income tax is considered subject to adjustment pending a final decision in OII-86-11-019.

In the event that a different method, other than requiring contributors to pay a full gross-up amount of the tax liability, is adopted by the Commission in OII 86-11-019, the utility will be required to refund the difference with interest computed at the average three month commercial paper rate as published in the Federal Reserve Bulletin.

5. All amounts for State income taxes collected by SoCal on Contributions in Aid of Construction from January 1, 1987 to 11:59 p.m. on February 10, 1987 will be refunded with interest.

6. All amounts collected by SoCal Gas for Federal and State Income Taxes in excess of its filed unit costs under Tariff Rules 20 and 21 from January 1, 1987 to 11:59 p.m. on February 10, 1987 will be refunded with interest.

7. SoCal Gas should not collect the equivalent amount of California Corporation Franchise Tax on Contributions in Aid of Construction or under Extension Rules 20 and 21, until authorized to do so by this Commission after passage of enabling legislation.

8. We find that these tariff modifications are just and reasonable.

THEREFORE:

1. Southern California Gas Company is hereby directed to revise Advice Letter 1678-G and associated tariff sheets to effect collection of only the expected amount of Federal Income Tax associated with Contributions in Aid of Construction. Collection of any pending California Corporation Franchise Tax on advances for construction must await further authorization of this Commission after enabling legislation, if any, is enacted.

2. Southern California Gas Company shall refund, with interest, all amounts collected by it earmarked for State Income Taxes associated with Contributions in Aid of Construction, for the period of January 1, 1987 to 11:59 p.m. on February 10, 1987.

3. Southern California Gas Company shall also refund collections for Federal and State Income Taxes in excess of its filed unit costs under Tariff Rules 20 and 21 for the period of January 1, 1987 to 11:59 p.m. on February 10, 1987.
4. Interest, as discussed in this resolution, shall be computed at the average three month commercial paper rate as published in the Federal Reserve Bulletin.
5. Southern California Gas Company shall maintain memorandum accounts detailing all collections of Contributions in Aid of Construction together with any Federal taxes collected therewith separately shown.
6. All contributions collected by Southern California Gas Company as gross of Federal Income Tax are considered subject to further adjustment pending a final decision in OII 86-11-019.
7. The revised tariff sheets shall be marked to show that they were authorized for filing by Commission Resolution G-2714. This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on February 11, 1987. The following Commissioners approved it:



Executive Director

I abstain.

G. Mitchell Wilk, Commissioner

STANLEY W. HULETT  
President  
DONALD VIAL  
FREDERICK R. DUDA  
Commissioners

TABLE A

FEDERAL INCOME TAX RATE FOR 1987

For 1987 the Federal Corporate Income Tax (FIT) rate for calendar year taxpayers is 40%. For purposes of the 1987 accrual and budget, the utility should use a rate of 40%, based on the following, which will apply to taxable revenue and taxable expense items, when such items are so taxable for Federal purposes:

<u>FIT Rate</u>	<u>Net-to-Gross Multiplier *</u>
.40000	0.667

\* DERIVATION, RATE =  $(1.0/(1.0-t)-1.0)$  where t=the Federal Income Tax rate of 40%