



**PENNGROVE WATER COMPANY [PWC]**

4982 Sonoma Highway Santa Rosa, CA 95409

707-539-6397

May 10, 2022

Advice Letter No. 119

TO THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Penngrove Water Company (PWC) hereby transmits for filing one original and one copy of this advice letter (AL) and the following tariff sheets which are enclosed:

<u>NEW SHEET #</u>	<u>TITLE</u>	<u>CANCELLING SHEET #</u>
502-503-W	Amend Rule 15.E Tax Factor for CIAC and AIAC	491-492-W
504-W	Table of Contents	501-W

**REQUEST**

This AL requests permission to amend PWC's Rule 15.E to update the Tax Factor used to calculate the Income Tax C Component (ITC) associated with the Contributions in Aid of Construction (CIAC) and Advances in Aid of Construction (AIAC) pursuant to Water Industry rule 7.3.1 or GO 96-B. This filing is designated as a Tier 1 AL.

**BACKGROUND**

In November of 2021, HR 3684 was signed into law changing, among other things, the federal tax law concerning income tax implications associated with CIAC and AIAC, as well as government grant funds received. Prior to this, all infrastructure contributed to a water utility as a CIAC and plant additions funded as AIAC were considered taxable income for federal tax purposes. Under HR 3684, only contributions for service connections are treated as taxable income. HR 3684 also eliminated the taxability of grants received from government agencies, except for grants related to water and sewer service connections. There has been no change to the applicability of income taxability for California (state) income tax purposes. This AL proposes new tax factors to calculate the gross-up Income Tax Component (ITC) associated with CIAC and AIAC plant additions consistent with the provisions of the Tax Cuts and Job Act (TCJA), as signed into law in 2017, HR 3684, and prior Commission decisions.

**DISCUSSION**

The commission previously addressed a federal income tax change affecting Rule 15 in its Decision D. 87-09-026, in which the Commission investigated five different methods of

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calculating the tax gross-up on CIAC and AIAC. This Decision allows water utilities to use one of two methods to gross-up the value of the CIAC or AIAC (the contribution) by enough money to pay the associated income tax on the contributed or advanced asset value and the income tax on the tax funding contribution itself as well, and to charge that amount to the contributor. Method 2 allows smaller utilities to gross up the contribution by enough money to pay the income tax on the contributed value as well as the tax on the funding contribution itself. Method 5 requires larger water utilities, to advance part of the tax, resulting in a lower gross-up. PWC is a Class C utility and will employ Method 2 to determine the Tax Method.

The Water Division has determined that all regulated water utilities will use the 21% federal tax rate specified in the TCJA for C-Corp utilities regardless of the tax structure for individual utilities (S-Corp. proprietorship etc.). The income tax rate for California is 8.84% The combined tax rates result in a Tax Factor of 38.85%, as shown in the attached work papers.

## **TIER DESIGNATION AND REQUESTED EFFECTIVE DATE**

This AL and the enclosed tariff sheets are submitted pursuant to General Order (GO.) 96-B. AL 114 is designated as a Tier 1 AL and the enclosed tariff sheets will become effective upon filing.<sup>1</sup>

## **NOTICE**

Since the approval requested in this AL will not result in an increase in rates to its customers, withdrawal of service, or more restrictive terms or conditions, customer notice is not required in accordance with Section 3.2 of GO 96-B. However, copies of this filing are distributed to the parties on the service list on the last page of this AL in accordance with Water Industry Rule 4.1 of GO 96-B.

## **RESPONSE OR PROTEST<sup>2</sup>**

Anyone may respond to or protest this AL. A response supports the filing and may contain information that proves useful to the Commission in evaluating the AL. A protest objects to the AL in whole or in part and must set forth the specific grounds on which it is based. These grounds are:

1. The utility did not properly serve or give notice of the AL;
  2. The relief requested in the AL would violate statute or Commission order, or is not authorized by statute or Commission order on which the utility relies;
  3. The analysis, calculations, or data in the AL contain material error or omissions;
  4. The relief requested in the AL is pending before the Commission in a formal proceeding;
- or

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<sup>1</sup> GO. 96-B, Water Industry Rule 7.3.1

<sup>2</sup> GO. 96-B, General Rule 7.4.1

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5. The relief requested in the AL requires consideration in a formal hearing, or is otherwise inappropriate for the AL process; or
6. The relief requested in the AL is unjust, unreasonable, or discriminatory, provided that such a protest may not be made where it would require relitigating a prior order of the Commission.

A protest may not rely on policy objections to an AL where the relief requested in the AL follows rules or directions established by statute or Commission order applicable to the utility. A protest shall provide citations or proofs where available to allow staff to properly consider the protest. DWA must receive a response or protest via email (**or** postal mail) within 20 days of the date the AL is filed. The addresses for submitting a response or protest are:

**Email Address:**

[Water.Division@cpuc.ca.gov](mailto:Water.Division@cpuc.ca.gov)

**Mailing Address:**

California Public Utilities Commission  
Water Division, 3rd Floor  
505 Van Ness Avenue  
San Francisco, CA 94102

On the same day the response or protest is submitted to DWA, the respondent or protestant shall send a copy of the protest to Penngrove Water Company at:

**Email Address:**

julie@mfcomputing.com

**Mailing Address:**

4982 Sonoma Highway  
Santa Rosa, CA 95409

Cities and counties that need Board of Supervisors or Board of Commissioners approval to protest should inform DWA, within the 20-day protest period, so that a late filed protest can be entertained. The informing document should include an estimate of the date the proposed protest might be voted on.

## **REPLIES**

The utility shall reply to each protest and may reply to any response. Any reply must be received by DWA within five business days after the end of the protest period, and shall be served on the same day on each person who filed the protest or response to the AL.

Same day on each person who filed the protest or response to the AL.

<sup>1</sup> GO. 96-B, General Rule 7.4.3

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**SERVICE LIST**

Susan Sommers  
City of Petaluma  
PO Box 61  
Petaluma, CA 94953

City of Rohnert Park  
130 Avram  
Rohnert Park, CA 94927

American Water Company  
Attn: Rates Department  
4701 Beloit Drive  
Sacramento, CA 95838

I hereby certify that the above service list has been served a copy of AL 119 on 6/8/2022.

Executed in Santa Rosa, California.

Penngrove Water Company

By: 

\_\_\_\_\_  
Julie Cavaz  
Manager

Enclosures

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## Advice Letter 118 Work Papers

The Tax Cuts and Jobs Act (TCJA) signed into law in 2017 and effective January 1, 2018 established several changes to existing law which impact regulated water utilities. Contributions in Aid of Construction (CIAC) and Advances in Construction (AIAC) have been reclassified as taxable income for federal taxes. Rule 15, Section E provides for an Income Tax Component (ITC) to be added to the net CIAC or AIAC by which the contributor pays the gross-up so that the utility's authorized rate of return is not compromised and so that the tax burden is not passed on to the utility's ratepayers. Facilities Fees (FF) are considered to be CIAC, FF are to grossed-up with an ITC the same as contributions of plant assets.

There are two components of the gross-up taxes in the ITC:

- 1 the income tax imposed by the State of California,
- 2 the income tax imposed by the federal government.

The ITC is a single gross-up tax covering both and determined by the combined income tax requirement of both. The TCJA specified a flat and maximum federal tax rate of 21% for corporations designated as C-Corps and the Water Division has determined that this listed rate will apply to all regulated water utilities. The California tax rate is 8.84%. Under the TCJA state income taxes paid continue to reduce the taxable income for federal taxes for corporations. This is reflected in the calculations to amend Rule 15.E which follow. As stated in the Discussion section of this AL, PWC will use Method 2 as set forth in D.87-09-026 to compute the combined state and federal tax rate and the Tax Factor to determine the ITC in any contribution situation:

### THE VARIABLES IN THE COMPUTATIONS:

N = the net cost (value) of the contributed or advanced facilities or FF;

ITC = the Income Tax Component of the grossed-up contribution or advance;

Federal Income Tax rate = 21%;

State Income Tax rate = 8.84%;

Combined federal & state tax rate = CTR.

### FOR SERVICE CONNECTION CONTRIBUTIONS AND ADVANCES EXCLUSIVELY:

(both federal and state taxes are imposed)

$$\text{CTR} = 21\% + 8.84 - (21\% \times 8.84\%) = 29.84\% - 1.86\% = 27.98\%$$

$$\text{Gross Contribution} = \text{Net Contribution} + \text{ITC} = (N + \text{ITC})$$

$$\text{ITC} = \text{CTR} \times (N + \text{ITC})$$

$$\text{ITC} = 0.2798 \times (N + \text{ITC})$$

$$\text{ITC} \times (1 - 0.2798) = 0.2798 \times N$$

$$\text{ITC} \times (0.7202) = 0.2798 \times N$$

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$$\text{ITC} = 0.2798/0.7202 \times N$$

$$\text{ITC} + 0.3885 \times N$$

$$\text{Tax Factor} = 0.3885\%$$

## EXAMPLE:

Net CIAC valued at N= \$100,000

$$\text{ITC} = 0.3885 \times \$100,000 = \$38,850$$

$$N + \text{ITC} = \$100,000 + 38,850 = 138,850$$

$$\text{ITC} = 0.2798 \times \$138,850$$

$$\text{ITC} = \$38,850$$

PWC proposes to retain the combined federal/state tax rate computation of 27.98 % and the ITC of 38.85% for contributions exclusively of service connection plant additions including Facilities Fees.

FOR CONTRIBUTIONS OF PLANT ASSETS OTHER THAN SERVICE CONNECTIONS:  
(no federal income tax is imposed and California continues to tax contributed and advanced plant additions.

The CTR is simply the state rate of 8.84%

$$\text{Gross contribution} = N + \text{ITC}$$

$$\text{ITC} = \text{CTR} \times (N + \text{ITC})$$

$$\text{ITC} = 0.0884 \times (N + \text{ITC})$$

$$\text{ITC} (1 - 0.0884) = 0.0884 \times N$$

$$\text{ITC} (0.9116) = 0.0884 \times N$$

$$\text{ITC} = 0.0884/0.9116 \times N$$

$$\text{ITC} = 0.096972 \times N$$

$$\text{The Tax Factor} = 0.096972$$

## Example 2

Net CIAC valued at N = \$100,000

$$\text{ITC} = 0.096972 \times 100,000 = \$9697.2$$

$$N + \text{ITC} = 109,697.2$$

$$\text{ITC} = 0.0884 \times 109,697.2 = 9697.2$$

PWC proposes to add the second tax factor for contribution or advance situations involving plant additions other than just service connections. such as mains, etc.

**Rule 15**

MAIN EXTENSIONS (Continued)

E. INCOME TAX COMPONENTS OF CONTRIBUTIONS AND ADVANCES PROVISION FOR ALTOS SONOMA CORPORATION (ASC) dba PENNGROVE WATER COMPANY

1. Contributions in Aid of Construction and Advances for Construction shall include, but are not limited to, cash, services, facilities fees, labor, and income taxes thereon provided by a person or agency to the utility. The value of non-cash contributions and advances shall be based on the utility's estimates. Contributions and advances shall consist of two components for purposes of recording transactions as follows:

- (a) Income tax component (ITC)
- (b) The balance of the contribution or advance

2. The ITC shall be calculated by multiplying the balance of the contribution or advance by (C) the tax factor of 0.3885 for situations involving service connection plant additions only, or by the tax factor of 0.096972 for situations involving plant additions other than service connections.

3. The combined state and federal income tax rate is 0.2798 for service connections only situations and a rate of 0.0884 for situations involving other plant additions.. (C)

4. The tax factor is established by using Method 2 as set forth in D. 87-09-026 in I.86-11-109.

5. The formula to compute the ITC using Method 2 includes the following factors:

- (a) California corporate tax rate of 8.84%
- (b) Federal tax rate of 21% for 2018 and thereafter.

6. The ITC will be collected subject to refund, pending the Commission's final determination of the method of accounting for the new tax on contributions and advances.

7. The utility shall inform the Applicant of the final cost of the installation of all contributed or advanced facilities (the balance) and the corresponding tax paid thereon (the ITC) to be collected from the Applicant.

8. In the event that the utility collects an ITC using an incremental tax rate that is more than its incremental tax rate as determined on a taxable year basis, without consideration of a tax credit or tax loss carry forward, the difference between what was and what should have been collected will be refunded to the Applicant.

9. This tariff is effective as of June 8, 2022. (C)

(To be inserted by utility)

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Decision No. \_\_\_\_\_

Issued By



**Manager**

(To be inserted by P.U.C.)

Date Filed \_\_\_\_\_

Effective \_\_\_\_\_

Resolution No. \_\_\_\_\_



**Rule 15**

MAIN EXTENSIONS (continued)

SPECIAL CONDITIONS

1) In the event that the utility collects a gross-up using an incremental tax rate that is more than its incremental tax rate determined on a taxable year basis, without consideration of a tax credit or tax loss carry forward, the difference between what was what should have been collected will be refunded to the applicant.

F. The following paragraph will be added under “**Refunds**” to each Utility’s Main Extension Contract Forms signed after October 9, 1996 in the forms section of the utility’s tariffbook.

“In the event that the utility collects a gross-up using an incremental tax rate that is more than its incremental tax rate as determined on a taxable year basis, without consideration of a tax credit or tax loss carry forward, the difference between what was and what should have been collected will be refunded to the applicant.”

(To be inserted by utility)

Advice Letter No. 119 \_\_\_\_\_

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Issued By



**Manager**

(To be inserted by P.U.C.)

Date Filed \_\_\_\_\_

Effective \_\_\_\_\_

Resolution No. \_\_\_\_\_

**TABLE OF CONTENTS**

The following listed tariff sheets contain all effective rates and rules affecting the charges and services of the utility, together with other pertinent information.

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(To be inserted by utility)

Issued By

(To be inserted by P.U.C.)

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Effective \_\_\_\_\_

Resolution No. \_\_\_\_\_