

## PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION & COMPLIANCE DIVISION  
Energy BranchRESOLUTION G-2721  
March 6, 1987

## RESOLUTION

ORDER AUTHORIZING SOUTHWEST GAS CORPORATION (SWG) TO ADD AN INCOME TAX COMPONENT TO ITS RATES FOR GAS MAIN AND SERVICE EXTENSIONS (RULES 15 & 16) PURSUANT TO THE FEDERAL TAX REFORM ACT OF 1986 (TAX ACT)

RECOMMENDATION

The Commission should adopt Resolution G-2721 which will allow Southwest Gas Corporation to collect 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

1. By Advice No. 385 filed February 2, 1987, SWG requests authority to add an income tax component to gas tariff Rule Nos. 15 and 16. This change is made necessary by provisions in the Tax Reform Act of 1986 (Tax Act) which cause contributions to the capital of a corporation, including Contributions in Aid of Construction (CIAC), to be currently taxable effective January 1, 1987. Previously, CIAC were excluded from taxable income.
2. Southwest Gas Corporation has submitted its filing to reflect the Federal Income Tax modification only, and not currently applicable California State Taxes. Since California has not yet amended its revenue code to be consistent with the new Federal law, CIAC will continue to be considered as non-taxable contributions to capital, not subject to depreciation.
3. The purpose of the filing is to increase the extension rule unit costs under the "periodic review provisions" of those rules. The increase in unit costs is required to offset the taxes SWG will now incur as a result of the Federal Tax Reform Act of 1986, which made customer Contributions in Aid of Construction (CIAC) taxable as of January 1, 1987.
4. 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. Rates in effect as of January 1, 1987 were made subject to refund pending the final determinations made by the Commission in the OII.

5. This Advice Letter is being filed in response to 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.

6. Pending a final policy determination by the Commission in the OII, Southwest shall collect contributions and advances from parties gross of federal income taxes. The factor required to convert to a gross of income tax is 1.67, as determined in the Formula below:

"GROSS UP" FOR TAXES APPLICABLE TO  
CONTRIBUTIONS IN AID OF CONSTRUCTION

Federal Tax Rate for 1987 = 40%

$$\text{Income Tax Factor} = \frac{1}{1 - .4}$$

Gross Revenue Conversion Factor = 1.67

7. At the utility's option, and on a case-by-case basis, a promissory note or other promise of payment for the applicable federal income taxes may be accepted. The note would be payable on demand if the Commission determines in its final Order in OII 86-11-019 that taxes be collected from the party making the advance.

8. Taxes will be collected subject to refund pending further determination by the Commission in Order Instituting Investigation 86-11-019.

9. These revisions are being made in accordance with the "periodic review" provisions in Section E.2 of Rule No. 15 and Section H of Rule No. 16 and in compliance with the December 10, 1986 letter from the Commission's Evaluation and Compliance Division. The periodic review provisions allow for annual revisions of unit costs when such costs have changed by more than 10%. The present and proposed rates are listed on Attachment "A".

10. The above sections of the rules also require a submission of proposed revisions to the Commission for review not less than forty days prior to any filing. Southwest requests a waiver of the 40-day requirement.

~~11. Southwest Gas requests that this filing become effective upon compliance with the regular 40 day notice period.~~

#### PROTESTS

1. The Commission has received numerous protests to the 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.

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. If the developers do not pay these taxes as part of their Costs of Construction, these taxes will be borne by SWG'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

1. 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.

2. Because California law does not yet allow collection of California Corporation Franchise Tax on CIAC, and line extensions, SWG should not be permitted to collect any CCFT in anticipation of such State tax changes.

3. This resolution cannot be approved retroactively, therefore SWG cannot be authorized to collect Federal Income Tax on any developer's advances received under Extension Rule 15 and 16 for the period January 1, 1987 to 11:59 p.m. on March 5, 1987. We therefore will require that SWG refund with interest any amounts so collected.

4. The tax component will be collected subject to refund in accordance with the refund provisions of the extension rules, and will be collected subject to further refund pending further determination by the Commission in Order Instituting Investigation 86-11-019.

5. 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.

6. 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.

FINDINGS

1. Failure of the utility 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 SWG.
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.
3. 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, 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.
4. All amounts collected by SWG for Federal and State income taxes in excess of its filed unit costs under Tariff Rules 15 and 16 from January 1, 1987 to 11:59 p.m. on March 5, 1987 will be refunded with interest.
5. SWG 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. Southwest Gas Corporation is authorized under Section 454 of the Public Utilities Code and by Section A of General Order 96-A, to place Advice Letter No. 385 and accompanying tariff sheets into effect today.
2. Southwest Gas Corporation shall refund with interest all collections for Federal and State Income Taxes in excess of its filed unit costs under Tariff Rules 15 and 16 for the period of January 1, 1987 to 11:59 p.m. on March 5, 1987.
3. Interest, as discussed in this resolution shall be computed at the average three month commercial paper rate as published in the Federal Reserve Bulletin.

4. Southwest Gas Corporation shall maintain memorandum accounts detailing all collections of Contributions in Aid of Construction and line extensions together with any Federal taxes collected therewith separately shown.
5. Contributions are considered subject to further adjustment pending a final decision in OII 86-11-019.
6. This Advice Letter and accompanying tariff sheets shall be marked to show that they were authorized for filing by Commission Resolution G-2721. This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on March 6, 1987. The following Commissioners approved it:



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Executive Director

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

SOUTHWEST GAS CORPORATION  
INCOME TAX COMPONENT OF CONTRIBUTIONS AND ADVANCES

<u>DESCRIPTION</u>	<u>Rule No.</u>	<u>Section</u>	<u>Amount- Pre Tax</u>	<u>Tax Factor</u>	<u>Total Requirement</u>
<u>HOJAVE DIVISION</u>					
Contributions	16	A.3.a.	\$4.90	1.67	\$ 8.20
Advances	15	B.3.a.	4.70	1.67	7.85
<u>SIERRA DIVISION</u>					
Contributions	16	A.3.a.	14.50	1.67	24.20
Advances	15	B.3.a	14.85	1.67	24.80