DAYN HARDIE
DEPUTY ATTORNEY GENERAL
IDAHO PUBLIC UTILITIES COMMISSION
PO BOX 83720
BOISE, IDAHO 83720-0074
(208) 334-0312
IDAHO BAR NO. 9917

Street Address for Express Mail:
11331 W CHINDEN BVLD, BLDG 8, SUITE 201-A
BOISE, ID 83714

Attorney for the Commission Staff

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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF SUEZ WATER'S PETITION FOR AUTHORIZATION TO ELIMINATE COLLECTION OF GROSS-UP PAYMENTS ASSOCIATED WITH CONTRIBUTIONS IN AID OF CONSTRUCTION	**CASE NO. SUZ-W-20-01** **COMMENTS OF THE COMMISSION STAFF**

STAFF OF the Idaho Public Utilities Commission, by and through its Attorney of record, Dayn Hardie, Deputy Attorney General, submits the following comments.

BACKGROUND

On June 22, 2020, Suez Water ("Company") filed a Petition requesting a Commission order permitting the Company to no longer collect the federal and state income tax gross-up amount related to the Contribution in Aid of Construction ("CIAC"). The Company proposes to change the CIAC income tax collection method by paying the tax itself and recovering its costs to serve the new development(s) through rates paid by the new customers served. The Company also requested to update its tariffs[1] to reflect the proposed changes. The Company requested its Petition be processed by Modified Procedure.

[1] The Company is proposing to modify Tariff Sheet Nos. 27, 33, 36, 43, and 45.

The Company's tariffs include charges and rules that apply when a developer requests the Company connect its water system to new individual, industrial, or commercial developments. Certain charges and allowances relate to main extensions requiring special facilities. These charges are designed to recover the Company's construction costs, annual overhead expenses, and depending on current tax law, federal and state income tax associated with the developer's CIAC.

From 1996 through 2017, federal tax law exempted CIAC from a water utilities' taxable income. The 2017 Tax Cuts and Jobs Act ("TCJA") removed this exemption. As a result, the Company has included CIAC in its annual taxable income since January 1, 2018.

In May 2018, the Commission directed the Company to account for the taxability of CIAC by grossing-up developers' contributions. *See* Order No. 34074, Case No. GNR-U-18-01. Effective June 1, 2018, the Company's tariffs have included a table illustrating the basis for calculating the tax gross-up factor so the charges would reflect the net present value of CIAC-related cash flows and the future tax deductibility of contributed assets. The tariffs' "special facilities charges" to developers include the gross-up factor and offset the Company's increased tax liability from CIAC under the TCJA.

The Company states it has conducted a study that shows its existing rates for water service will generate sufficient revenue from customers in a new development to cover the Company's CIAC-related tax expenses from that development.[2] The Company thus proposes to modify the method of CIAC payment approved in Order No. 34074 and update the Company's tariffs so developers no longer pay for future CIAC-related taxes. The Company states its proposal ensures development will pay for the additional costs it imposes, and existing customers will not subsidize the development through rate increases.

The Company proposes to cease grossing-up contributed property on the effective date of the final order in this case. CIAC would become taxable upon transfer of ownership to the Company. The Company would refund the tax gross-up for any project that closes on or after the effective date. If the Company has incurred a tax liability on a project that closed before the effective date, then the Company would retain the gross-up payment.

[2] *See* Direct Testimony of Cathy Cooper at 5-7.

STAFF REVIEW AND ANALYSIS

Staff has reviewed the Company's Application and the direct testimony of Company witnesses Jarmila Cary and Cathy Cooper. Based on its review, Staff supports the request to cease collection of state and federal income taxes associated with the taxability of CIAC and revise the Company's tariffs. Under the Company's proposal, the additional growth on the Company's system will pay for itself and generate additional revenue which will benefit all customers, while spreading costs over a larger customer base.

The collection of federal and state income tax associated with the taxability of CIAC has a negative impact for SUEZ customers because it has become a barrier to growth. This collection of the tax gross-up is driving large developers to seek alternatives for water service. This includes seeking service from municipalities or setting up a new water system to serve the development. Because the taxability of CIAC does not apply to publicly-owned municipal water providers, the Company is at a competitive disadvantage in attracting growth to its service territory.

High upfront costs appeared to be a concern even prior to the CIAC gross-up tax being paid by developers. The Company indicated it had received complaints regarding high overhead and inspection fees included in main extension costs even before adding the CIAC gross-up. Cathy Copper DI at 3. Because of these issues, Staff reviewed the Company's current water main extension policy to better understand if the policy fits within its proposal and if there are any identifiable issues. Staff did not identify any critical issues but plans to continue investigating the Company's main extension policy in the future.

With less development, there are fewer new customers providing additional revenue to help cover costs. The Company asserts that new developments will bring new customers, which benefits existing customers by creating a larger customer base to spread costs among. The Company provided several examples where developers, cities, and schools experienced negative impacts from the additional CIAC tax gross-up charges. The Company's analysis of developer projects completed from January 2016 through March 2020 demonstrates that the developer projects generate sufficient annual revenues to cover the incremental revenue requirement to serve these new customers and the CIAC tax obligation.

The Company asserts that the requirement for developers to fund the tax obligation for CIAC is "ultimately detrimental to the Company's existing customers." Jarmila Cary at 10.

Therefore, to remove barriers to future development and keep customer rates low, the Company is proposing to adopt the "no CIAC gross-up" method. The Company would pay the taxes on the CIAC rather than collecting the funds for the tax from developers. The income tax effect will be recorded in the accumulated deferred income tax ("ADIT") accounts, which will reduce ADIT in future rate cases. Future tax depreciation funded by non-grossed up CIAC will cause the deferred tax asset to reverse over its tax life, increasing ADIT liabilities as the tax benefit of the additional depreciation is realized over time. This future depreciation reduces current tax expense and incrementally reduces the revenue requirement in future rate cases, since the ADIT is a reduction to rate base. The associated tax on CIAC would be included in rate base and the deferred tax balances would be amortized over a 25-year period. The Company provided revised tariffs to reflect the change in methodology.

Based on development activity since 2014, the associated tax obligation collected would be between $1 and $2 million annually. This is approximately 1% of the Company's rate base investment of $180 million. The average annual revenue from the 2016 through March 2020 developer constructions projects is higher than the incremental revenue requirement needed to serve customers and to cover the CIAC tax gross-up amount.

Staff reviewed the Company's analysis of developer-funded construction projects and confirms that the average annual revenue from development projects is more than sufficient to cover the incremental operating cost of serving those customers and also the revenue requirement of the CIAC tax gross-up amount. The proposed 25-year amortization period is consistent with the Modified Accelerated Cost Recovery System tax depreciation life for water utilities and matches the actual tax depreciation life.

Tariff Changes and Customer Comments

Staff has reviewed the proposed tariff changes. Staff believes that the changes clearly convey the intent of the Application, by removing all references to the gross-up for income tax.

As of Monday, September 14, 2020, 23 public comments have been received, all in support of eliminating the tax gross-up on CIAC. While the majority of the comments are from developers, there is also a letter from 24 homeowners in a community that is considering SUEZ for its water. In addition, the Independent School District of Boise also supports the request by SUEZ to eliminate the tax gross-up on CIAC. The Building Contractors Association of

Southwestern Idaho, Inc. on behalf of the over 400 member companies sums up the concerns of all the public comments when it states, "Eliminating the fee will help to keep costs more consistent regardless if the water system is owned by a private company or a government entity, reduce the disincentive to use a private water system in new developments, and help make housing more affordable."

STAFF RECOMMENDATIONS

Staff recommends that the Commission approve the Suez Water Idaho's requested change in methodology that removes the tax gross-up for state and federal income taxes associated with all CIAC and its revision to the tariffs to reflect the change.

Respectfully submitted this 15th day of September 2020.

Dayn Hardie
Deputy Attorney General

Technical Staff: Kathy Stockton
Michael Eldred
Bentley Erdwurm

i:umisc/comments/suzw20.1dhklsmebe comments

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 15^{TH} DAY OF SEPTEMBER 2020, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. SUZ-W-20-01, BY E-MAILING A COPY THEREOF TO THE FOLLOWING:

MICHAEL C CREAMER
PRESTON N CARTER
GIVENS PURSLEY LLP
PO BOX 2720
BOISE ID 83701-2720
E-MAIL: mcc@givenspursley.com
prestoncarter@givenspursley.com

MARSHALL THOMPSON
SUEZ WATER IDAHO INC
8284 W. VICTORY RD
BOISE ID 83709
E-MAIL: marshall.thompson@suez.com

Jo Nelson

SECRETARY