

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



May 10, 1990

To: All Class A Water Utilities

Subject: Deductibility of State income tax on federal tax.

Gentlemen:

Commission Decision D.89-11-058 effective December 22, 1989, in A.85-12-050 and I.86-11-019 requires utilities to change the way that state income taxes (CCFT) are deducted to determine the federal income tax expense. In the past, the taxes were calculated assuming that the CCFT was deductible concurrently on the federal income tax (FIT). D.89-11-058 requires all results of operations for utilities to reflect the prior year's CCFT as a deduction for the current year. Thus for calculating revenues for a test year, the 1989 CCFT is deducted in 1990 to determine the FIT expense.

This change in procedure requires a change in the calculation of the net-to-gross multiplier (NTG) and summary of earnings comparison. The NTG is used to easily convert a change in net revenue to a corresponding change in gross revenue. The enclosed memorandum outlines the calculation of the NTG and summary of earnings comparison with example calculations. If you have any questions about the new procedure, please call me at (415) 557-0282.

Very truly yours,

A handwritten signature in cursive script that reads "Han L. Ong".

Han L. Ong, supervisor
Large Water Utilities Section

enclosures

San Francisco, California
May 10, 1990

File Nos. A.85-12-050
I.86-11-019

The attached letter was sent to the following:

AZUSA VALLEY WATER COMPANY
CALIFORNIA-AMERICAN WATER COMPANY
CALIFORNIA WATER SERVICE COMPANY
CITIZENS UTILITIES CO. OF CALIFORNIA
DEL ESTE WATER COMPANY
DOMINGUEZ WATER CORPORATION
EAST PASADENA WATER COMPANY, LTD.
GREAT OAKS WATER COMPANY
PARK WATER COMPANY
SAN GABRIEL VALLEY WATER COMPANY
SAN JOSE WATER COMPANY
SANTA CLARITA WATER COMPANY
SANTA PAULA WATER WORKS, LTD.
SOUTHERN CALIFORNIA WATER COMPANY
SUBURBAN WATER SYSTEMS
TEMESCAL WATER COMPANY
VALENCIA WATER COMPANY

Attachment

HLO/LH:jj

M E M O R A N D U M

Date : May 4, 1990
To : Large Water Utilities Staff
From : Han L. Ong, Supervisor 
Large Water Section

File No.: 565

Subject : Net-to-Gross Multiplier Calculation
and Summary of Earnings Comparison

Introduction

In past practice, the taxes on income were computed allowing a deduction for the California Corporate Franchise Tax (CCFT) from the Federal Income Tax (FIT) for the current year. Recently, in Application A.85-12-050 PG&E requested that the deduction of the current year's CCFT be reflected in the next year's FIT because that is the way that the tax deduction actually occurs. Decision D.89-11-058 in I.86-11-019 & A. 85-12-050 requires all results of operations for utilities to reflect the flow-through for CCFT deduction in computing federal income tax expense. This change will affect large water utilities because there are two test years and an attrition year. The revenue changes had been calculated using the net-to-gross multiplier (NTG) which assumed that the CCFT was deductible concurrently on the federal income tax. In order to incorporate this change, the method of calculating the NTG needs to be modified.

Net to Gross Multiplier Calculation

The NTG is used to convert a net revenue change to a gross revenue change. All of the changes in revenue-related expenses are used in the calculation. These include uncollectibles, franchise fees, business license fees and income taxes that are changed with revenue. An example of the calculation of the NTG is attached to this memo. There are other algorithms for the calculation that will give algebraically equivalent results.

Accounting for CCFT Deduction in the Summary of Earnings

The CCFT for the prior year will be used in the determination of federal income tax expense. Since there are two test years, the CCFT expense from the first test year should be used to determine federal tax in the second test year. In the past, both test years have used current rates (at the beginning of the first test year) for present rates in the summary of earnings comparisons. To calculate revenue changes using flow through of CCFT deductibility the summary of earnings comparison for the first

test year remains the same as in the past. However, for the second test year, the first column will show the Results of Operation at the adopted first test year rates and the second column will show the adopted second test year rates. The attached examples delineate the format to be used in the future summary of earnings comparisons for the R/O reports and Commission decisions.

Attachments

EXAMPLE - CALCULATION OF NET-TO-GROSS MULTIPLIER

| | | | | |
|----|--|----------|---------|-----------|
| 1 | Uncollectibles | 0.00752% | _____ % | 0.07520% |
| 2 | 1 - uncollectibles (100% - line 1) | | _____ % | 99.92480% |
| 3 | Local franchise (.77470 x line 2) | 0.77470% | _____ % | 0.77412% |
| 4 | Business license (.10216 x line 2) | 0.10216% | _____ % | 0.10208% |
| 5 | Subtotal (line 1 + line 3 + line 4) | | _____ % | 0.95140% |
| 6 | 1 - subtotal (100% - line 5) | | _____ % | 99.04860% |
| | Remaining amount subject to CCFT & FIT | | | |
| 7 | CCFT (line 6 x 9.3%) | 9.30% | _____ % | 9.21152% |
| 8 | FIT (line 6 x 34.12%) | 34.12% | _____ % | 33.79538% |
| 9 | Total taxes paid (line 5 + line 7 + line 8) | | _____ % | 43.95830% |
| 10 | Net after taxes (1 - line 9) | | _____ % | 56.04170% |
| 11 | Net-to-Gross multiplier (1 / line 10) | | _____ | 1.78439 |

900504

California Water Service Company
 Adopted Summary of Earnings
 (Dollars in Thousands)

| | Bakersfield District | | | | San Mateo District | | | |
|----------------------|----------------------|---------------|-----------------------|-----------------------|--------------------|---------------|-----------------------|-----------------------|
| | 1990 | | 1991 | | 1990 | | 1991 | |
| | Present Rates | Adopted Rates | Adopted at 1990 Rates | Adopted at 1991 Rates | Present Rates | Adopted Rates | Adopted at 1990 Rates | Adopted at 1991 Rates |
| Operating revenues | \$15,168.8 | \$16,261.8 | \$16,347.3 | \$16,921.1 | \$7,308.3 | \$7,704.7 | \$7,983.5 | \$8,048.5 |
| O&M, A&G | 11,602.9 | 11,602.9 | 12,038.9 | 12,038.9 | 5,431.0 | 5,431.0 | 5,697.7 | 5,697.7 |
| Uncollectibles | 83.1 | 89.1 | 89.6 | 92.7 | 9.9 | 10.5 | 10.8 | 10.9 |
| Franchise tax | 220.4 | 236.3 | 237.5 | 245.9 | 0.0 | 0.0 | 0 | 0 |
| State income tax | 118.0 | 217.6 | 172.5 | 224.8 | 76.7 | 113.5 | 109.5 | 115.5 |
| Federal income tax | 595.2 | 960.7 | 780.6 | 972.4 | 353.9 | 489.0 | 471.3 | 493.5 |
| Total oper. expenses | 12,619.6 | 13,106.6 | 13,319.1 | 13,574.7 | 5,871.5 | 6,044.0 | 6,289.3 | 6,317.6 |
| Net oper. revenues | 2,549.2 | 3,155.2 | 3,028.2 | 3,346.4 | 1,436.8 | 1,660.7 | 1,694.2 | 1,730.9 |
| Rate Base | 28,058.7 | 28,058.7 | 29,891.3 | 29,891.3 | 14,768.1 | 14,768.1 | 15,461.2 | 15,461.2 |
| Rate of return | 9.09% | 11.25% | 10.13% | 11.20% | 9.73% | 11.25% | 10.96% | 11.20% |

California Water Service Company
Bakersfield District

Income Tax Calculation

| | 1990 ---- | 1991 ---- |
|--------------------------------------|------------------------|--------------|
| | (Dollars in thousands) | |
| Operating Revenue (authorized rates) | \$16,261.8 | \$16,921.1 |
| Expenses | | |
| Purchased water | 783.0 | 783.0 |
| Purchased power | 3,458.7 | 3,476.4 |
| Pump tax | 992.6 | 999.6 |
| Payroll | 1,831.6 | 1,933.5 |
| Purchased chemicals | 1.9 | 2.0 |
| Other O & M | 1,474.0 | 1,595.0 |
| Other A & G | -402.4 | -423.7 |
| G.O. prorations | 1,762.8 | 1,878.6 |
| Business license | 0.0 | 0.0 |
| Taxes other than income | 501.1 | 525.6 |
| Uncollectibles | 89.1 | 92.7 |
| Franchise tax | 236.3 | 245.9 |
| Transportation depreciation | -70.2 | -75.8 |
| Interest expense | 1,341.2 | 1,443.7 |
| Total Deduction | 11,999.7 | 12,476.5 |
| State Tax Depreciation | 1,922.6 | 2,027.4 |
| Net Taxable Income | 2,339.5 | 2,417.2 |
| State Corp. Franch. Tax 9.3% | 217.6 | 224.8 |
| Federal Tax Depreciation | 1,320.6 | 1,369.1 |
| State Income Tax | 118.0 * | 217.6 |
| Less Preferred Stock Dividend | 7.9 | 7.9 |
| Net Taxable Income | 2,815.6 | 2,850.0 |
| Fed. Income Tax 34.12% | 960.7 | 972.4 |
| Total Federal Income Tax | 960.7 | 972.4 |
| Total Income Tax | 1,178.3 | 1,197.2 |

* Based on revenue at present rates