

M E M O R A N D U M

Date : December 19, 1989
To : Fred Curry, Chief, Water Branch, CACD
From : Gil Infante, Supervisor, Sp Proj Sec, Eng Audit Br.
File No.: OII 86-11-019
Subject : Water Utility Compliance With The Requirements of
Decision 89-11-058

D. 89-11-058, dated November 22, 1989, in OII 86-11-019 (The TRA 86 OII), adopted the DRA recommendation to change the current Commission policy of using the test year California Corporate Franchise Tax (CCFT) as a test year deduction for calculating federal income tax (FIT) expense. This change in policy involves using the prior years CCFT as a deduction in calculating test year or attrition year FIT expense. This change brings the ratemaking FIT calculation in conformance with the FIT calculation required in the real world and eliminates any timing difference between actual and ratemaking.

The decision applies to all utilities regulated by the Commission including water utilities (especially Class A's). Water utilities, because their rates are set on a two test year and one attrition year basis, or in some instances, go for a number of years without a ratecase, may require treatment which would be somewhat different than that applied to gas, electric, and telephone utilities in order to comply with the CCFT decision.

DRA proposes that the following policy be applied to ensure water utility compliance with the CCFT decision:

1. To the extent possible, test year and attrition year CCFT expense should be identified and tracked on a on-going basis to insure that the adopted CCFT expense can be used as a ratemaking deduction for FIT purposes in the next year.
2. In cases where a water utility has not had a rate case for a number of years, and the adopted CCFT for the year prior to the test year is not available, the CCFT expense at present rates for the test year should be used as the FIT deduction in calculating the FIT expense at present and proposed rates. While this method is not entirely accurate, it is much more so than using the old Commission policy of using the calculated test year CCFT as the FIT deduction for the test year at proposed rates.
3. The net-to-gross multiplier for developing the gross revenue requirement at proposed rates must also be modified to compensate for the change in the CCFT deduction for FIT purposes.

a. Under prior Commission policy, the statutory CCFT rate as deducted from 100, the remainder was multiplied times the statutory FIT rate, and the remainder less the FIT effect, was divided into 100 to derive the net-to-gross multiplier (disregarding franchise fees and uncollectables in this discussion). This calculation assumed that the test year CCFT was deductible for test year FIT purposes at proposed rates.

b. Under Current Commission policy, the above calculation must be modified to reflect that test year CCFT expense is no longer deductible for FIT purposes and the prior years CCFT must be used. Since the FIT expense at present rates will reflect the deduction of the prior years CCFT (unless years have occurred between rate cases), the effect of this change will have been reflected in the present rates calculation. When proposed rates are being derived, the increase in CCFT and FIT expense will require that the gross revenue requirement be derived by using a net-to-gross multiplier which is calculated in the following manner:

1.) 100 is multiplied by the statutory CCFT rate and the result is added to 100 multiplied by the statutory FIT rate.

2.) These two results are added together and divided into 100.

3.) The resulting net-to-gross multiplier will produce a gross revenue requirement which contains the appropriate level of CCFT and FIT expense in it without distortion from the prior years CCFT. An Example Follows:

CCFT Stat. Rate of 9.3% X 100 =	9.3%
FIT Stat. Rate of 34% X 100 =	34.0%
Composite rate of	43.3%
Subtract 43.3% from 100% =	56.7%
100 divided by 56.7% =	the net-to-gross multiplier of 1.764

cc: J. McVicar
H. Ong
C. Conner

*- Take prior year CCFT, to calculate this year's FIT
in summary of carrying over this year's CCFT & FIT
5 months
new CCFT*