

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter Of A Working Case Regarding Missouri-)
American Water Company 1st Revised Tariff Sheet) **File No. WW-2018-0388**
No. R.65) Tracking No. JW-2018-0167

STAFF REPORT ON WORKSHOP

COMES NOW, Staff of the Missouri Public Service Commission (Staff), by and through counsel, and provides to the Commission, all interested parties, and the public, a summary of the discussion occurring at the Workshop on July 19, 2018, regarding the above-styled matter.¹

Background

In December 2017, Congress passed and the President signed into law, the Tax Cut and Jobs Act of 2017 (TCJA 2017). That law changed provisions of the Internal Revenue Code (IRC or Tax Code). Specifically, it changed 26 U.S.C. § 118 “contributions to the capital of a corporation.” The change to the Tax Code made contributions in aid of construction (CIAC) an exception to the general rule that “gross income does not include any contribution to the capital of the taxpayer.” This exception effectively made all new CIAC taxable gross income, and particularly affects water utilities due to water infrastructure playing a significant part of the utility’s capital needs.

¹ On August 14, 2018 by operation of law, a substituted 1st Revised Tariff Sheet No. R 65 became effective. The Commission closed this case file WW-2018-0388 the following day, August 15, 2018. This *Staff Report on Workshop*, was drafted after the workshop, but prior to the closing of the WW-2018-0388 case file. A subsequently filed 2nd Revised Tariff Sheet No. R. 65 (Tracking No. JW-2019-0019), by Missouri-American proposes to adopt the No Gross-Up Approach proposed by the HBA, and described in this document. Thus, this *Staff Report on Workshop* provides some context on issue before the Commission by summarizing positions and concerns raised by the various stakeholders. Nevertheless, readers should keep in mind that the Revised R. 65 discussed in this document is different from the 2nd Revised R. 65 (JW-2019-0019) currently pending at the time of filing.

This particular section of the IRC has experienced Congressional revisions over the past few decades, either making or exempting CIAC as taxable gross income. Due to these historical changes, Missouri-American Water Company (MAWC or Company) had already in existence R.65, which allowed for the collection of the estimated income tax from developers upon any CIAC received by the Company. With the passage of TCJA 2017, the conditions that activated tariff R.65 occurred again.

In the course of applying the existing tariff, MAWC learned that the formula to calculate the amount to be collected from developers due to the tax on related CIAC was inaccurate. As a result, on June 15, 2018, MAWC filed a proposed 1st Revised R.65 (Revised R.65)² that adjusts the calculation formula in the tariff to better reflect the amount to be charged to developers to cover the tax liability resulting from CIAC.

As a result of the tariff filing, Staff moved for the opening of this case, File No. WW-2018-0388. The Commission granted Staff's motion, and scheduled a workshop to occur at 10 AM, on July 19, 2018.

The Workshop

On July 19, 2018, the workshop commenced. Approximately 18 persons³ attended to discuss the content and function of the proposed 1st Revised Tariff R.65. Besides Staff, attendees ranged from representatives of MAWC, Liberty Utilities (Missouri Water), LLC, the Home Builders Association of St. Louis and Eastern Missouri (HBA), several home developers, counsel for the Metropolitan Sewer District (MSD), a

² Tracking No. JW-2018-0167

³ See, File No. WW-2018-0388, Item No. 5, *Sign-in Sheets for Workshop July 19, 2018*.

representative of the Association of General Contractors of Missouri (AGCMO), and several law firms advising the various parties and interests.

The attendees discussed three major topics. First, MAWC presented the Revised R.65 and answered questions. Next, counsel for HBA presented comments filed on July 17, 2018, in response to the Revised R.65 (HBA Comments), including the statements from two developers and a representative of the HBA who attended.⁴ Finally, general discussion occurred concerning consequences of the changes to the Tax Code and tariff, and a procedural discussion of how to move forward.

MAWC conducted a power point presentation that discussed the current tariff, explained why it should be replaced, and walked through the calculation of the example provided in MAWC's Appendix A of their *Response to Order Opening Working Case* in this case.⁵ The Revised R.65 presents a mathematical formula intended to implement a net present value approach to calculating the fee to charge to cover tax liability resulting from CIAC. The formula offsets the present value of the taxes paid with the present value of the tax savings resulting from tax depreciation over the life of the contributed asset. In other words, the fee charged would be reduced due to the benefit of offsetting depreciation taken as a deduction over the taxable life of the CIAC asset.

Attendees asked multiple questions and provided feedback on the operation of the tariff. Two notable suggestions by attendees recommended that: (1) the Revised R.65 calculation should acknowledge the time-value of the payment by CIAC donators

⁴ File No. WW-2018-0388, Item No. 4, *Comments of Home Builders Association of St. Louis and Eastern Missouri*.

⁵ File No. WW-2018-0388, Item No. 3, *Response to Order Opening Working Case and Scheduling a Workshop Meeting*.

to the Company (payments from developers are likely to be received significantly in advance of when the associated tax liability becomes due); and, (2) that MAWC consider whether inspection costs should be properly included in the total project cost. Other questions raised how MAWC would reflect CIAC on its taxes, and how the Company determined the proposed formula appropriately covered only the necessary taxable amount.

Counsel for HBA then presented the HBA Comments. The HBA Comments detailed the unanticipated nature of this particular change to the Tax Code, and the resulting unexpected costs incurred by home developers in the MAWC service area. The comments also explained the financial concerns, constraints, and the possible consequences to both new home prices and customer choices resulting from changes in price.

Counsel for HBA suggested that an alternative to the Revised R.65 would be to adopt a “No Gross-Up Approach.” This method requires the Company to pay the taxes, and let the depreciation on the asset taken for tax purposes offset the initial tax liability over the life of the asset. Moreover, the Company would then record the tax liability associated with CIAC in a deferral account equivalent to recording a deferred tax asset, and thus reduce a portion of accumulated deferred income tax (ADIT). Such reduction would effectively incrementally increase the value of rate base. Increased rate base valuation resulting from the “No Gross-Up approach” would effectively transfer to utility ratepayers ultimate responsibility for CIAC tax liabilities.

Attendees provided statements in support of the HBA Comments. The commentators described the uniqueness of the Revised R.65 in comparison to other

large utilities' approach to CIAC, the potential financial burden upon developers to provide the fee upfront to MAWC, and the subsequent business need to pass the costs along to the price of the homes, potentially affecting home buyers' decisions. Separately, counsel for MSD raised concerns about the Revised R.65 and its effect upon governmental entities.

Finally, more general discussion occurred regarding the operation of the No Gross-Up Approach and the Revised R.65. No consensus was reached on one approach over another. Nevertheless, the attendees acknowledged the difficulties that either approach could produce for the Company, customers and developers.

At the close of the discussion, the undersigned counsel for Staff committed to memorialize a summary of the discussion for the benefit of the Commission and other interested stakeholders.

WHEREFORE, Staff respectfully submits this *Staff Report on Workshop*.

Respectfully submitted,

/s/ Jacob T. Westen

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile, or electronically mailed to all parties and or counsel of record on this 24th day of August, 2018.

/s/ Jacob T. Westen