

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE EFFECTS OF THE TAX REFORM ACT )  
OF 1986 ON CONTRIBUTIONS IN AID OF ) ADMINISTRATIVE  
CONSTRUCTION AND CUSTOMER ADVANCES ) CASE NO. 313

O R D E R

On October 22, 1986, the President of the United States signed into law the Tax Reform Act of 1986 ("Tax Reform Act"). Under Section 824 of this Act, the value of any property received, including money, by a corporate regulated utility (which this Commission interprets to be utilities which file federal income tax returns) after December 31, 1986, which was given to encourage the provision of service to, and for the benefit of, the person transferring the property, is to be included as taxable gross income to that utility.

The Act considers the person transferring the property to have benefited if: "he is the person who will receive the services, an owner of the property that will receive the services, a former owner of the property that will receive the services, or if he derives any benefit from the property that will receive the services."<sup>1</sup>

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<sup>1</sup> The Tax Reform Act of 1986. Law and Controlling Committee Reports. Published by Commerce Clearing House, Inc., page 1222.

The Commission, on its own motion, is initiating this proceeding to investigate the effects of this section of the Tax Reform Act on the affected regulated utilities in the Commonwealth of Kentucky and the manner in which the effects of this Act are to be handled by those utilities.

The Commission therefore finds that:

1. A proceeding should be established to investigate the effects of the provisions of the Tax Reform Act requiring contributions in aid of construction to be included as gross taxable income to corporate regulated utilities.

2. All corporate regulated utilities under the jurisdiction of this Commission are invited to file testimony in this proceeding describing the effects of this provision of the Tax Reform Act on their operations no later than September 15, 1987. Said testimony should include at a minimum a discussion of and answers to the following items along with all supporting evidence corroborating the discussion:

A) Does this provision of the Tax Reform Act apply equally to non-refundable contributions and refundable customer advances?

B) Identify all items previously not included in taxable income which you consider to be included in this provision of the Tax Reform Act.

C) Does this provision of the Tax Reform Act require the difference between the net original cost book value, and the purchase price and/or fair market value at the time of acquisition of utility assets to be recorded as a taxable contribution if the

acquisition price is below book or fair market value? How is fair market value to be determined?

D) Does this Act apply to monies received from governmental agencies or other parties for the relocation of utility assets?

E) Does this Act apply to grants received by utilities from governmental agencies and other third parties for the upgrading of service to existing customers and/or the extension of service to new customers?

F) Estimate and supply all assumptions on the following effects of this provision of the Tax Reform Act on utility operations under the rate-making options set out below:

- a) The expected financial effects based on growth estimates for 1987, 1988, 1989, and 1990. Provide before and after growth estimates.
- b) The expected effects on quality of utility service.
- c) The expected annual cost of additional complaints or court actions as a result of this provision of the Tax Reform Act.
- d) Any revised expectations of potential acquisition(s) of other public utilities or utility assets as a result of this provision of the Tax Reform Act.
- e) Any legal constraints.

- f) The expected increase or decrease in revenue requirements under the act for 1987, 1988, 1989, and 1990.

Rate-making Options:

- a) Requiring the contributor to increase the amount of the contribution to include the associated tax liability.
  - b) The utility bearing the tax liability associated with the contribution and passing the increase to ongoing customer rates.
  - c) The utility paying the tax associated with the contribution and splitting any resulting revenue requirement between the ongoing customer rates and the contributor.
  - d) A leasing agreement between the utility and the outside party rather than a contribution transaction.
  - e) Recording the contribution at its net present value and basing the tax liability on this value.
  - f) Treating the contribution as deferred revenue and basing the current tax liability on that portion of the contribution treated as current revenue.
  - g) Any other method under consideration.
- G) State whether or not the various options listed above would provide viable alternatives for the treatment of

contributions. State the reasoning involved in reaching this determination.

H) Any current or pending rulings or requests for private letter rulings by the Internal Revenue Service of which the utility is aware, dealing with the taxability of contributions and the various alternative methods of treating contributions.

I) Any other consideration which the utility wishes to address concerning this matter.

3. Other interested parties may file testimony or comments and such information as they may have on any items enumerated in this Order no later than September 15, 1987.

IT IS THEREFORE ORDERED that:

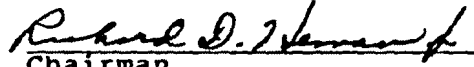
1. A generic proceeding be established to investigate the effects of the provisions of the Tax Reform Act requiring contributions in aid of construction to be included as gross taxable income to corporate regulated utilities.

2. All affected utilities wishing to file testimony in this proceeding must do so by September 15, 1987. Said testimony is to comply with the guidelines set out in Finding No. 2 herein.

3. Other interested parties wishing to file testimony or comments in this proceeding must do so by September 15, 1987.

Done at Frankfort, Kentucky, this 12th day of August, 1987.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Executive Director