

## PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION & COMPLIANCE DIVISION  
Energy BranchRESOLUTION G-2716  
February 11, 1987

## RESOLUTION

ORDER AUTHORIZING SAN DIEGO GAS AND ELECTRIC COMPANY (SDG&E) TO ADD AN INCOME TAX COMPONENT TO ITS RATES FOR GAS MAIN AND SERVICE EXTENSIONS (RULE 15 & 16) AND FOR ELECTRIC LINE EXTENSIONS (RULE 15) PURSUANT TO THE FEDERAL TAX REFORM ACT OF 1986 (TAX ACT)

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RECOMMENDATION

The Commission should adopt Resolution G-2716 which will direct SDG&E to refile new tariff sheets allowing SDG&E to collect only the additional Federal Income Tax which it must pay on all Contributions in Aid of Construction (CIAC) in 1987, received primarily for line extensions to serve housing and industrial developments.

BACKGROUND

By Advice Letters 605-G and 695-E filed January 23, 1987 SDG&E requests authority to add an income tax component to its existing rates and rules governing gas main and electric line extensions, respectively.

This change is made necessary by provisions in the Tax Reform Act of 1986 (Tax Act) which now 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. The facts are as follows:

1. The filings are for the purpose of revising the Gas and Electric Department Preliminary Statements in order to add a new Section, "Income Tax Component of Contributions Provision". This section has been added in order to clarify that contributions, including (CIAC), received from any person or agency by SDG&E under its filed tariffs shall include a cost component for Federal and State Income Taxes and establish a provision for accounting for said cost component collected from contributors. The Federal

taxes that SDG&E will incur are a result of the Tax Reform Act of 1986 (Tax Act).

2. Tariffs with contribution provisions include, but are not limited to Gas Rules 2, 15 and 16, and Electric Rules 2, 15, 20, and 21.

Contributions under the tariffs presently include SDG&E's estimated costs of overheads, installation, and associated expenses incurred as a result of the contribution. Associated costs are considered by SDG&E to include all costs, including taxes that would be incurred as a result of a contribution.

3. SDG&E expects new tax laws to be effective on January 1, 1987, for both State and Federal Income Taxes. Normally, such tax law changes would not pose a difficulty for SDG&E, as it would include all applicable cost factors under its tariff provisions. However, since contributions under the tariffs have not been considered as taxable by either the Federal or State Government, until now, clarification is appropriate to identify the fact that a tax cost component is collected from contributors.

4. The Tax Act changes the federal law regarding contributions to the capital of a corporation, including CIAC. The Tax Act repeals the law prior to 1987 allowing contributions received by a regulated public utility to be excluded from gross taxable income.

5. In the case of a corporation such as SDG&E, gross income shall include any contribution to the capital of the taxpayer commencing January 1, 1987. In this filing SDG&E anticipates that the State of California will adopt this tax application.

6. Therefore, SDG&E requests authority to collect all such contributions "gross of federal and state income tax", as estimated by SDG&E, from contributing parties. The factor required to establish a "gross of tax" contribution is referred to as a net-to-gross factor and is 1.8634 for 1987 contributions.

7. The table below shows the existing and proposed revised unit costs for each gas rule requiring revision:

<u>Rule and Section</u>	<u>Present Unit Cost Per Foot</u>	<u>Revised Unit Cost Per Foot</u>
Rule 15.B.3.a.(1)	\$ 9.79	\$ 18.24
Rule 15.B.3.b.(1)	9.79	18.24
Rule 16 A.3.a	4.74	8.83

These revisions are being made in accordance with the Periodic Review provisions of Section E.2. of Gas Rule 15 and Rule 16.H.1.,

Decision 59801, dated March 22, 1960, and Decision 76394, dated November 4, 1979, which provide for unit cost revisions when such costs have changed by more than 10% since the last revision.

8. The table below shows the existing and revised unit costs for each electric rule requiring revision:

<u>Rule and Section</u>	<u>Present Unit Cost Per Foot</u>	<u>Revised Unit Cost Per Foot</u>
Rule 15.B.3.a.(1)	\$ 7.97	\$ 14.85
Rule 15.B.3.b.(1)	7.97	14.85
Rule 15.1 C.1.a.	8.94	16.66
Rule 15.1 C.1.b.	17.46	32.53
Rule 15.1 C.3.	0.65	1.21
Rule 15.1 C.3.	1.25	2.33

These revisions are being made in accordance with the Periodic Review provisions of Section E.2. of Rules 15 and 15.1, Decision 59801, dated March 22, 1960, and Decision 76394, dated November 4, 1979, which provide for unit cost revisions when such costs have changed by more than 10% since the last revision.

9. Included in the charge for a contribution is an Income Tax Component of Contribution (ITCC) and the balance of the contribution, excluding income tax (Balance of Contribution). The ITCC is calculated by multiplying the Balance of Contribution by the Tax Factor of 0.8634. The Tax Factor of 0.8634 for 1987 was developed by the following calculation:

$1.0 / (1.0 - t) - 1.0$  where  $t$  = the estimated composite State and Federal Income Tax rate of 0.46336.

10. The collection of such income tax cost component would be accounted for in SDG&E's Gas and Electric Department Preliminary Statements as previously proposed in this filing, until such time as the Commission issues a final decision, in 86-11-019 or otherwise, regarding the monies collected. Also, customer advances for construction are subject to refund under the provisions of the line extension rules.

11. SDG&E states that because the revisions filed herein are much less complicated than those normally covered by the "Periodic Review" provision and are being made as a result of a change in law which became effective January 1, 1987, that it requests a waiver of the 30-day proposal requirement of the "Periodic Review" provision, and that this filing become effective on either the date filed, or on such other date as the Commission shall set in an approving resolution.

12. 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.

13. 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.

2. The staff of the Evaluation and Compliance Division is of the opinion that although the protestors may have grounds for their protests, 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. SDG&E estimates that it will incur about \$11 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 SDG&E's 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

While the federal 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.

Because California law does not yet allow collection of CCFT on CIAC, and line extensions, SDG&E should not be permitted to collect any California Corporation Franchise Tax (CCFT) in anticipation of such state tax changes.

This resolution cannot be approved retroactively, therefore, SDG&E cannot be authorized to collect Federal Income Tax on any developer's advances received under Line Extension Rules 15 and 16, for the period of January 1, 1987 to 11:59 p.m. on February 10, 1987. We therefore will require that SDG&E refund with interest any amounts so collected.

#### FINDINGS

1. Failure of the 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 ratepayers of SDG&E.

2. The tax component of contributions collected gross of Federal income tax are 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 of the tax liability, is adopted by the Commission in OII 86-11-019, then 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.

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

4. All amounts collected by SDG&E for Federal and State income taxes in excess of its filed unit costs under Tariff Rules 15 and 15.1 from January 1, 1987 to 11:59 p.m. on February 10, 1987 will be refunded with interest.

5. SDG&E should not collect the equivalent amount of California Corporation Franchise Tax on Contributions in Aid of Construction until authorized to do so by this Commission after passage of enabling legislation.

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

THEREFORE:

1. San Diego Gas and Electric Company is hereby directed to revise Advice Letters 605-G and 695-E 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 any construction must await further authorization of this Commission after enabling legislation, if any, is enacted.

2. San Diego Gas and Electric 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. San Diego Gas and Electric Company shall also refund collections for Federal and State Income Taxes in excess of its filed unit costs under Tariff Rules 15 and 15.1 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. San Diego Gas and Electric 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 San Diego Gas and Electric 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-2716. 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

STANLEY W. HULETT  
President  
DONALD VIAL  
FREDERICK R. DUDA  
G. MITCHELL WILK  
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%