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August 2, 2019

Aida Camacho-Welch, Secretary
State of New Jersey
Board of Public of Public Utilities
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In the Matter of the Proposed amendment to N.J.A.C. 14:3-8 to Consider the Impact of the Tax Cuts and Jobs Act of 2017 on Main Extensions - Docket No. AX19050615

Dear Secretary Camacho-Welch:

SUEZ Water New Jersey Inc. ("SWNJ") offers the following as comments in response to the Notice issued in the docket referenced above. In summary, the request for comment seeks input as to the appropriate gross-up mechanism (if any) which should be utilized to recover income tax costs associated with the taxable nature of Contributions in Aid of Construction and Advances for Construction.

For water and sewer companies, such contributions became taxable with the Tax Reform Act of 1986 (TRA86). The related portion of TRA86 was changed in the mid 1990s and, until again changed by the TCJA was non-taxable. As a result of the passage of the TCJA, CIAC are now taxable after more than 20 years.

To summarize the issue, the value of the transferred assets (either cash, property, or a combination) is now taxable. If the contributor is to pay for the income tax impact and to sufficiently compensate for the amount of taxes due, this value provided would be gross-ed up to reflect the tax on the total amount including the amount of the gross-up. For income tax purposes, the amount of the contribution is considered to have an equivalent tax basis which is then depreciated over the tax life of the asset (for utility plant, this is generally 25 years with ½ year convention). Consequently, at the time of contribution, the amount of tax due is 21% (FIT only) of the total contribution. The book basis of the contribution is zero and the tax basis is the amount of the contribution which creates a book deferred tax asset (DTA) representing the timing difference between the cash payment for taxes in year 1 and the tax depreciation which represents the reduction in cash taxes received over the tax life of the asset.



As described in the request for comment, a template exists for use in calculating the amount of CIAC to represent the gross-up of taxes utilized by electric and natural gas companies. The calculation results in a gross-up which represents the NPV of the future cash flows which the taxable nature of CIAC results in order to compensate the utility for the additional cash needed to fund the deferred taxes. The template accounts for the capital structure components and embedded cost rates for debt and equity costs but does not represent the pre-tax rate of return which the utility would anticipate otherwise earning on incremental capital utilized. SWNJ believes the pre-tax rate of return from a company's last rate case should be utilized.

Additionally, certain other considerations should be addressed in this amendment. For example, are there certain instances where a gross-up should not be required? While there may be other instances, SWNJ believes contributions which may be made by Federal and State agencies where the contribution is at the option of the agency should be exempted from the gross-up and the impact included as a part of Accumulated Deferred Income Taxes ("ADIT") for general ratemaking purposes. Simply put, if such an agency is willing to make a contribution without gross-up but not willing to make a contribution with gross-up, SWNJ believes that it is more favorable to ratepayers to accept the funds without gross-up and pay the taxes rather than lose the benefit of the contribution.

SWNJ looks forward to working with the Board and all other stakeholders in this matter.

Best regards,

A handwritten signature in black ink, appearing to read "James C. Cagle", enclosed within a large, loopy scribble.

James C. Cagle
Vice President – Rates and Regulatory Affairs

JCC:kmk



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August 2, 2019

Via Hand Delivery

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Re: I/M/O Proposed Amendment to N.J.A.C. 14:3-8 to Consider the Impact of the Tax Cuts and Jobs Act of 2017 on Main Extensions
BPU Docket No.: AX19050615

Dear Secretary Camacho-Welch:

By notice dated June 5, 2019, the Staff of the Board of Public Utilities ("Board Staff") initiated a stakeholder process to discuss proposed modifications to several aspects of the Board's water and wastewater regulations. Board Staff subsequently held a stakeholder meeting on June 13, 2019. Board Staff now seeks input regarding modifications to the Board's main extension rules pertaining to amendments necessitated by the federal Tax Cuts and Jobs Act (TCJA) of 2017. Among the changes to the Internal Revenue Code set forth in the TCJA is the requirement that Contributions in Aid of Construction (CIAC) for water and wastewater main extensions are now taxable at the Federal level. Since 1986, only CIAC for natural gas and electric mains were taxable, and the Board's existing rules refer to a template located on the Board's website for use in calculating CIAC-related Federal Income Tax as it applies to gas and electric mains. N.J.A.C. 14:3-8.6(c). Board Staff seeks stakeholder input on the appropriateness of implementing a template similar to that used by electric and natural gas companies for water and wastewater main extensions.


First, Rate Counsel notes that the depreciation cycles for water and wastewater mains are much longer than those for gas and electric extensions. Accordingly, if the Board chooses to use a similar template, the template may need to be modified to reflect these longer asset lives. Secondly, the Board should evaluate the template in light of the recent decisions by two water companies to potentially take advantage of the IRS' rules on tangible property repairs. The Board should consider whether there are any benefits to the ratepayers of a company that has opted to use the tangible property rule in terms of how CIACs are handled, consistent with the TCJA. If there are, these benefits should be reflected in the template.

Rate Counsel thanks the Board for the opportunity to provide these comments. Rate Counsel reserves its right to offer additional, more specific comments at a future date. We ask the Board to make all parties' comments publicly available, and to set a future date for the filing of a second round of comments this fall.

Respectfully submitted,

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Director, Division of Rate Counsel

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**STATE OF NEW JERSEY
BEFORE THE BOARD OF PUBLIC UTILITIES**

In the Matter of the Proposed Amendment :
to N.J.A.C. 14:3-8 to Consider the Impact : Docket No. AX19050615
of the Tax Cuts and Jobs Act of 2017 :
on Main Extensions :

COMMENTS OF THE NEW JERSEY BUILDERS ASSOCIATION

Pursuant to the Notice dated June 20, 2019 issued by the Board of Public Utilities (“BPU” or “Board”) in the above-captioned proceeding (“June 20 Notice”), the New Jersey Builders Association (“NJBA”) submits these comments. The June 20 Notice requests written comments from interested stakeholders related to modifications of the BPU’s Main Extension Rules necessitated by the federal Tax Cuts and Jobs Act signed into law on December 22, 2017 (“TCJA” or “2017 Act”).

I. INTRODUCTION

The potential implications of the TCJA could further exacerbate New Jersey’s already-existent housing affordability and supply problems. To curtail these potential detrimental impacts, NJBA respectfully urges the Board to refrain from adopting a gross-up methodology for recovering the consequences of a federal income tax imposed on Contributions in Aide of Construction (“CIAC” or “Contributions”) for water and wastewater utilities and to, instead, adopt a no gross-up method for these utilities. As explained in more detail below, the no gross-up method is just and reasonable, consistent with reasonable ratemaking policy, and in the public

Since 1948, the New Jersey Builders Association (NJBA) has been the State's leading trade association and voice of the homebuilding industry in Trenton. As a major influencer on the state's economic strength, its mission is to advocate for a sustainable and healthy economy and a more affordable and vibrant housing market. NJBA's diverse membership includes residential builders, developers, remodelers, subcontractors, suppliers, engineers, architects, lawyers, consultants and industry professionals that are involved in constructing entry-level to luxury units in for-sale, rental and mixed-use developments.

interest. The no gross-up method provides a public benefit, as it is conducive to economic development and the growth of commerce. The no gross-up method also encourages the construction of new developments in New Jersey and the use of public water supply. Existing customers will also benefit from the adoption of the no gross-up method, as the no gross-up method will result in more customers with whom to spread the cost of maintaining public water and wastewater systems. The no gross-up method also results in a fairer allocation of all costs because the initial costs of line extension (not including the tax effect) will continue to be paid in full by the developer or homebuilder. Further, the no gross-up method will not result in unreasonable rates for ratepayers, as the no gross-up method imposes virtually de minimus costs on ratepayers over scores of years.

To the contrary, the gross-up method will require individual builders and homebuyers to front the tax on CIAC and will negatively affect the construction and sale of homes in New Jersey. The gross-up method may drive economic developers to other jurisdictions where these significant additional costs are more fairly socialized among all ratepayers and paid over the life of the newly added property, and/or discourage the use of public water and wastewater systems.

As such, NJBA respectfully urges the Board to modify its Main Extension Rules to authorize a “no-gross up” method for water and wastewater utilities. Should the Board reject this position and find that gross-up method is more appropriate, NJBA urges the Board to adopt the “discounted gross-up method.” Adoption of a discounted gross-up method, as opposed to a full gross-up method, will result in a lower, upfront cost charged to developers, which may help to reduce the potential, significant consequences that the gross-up method may have on economic development and will be easier to administer.

II. INTEREST OF NJBA

NJBA is a professional trade organization representing individuals and businesses in the construction industry in New Jersey. NJBA members include residential and commercial builders, developers, remodelers, subcontractors, suppliers, engineers, architects, consultants, and other professionals. Chartered in 1947, the NJBA represents its members on state regulatory and legislative issues. NJBA and its members strive for a more vibrant and affordable housing market in New Jersey. As such, NJBA has a direct and substantial interest in any modifications to the Board's Main Extension Rules, as said modifications may impact economic development and the affordability of housing in New Jersey.

III. BACKGROUND

Contributions in Aid of Construction refer to money or property that a developer, or potential customer, contributes for the development of main and service line extensions to expand utility services to new customers or locations. In New Jersey, as in most states, developers are required to pay the CIAC, essentially financing the utility's extension.¹ Since the developer is providing a payment to the utility, the amount paid is income to the utility, on which ordinarily the utility would have to pay federal income tax.

¹ The Board's regulations provide that the cost an applicant pays a regulated entity for an extension shall be determined by mutual agreement between the regulated entity and the applicant. If a regulated entity and an applicant cannot agree on the applicant's cost of an extension, deposit, or non-refundable contribution, either party may petition the Board to apply the suggested formula set forth at N.J.A.C. 14:3-8.9 [suggested formulae for allocating extension costs -- general provisions], 8.10 [suggested formulae for allocating extension costs -- multi-unit or nonresidential development], or 8.11 [suggested formulae for allocating extension costs -- single residential customer], as applicable. N.J.A.C. 14:3-8.5(a).

Prior to the Tax Reform Act of 1986 (“TRA 86”),² Contributions were specifically exempt from federal income taxation pursuant to Section 118 of the Internal Revenue Code (“IRC”).³ The passage of TRA 86, however, made Contributions taxable for all utilities by amending the IRC to provide that Contributions would no longer be treated as contributions to capital and, instead, would be included in taxable income when received. In 1996, water and wastewater utilities became exempt from taxable CIAC as a result of the passage of the Small Business Job Protection Act.⁴ For a period of over 20 years, water and wastewater utilities remained exempt from taxable CIAC. During this time period, Contributions remained taxable for other utility industries. The recent enactment of the TCJA, however, once again, eliminated the exemption for water and wastewater utilities from recognizing CIAC as federal taxable income. The reestablishment of this requirement raises the issue of how water and wastewater utilities will recover this expense. While utilities have various options for recovery, generally the options fall into one of two categories: 1) a “no gross-up” method, or 2) a “gross-up” method.

Under the “no gross-up” method, (also called the “utility finance” or “socialization” method), the utility pays the tax and then adds that amount to its rate base, allowing the utility to earn a return on the amount, which decreases as the asset is depreciated. Essentially, the utility finances the payment of the tax expense and gets reimbursed through rates over the life of the CIAC asset.

² Pub.L. 99-514, 100 Stat. 2085, enacted Oct. 22, 1986.

³ 26 U.S. Code § 118.

⁴ Pub.L. 104-188, 110 Stat. 1755, enacted Aug. 20, 1996.

Under a “gross-up” method, the tax, or a portion thereof, is recovered by the developer or potential customer by “grossing up” the CIAC to reflect the amount of tax that the utility will be required to pay. Under this method, the asset is also depreciated for tax purposes. As the asset is depreciated, the utility will either remit the savings resulting from the annual depreciation back to the developer as those savings are realized, *or* the discounted present value of those future savings will be netted out of the original gross-up amount (the “discounted gross-up method”).

The Board’s existing Main Extension Rules require electric and natural gas utilities to utilize a “gross-up method” for the recovery of CIAC taxes resulting from TRA 86. Specifically, the Main Extension Rules provide that:

The cost of an extension for which a regulated entity receives a deposit, or receives a non-refundable contribution, shall include the tax consequences incurred by the regulated entity as a result of receiving deposits under the Tax Reform Act of 1986, in accordance with N.J.A.C. 14:3-8.6.

N.J.A.C. 14:3-8.5. N.J.A.C. 14:3-8.6, titled “Deposits, contributions, and refunds – Tax Reform Act of 1986,” includes provisions related to the calculation of the gross-up factor and requires gas and electric utilities to calculate the gross-up factor using a template available on the Board’s website. Through its June 20 Notice, the Board seeks comments on the appropriateness of implementing a template similar to that utilized by the electric and natural gas companies for water and wastewater main extensions to be applied to the tax liability resulting from the recent changes to the law.

IV. NJBA URGES THE BOARD TO MODIFY ITS MAIN EXTENSION RULES TO AUTHORIZE A NO GROSS-UP METHOD FOR RECOVERY BY WATER AND WASTEWATER UTILITIES OF THE CIAC TAX.

Under the NJBA proposal, the utility would initially finance the tax, and it would be included in the utility’s rate base. The utility would be entitled to earn a return, or a percentage,

of the deferred tax asset from its entire customer base. The return on the deferred tax asset would be paid off by all of the utility's customers, including the customers that were responsible for the CIAC, over the entire life of the property as the property is depreciated (which, in the case of water and wastewater facilities, is likely to be decades). Payment on the tax would decline as the tax deductions from depreciation are realized. Thus, the tax effect would be reflected in rates at the same pace as the benefits that would accrue from adding these new customers – over the life of the facilities. While existing customers will pay a portion of the return of the deferred tax asset, existing customers will also receive the benefit of being able to share in the price of maintaining the water and wastewater system. In evaluating the appropriate method for recovery, it is important for the Board to consider the impact on economic development, as well as the benefits to existing customers.

A. Economic Development Considerations

The no-gross up method will curtail the potential detrimental impacts that the TCJA may have on economic development, as well as benefit the existing community at large. The construction of water and wastewater main and service line extension is often a necessary component in the construction of new businesses and residential developments. Once constructed, the new businesses and developments will assist in bringing new jobs and resources to the surrounding communities. As such, it is imperative for BPU to adopt a method for recovery that is conducive to economic development.

The adoption of a gross-up method for water and wastewater utilities could seriously impact economic development in New Jersey. Under a full gross-up method, the income tax consequences of CIAC would fall upon developers or others requesting service line extensions in

one large payment up front. Requiring developers to pay the grossed-up CIAC would place an extreme financial burden on them and may serve as a deterrent for developers to undertake such projects.

In today's world, the cost of building a home is very high. Every added cost impacts the affordability for potential purchasers. According to the National Association of Home Builders, 3,230 households will be priced out of the market for a median-priced new home in New Jersey if the price of a new home increases by just \$1,000.⁵ Fewer buyers results in reduced sales of median-priced homes. Reduced sales either means a reduction in the development of median-priced homes, *or* a risk for developers that they will be unable to recover the full cost from the purchaser. As such, developers will consider all costs, including a tax imposed on CIAC, in determining if and where to construct new developments.

The Board should also consider that New Jersey and its residents already suffer from both a housing affordability problem and an affordable housing supply problem. New Jersey's slow economic growth can be attributed to many factors including high land costs and high cost of living, restrictive and expensive land-use and environmental policies, the federal tax reform's disproportionate impact on New Jersey incomes, and numerous incremental increases to housing costs. Applying the gross-up methodology would only exacerbate the difficulties in being a builder in New Jersey and the difficulty in building affordable homes.

If faced with having to front unreasonable costs without reasonable certainty of recovery, including a gross-up of CIAC, developers will consider alternatives. Developers have geographic

⁵ See *Households Priced-Out by Higher House Prices and Interest Rates*, National Association of Home Builders, available at <https://www.nahb.org/en/research/housing-economics/housings-economic-impact/households-priced-out-by-higher-house-prices-and-interest-rates.aspx>. Accessed July 22, 2019.

alternatives, which may be problematic to economic development in New Jersey. These geographic alternatives may include the development: 1) in areas where there is an existing service line; and/or 2) in other states that utilize the no gross-up method, such as New York⁶ and Pennsylvania;⁷ 3) and/or in areas with municipal and authority-owned water/wastewater companies (which are not subject to the tax). Alternatively, developers may simply “sit on the sidelines” and not develop a given plot of land when conditions become too expensive, just as an investor will choose not to purchase additional stock when the market is overvalued. When this situation arises, those seeking a home will have no choice but to choose among older, aging homes, built to less stringent, less sustainable codes and using aging infrastructure, including aging water and wastewater lines. Consistent and in concert with the Board’s recently released draft of its Energy Master Plan, the Board should be encouraging the construction of new homes since new homes are substantially more energy efficient than the existing housing supply and present an overall advantage for the health of the community. Additionally, it is apparent that the no gross-up method provides a public benefit in that it eliminates the serious potential consequences that the gross-up method could have on economic development in New Jersey.

⁶ The New York Public Service Commission (“NY PSC”) had responded to the taxation of CIAC imposed by TRA 86 by requiring electric, gas, and telephone companies to utilize the no gross-up method and for water and wastewater utilities to gross-up contributions. In response to the TCJA, however, the NY PSC determined that facts and circumstances had changed in the intervening years and, therefore, directed major water and wastewater utilities to use the no gross-up method. *Proceedings on the Motion of the Commission on Changes in Law that May Affect Rates*, Case No. 17-m-0815 (NY PSC Order issued Aug. 9, 2018), pp. 32-33.

⁷ House Bill No. 751, enacted on July 2, 2019, requires water and wastewater companies to be solely responsible for funding the income taxes on CIAC and to record the income taxes as accumulated deferred income taxes for accounting and ratemaking purposes.

B. Benefits to and Impacts on Existing Customers

Additionally, existing customers will benefit from the advances in infrastructure and extensions to facilities that are funded through CIAC. Under the no gross-up method, developers will still pay the equipment and installation costs necessary to serve new customers. New ratepayers being served by these new facilities will pay the regular rate for water and wastewater service, which will produce additional revenue for the respective utility and allow the utility to recover the cost of service over a larger customer base, thereby reducing the burden on each individual customer. The utilities would not get this additional revenue if not for the contribution. In this manner, existing ratepayers benefit by being able to share the cost of water and wastewater services with a larger group of ratepayers.

While the benefits to existing customers are large, the financial impact is de minimus. The impact on individual ratepayers is both very modest and spread out over the life of the new facilities -- scores of years. As discussed above, under NJBA's proposed no gross-up method, the utility will initially finance the tax and it will be included in the utility's rate base. The utility will be entitled to earn a return, or a percentage, of the deferred tax asset, the expense of which will be split among all customers and paid for over the entire life of the property. Payment on the tax will decline as the tax deductions from depreciation are realized. Such an expense would have virtually no impact on customers. Moreover, the costs associated with taxable CIAC will be offset by the additional revenue generated from the additional customers that have access to the system. When balancing the benefits and costs, there appears to be no question that the no gross-up method is the most reasonable and in the public interest.

To the contrary, under the gross-up method, a developer would be required to pay the entirety of the tax (plus the tax on the tax)⁸ in year 1 for property that may have a 25-40 year life. As such, socializing the cost in the manner described above is appropriate from a policy standpoint.

V. SHOULD THE BPU ADOPT A GROSS-UP METHOD, IT SHOULD REQUIRE WATER AND WASTEWATER UTILITIES TO UTILIZE THE DISCOUNTED GROSS-UP METHOD.

Should the BPU determine that a gross-up method is appropriate for water and wastewater utilities, NJBA urges the Board to require water and wastewater utilities to adopt the discounted gross-up method. Under a discounted gross-up method, a utility would gross-up CIAC by the tax liability the utility incurs upon receipt of CIAC, less the Net Present Value of the future tax deduction that will accrue to the benefit of the utility (and its existing customers) from tax depreciation deductions over the life of the assets. In other words, under the discounted gross-up method, developers would pay less up front than required under a full gross-up method, but would not receive credits as depreciation is realized.

The discounted gross-up method, as opposed to a full gross-up method, will result in a lower upfront cost of the CIAC tax for developers, which may help to reduce the potential consequences to economic development. It will also be easier for utilities to administer and track. Otherwise, the utilities would have to keep records as each developer initially provides the tax payment and then return refunds to the developers as the facilities are depreciated and create a tax deduction. The far simpler and more reasonable approach is to net out the initial gross-up required for this stream of future payments, discounted to recognize the time value of money.

⁸ Technically, the gross-up method would require the developer to pay not only the tax on the contribution, but also a tax on the tax in order to keep whole the utility that bears the tax liability. *See Old Colony Trust Co. v. Comm'r*, 279 U.S. 716 (1929) (The discharge of a taxpayer's tax obligation by a third party is equivalent to the direct receipt of income by the taxpayer that the taxpayer then uses to pay its tax liability.).

VI. CONCLUSION

For the reasons explained above, the no gross-up method proposed by NJBA is just and reasonable, consistent with reasonable ratemaking policy, and in the public interest. The no gross-up method provides a public benefit in the form of economic development and provides benefits to existing customers who will be able to share the cost of water and wastewater services with a larger group of ratepayers as a result of the extension. The no gross-up method also imposes virtually de minimus costs on ratepayers over scores of years. When balancing the benefits and costs, there appears to be no question that the no gross-up method is the most reasonable and in the public interest. As such, NJBA respectfully requests that the Board modify its Main Extension Rules to authorize water and wastewater utilities to utilize a no gross-up method to recover the CIAC federal income tax. If the BPU determines that a gross-up method is more appropriate, NJBA requests that the Board require water and wastewater utilities to utilize a discounted gross-up method.

Respectfully Submitted,



Carol Ann Short

New Jersey Builders Association

Date: August 2, 2019



August 2, 2019

VIA E-Mail and Overnight Mail

Honorable Aida Camacho-Welch
Secretary of the Board
New Jersey Board of Public Utilities
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RE: BPU Docket No. AX19050615 – In the Matter of the Proposed Amendment to N.J.A.C. 14:3-8 to Consider the Impact of the Tax Cuts and Jobs Act of 2017 on Main Extensions

Dear Secretary Camacho-Welch:

Middlesex Water Company (the “Company” or “Middlesex”) submits these comments in response to the Notice issued in the above-referenced docket on June 20, 2019. In this Notice, Board Staff invites all interested parties to comment on the appropriateness of amending N.J.A.C. 14:3-8 to reflect certain changes made by the federal Tax Cuts and Jobs Act signed into law on December 22, 2017 (the “2017 Act”), most prominently the 2017 Act’s provision that Contributions in Aid of Construction (“CIAC”) for water and wastewater main extensions are taxable for federal income tax purposes.

As Board Staff correctly points out in its Notice, the 2017 Act profoundly impacts the income tax liability associated with CIAC as applied to water and wastewater companies. It is Middlesex’s position that amendments to N.J.A.C. 14:3-8 to reflect this profound impact are wholly appropriate, warranted and necessary. In order to better understand what specific changes are necessary it is important to understand what CIAC is and the historic context of this subject matter covered in N.J.A.C. 14:3-8 and more specifically N.J.A.C. 14:3-8.5 and 8.6.

CIAC is defined by federal Internal Revenue Service (“IRS”) regulations as “any amount of money or other property contributed to a regulated public utility that provides water or sewerage disposal services to the extent that the purpose of the contribution is to provide for the expansion, improvement or replacement of the utility’s water or sewerage disposal facilities.”¹ CIAC plays a critical role in the financing of capital costs for water and wastewater utilities. State public utility

¹ Section 118-2(b)(1) of the Internal Revenue Code, codified as 26 C.F.R. §1.118-2(b)(1).

commissions – the New Jersey Board of Public Utilities included – do not allow CIAC to be included in rate base upon which the utility is allowed the opportunity to earn a fair return as CIAC is considered an advance. In addition, utilities are not allowed to depreciate CIAC property on their tax returns.

Under the federal Tax Reform Act of 1986 (“TRA”), CIAC funds were and are treated as income to utilities and therefore subject to federal income taxation. As a result, the Board adopted within its main extension rules N.J.A.C. 14:3-8.5(c), which provides:

The cost of an extension for which a regulated entity receives a deposit, or receives a non-refundable contribution, shall include the tax consequences incurred by the regulated entity as a result of receiving deposits under the Tax Reform Act of 1986, in accordance with N.J.A.C. 14:3.8.6.²

N.J.A.C. 14:3-8.6 sets forth the Board’s rule for calculation of the tax consequences of CIAC as treated under the TRA. Included in this rule is a template for calculating the gross-up factor that captures these tax consequences as provided in N.J.A.C. 14:3-8.6(c) as well as formulae for utilities to calculate the amount of a CIAC deposit or non-refundable contribution that includes these tax consequences. Since the TRA’s inception, these rules have consistently applied to electric and gas utilities up to present day.

With respect to water and wastewater utilities, however, this application has not been consistent. For many years following the passage of the TRA, water and wastewater utilities argued that the TRA’s treatment of CIAC funds as taxable income subject to federal income taxation resulted in an unfair increase to the cost of providing water and wastewater service to the public. As a result, in 1996 Congress passed and the President signed into law an amendment to the TRA that made CIAC funds received by an investor-owned water and wastewater utility exempt from federal income taxation under Section 118 of the Internal Revenue Code. In other words, under the 1996 Amendment, CIAC received by water and wastewater utilities was not treated as income subject to federal income taxation.

The 2017 Act effectively reverses the 1996 Amendment to the TRA – once again treating CIAC received by water and wastewater utilities as income for federal income tax purposes. Under the 2017 Act, water and wastewater utilities – just like electric and gas utilities – cannot exclude CIAC from their gross income as contributions to capital. With the passage of the 2017 Act, all utilities in New Jersey – electric, gas, water and wastewater – have returned to the world of the TRA as it was enacted in 1986 with respect to the taxability of CIAC.

The purpose of an income tax liability gross-up payment associated with CIAC fees – as is provided for in N.J.A.C. 14:3-8.5(c) and calculated following the dictates of N.J.A.C. 14:3-8.6 – is to ensure that a utility’s existing customers are not placed in the position of subsidizing a utility’s new customers for costs to place the new customers onto a utility’s systems as is what happens with respect to main extensions. This was true at the time the TRA was enacted in 1986 and has been true through present day with respect to the electric and gas utilities that were never exempt from applicability of federal income tax to their received CIAC.

² N.J.A.C. 14:3-8.5(c)

With the return of water and wastewater utilities to this same applicability of federal income tax courtesy of the 2017 Act there is no policy justification to treat water and wastewater utilities any differently under N.J.A.C. 14:3-8.5 and 8.6 than electric and gas utilities. It is therefore wholly appropriate, warranted and necessary for the Board to amend N.J.A.C. 14:3-8 to ensure water and wastewater utilities have the same ability to receive an income tax liability gross-up payment associated with the CIAC they receive from new customers seeking a main extension to receive their water or wastewater service.

With respect to specific amendments to N.J.A.C. 14:3-8, Middlesex recommends that N.J.A.C. 14:3-8.5 and 14:3-8.6 be amended to reference both the TRA and the 2017 Act to ensure availability of the gross-up factor applies to water and wastewater utilities. In addition, Middlesex recommends that a 2017 Act gross-up factor be developed for water and wastewater utilities that includes a template to be posted on the Board's website similar to the template for electric and gas utilities mandated by N.J.A.C. 14:3-8.6(c)(3).

While development of a 2017 Act-based gross-up factor for water and wastewater utilities will inevitably require some technical updating, structurally this gross-up factor can follow along the same lines as the calculation requirements set forth for electric and gas utilities under N.J.A.C. 14:3-8.6(d). Whether the method for achieving this is to amend the current N.J.A.C. 14:3-8.6(c) and (d) to include water and wastewater utilities in the textual language or to create a new subsection identical to N.J.A.C. 14:3-8.6(c) and (d) but applicable to water and wastewater utilities, Middlesex sees no need for the Board to "reinvent the wheel" with respect to ensuring similar treatment for all utilities with respect to recovery of income tax liability associated with CIAC.

With these observations, it is Middlesex's position that as a minimum baseline water and wastewater utilities should be permitted to have their federal income tax liability reflected in the gross-up calculation associated with the CIAC they receive. Accordingly, the Board's main extension rules set forth in N.J.A.C. 14:3-8, and specifically N.J.A.C. 14:3-8.5 and 8.6, should be amended to clarify this policy and ensure that water and wastewater utilities are treated the same as electric and gas utilities with respect to the opportunity to reflect their federal income tax liability in the CIAC they receive.

Respectfully submitted,



Jay L. Kooper
Vice President, General Counsel & Secretary
Middlesex Water Company

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ARNSTEIN
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August 1, 2019

*Via overnight delivery &
Electronic mail*
Aida.camacho@bpu.nj.gov
Board.secretary@bpu.nj.gov

Hon. Aida Camacho-Welch, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 3rd Floor, Suite 314
P.O. Box 350
Trenton, New Jersey 08625-0350

Re: I/M/O the Proposed Amendment of *N.J.A.C.* 14:3-8 to Consider the Impact of the
Tax Cuts and Jobs Act of 2017 on Main Extensions
BPU Docket No. AX19050615

Dear Secretary Camacho-Welch:

On behalf of Aqua New Jersey, Inc. (“Aqua” or the “Company”), enclosed for filing please find an original and two copies of the Company’s comments regarding amendments to *N.J.A.C.* 14:3-8.1 *et seq.*, the regulations governing extensions of facilities to provide regulated utility services (the “Main Extension Rules”). Aqua appreciates this opportunity to provide its views to the Board of Public Utilities (the “Board”), and the efforts of Board Staff to ensure that the Main Extension Rules accurately reflect the tax treatment of contributions made to extend public utility facilities.

As the Board is well aware, the Tax Cuts and Jobs Act of 2017 (the “TCJA”) amended the federal income tax code resulting in a number of changes to the taxation of public utilities. Of particular importance to water and wastewater public utilities was the elimination of the tax exemption on Contributions in Aid of Construction (“CIAC”) paid to public utilities by customers seeking water and sewer main extensions. Previously, CIAC paid to water and sewer utilities was tax exempt for federal income tax purposes. Because of that tax exemption, CIAC for water and sewer main extensions was not “grossed up” to include the tax consequences to the

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DELAWARE FLORIDA ILLINOIS MARYLAND MASSACHUSETTS MINNESOTA NEW JERSEY NEW YORK PENNSYLVANIA WASHINGTON, DC

utility of the CIAC payment.¹ The TCJA, however, has now conclusively eliminated the tax exemption for CIAC on water and sewer main extensions, and this fact should be reflected in the Main Extension Rules. Thus, the Main Extension Rules should be revised to make it clear that customers requesting water and sewer main extensions must be responsible for the tax consequences of those extensions, and CIAC should be calculated in a manner that accounts for those tax consequences. To that end, Aqua supports inclusion in revised Main Extension Rules of a “gross up factor” template—an approach the Board employed for electric and gas utilities in *N.J.A.C. 14:3-8.6(c)(3)*. Aqua has reviewed that template and supports its use.

Finally, Aqua believes there would be some value in continuing the working group initiated by Staff to discuss the detailed changes required to ensure the Main Extension Rules are consistent with the TCJA. The Company believes continuing the current collaborative process will result in clear and well-crafted draft regulations that can be adopted pursuant to the Administrative Procedure Act, *N.J.S.A. 52:14B-1 et seq.* Aqua looks forward to continuing to work with Board Staff and interested parties on this important endeavor.

Respectfully submitted,



Colleen A. Foley, Esq.

Cc: Mike Kammer

¹ Interestingly, CIAC paid to electric and/or gas utilities for the extension of electric or natural gas facilities is taxable and has been for many years. *N.J.A.C. 14:3-8.6* sets out the process to be used to “gross up” CIAC for electric and gas extensions.

THE ATLANTIC CITY SEWERAGE COMPANY

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August 2, 2019

Aida Camacho-Welch, Secretary
State of New Jersey
Board of Public Utilities
44 South Clinton Avenue
P.O. Box 350
Trenton, NJ 08625

**In the Matter of the Proposed Amendment to N.J.A.C. 14:9 Wastewater (Sewer) System
Improvement Charge – Docket No. WX19050614**

The Atlantic City Sewerage Company (ACSC) would first like to thank the Board and its Staff for the opportunity to participate in the stakeholder meeting to discuss thoughts about the BPU's rules regarding water and wastewater set forth in the New Jersey Administrative Code as they pertain to a potential Wastewater (Sewer) System Improvement Charge (WSIC).

ACSC fully supports such a review and examination and looks forward to the opportunity to one day participate in, and benefit from, such a regulatory initiative. As I commented at the stakeholder meeting, ACSC's current financial resources are fully committed [to projects approved under our latest NJEDA financing]; however, it is our hope that a WSIC program will be in place when the company is better positioned to utilize it.

We look forward to working with the Board, its Staff, Rate Counsel, and all other stakeholders in this process.

Respectfully,



Thomas S. Kavanaugh
President & General Manager
The Atlantic City Sewerage Company

CC: Carl Cordek
Stephen Genzer



Christine Soares, Corporate Counsel P 856.955.4879
christine.soares@amwater.com
One Water Street
Camden, NJ 08102

August 2, 2019

Via Email

Aida Camacho-Welch, Secretary
New Jersey Board of Public Utilities
ATTN: BPU Docket No. AX19050615
44 South Clinton Avenue, 3rd Floor, Suite 314
Trenton, New Jersey 08625-0350

Re: I/M/O the Proposed Amendment to N.J.A.C. 14:3-8 to Consider the Impact of the Tax Cuts and Jobs Act of 2017 on Main Extensions – Docket No. AX19050615

Dear Secretary Camacho-Welch:

New Jersey-American Water Company, Inc. ("New Jersey-American Water") welcomes the opportunity to provide comments to the proposed modifications to the main extension rules of the New Jersey Board of Public Utilities ("BPU") as they pertain to the Federal Tax Cuts and Jobs Act of 2017 ("TCJA").

Background

The Tax Reform Act of 1986 ("TRA-86") made contributions in aid of construction and customer advances for construction (collectively, "Contributions and Advances") taxable income for utilities that receive such payments; however, for water companies this required tax was repealed in 1996 following enactment of the Small Business Jobs Protection Act.

The TCJA changed the federal income tax law to make Contributions and Advances taxable income to water and wastewater utilities. As a consequence, water and wastewater utilities now incur, and must pay, federal income tax on such payments as well as the value of in-kind contributions of water and wastewater assets in the year they are received.

By making Contributions and Advances taxable income to water and wastewater utilities, the TCJA has increased the overall cost of connecting new customers to a water or wastewater system.¹ New Jersey-American Water requests that when the BPU considers implementing a template for calculating the tax related to Contributions and Advances that the BPU analyze a second, alternative approach whereby the Company assumes the tax liability for the receipt of Contributions and Advances. This second alternative balances the costs of adding the tax liability by adding new customers to the system with the benefits to existing customers.

¹ Customers of municipal or other public water or wastewater utilities are not subject to the incremental increased cost related to the TCJA.

The Current Template

After TRA-86 was enacted, the BPU passed regulations related to the tax on Contributions and Advances and implemented a template for electric and gas utilities to use in calculating the Federal income tax related to Contributions and Advances (the "Current Template"). The Current Template allows those electric and gas utilities to use the present-value gross-up method. Under the present-value gross-up method, the amount paid by the contributor/developer is the utility's tax on the Contributions and Advances minus the present value of the future tax depreciation benefits.

The No-Gross-Up Method

New Jersey-American Water proposes that the Board consider a no-gross-up method, whereby the utility finances the tax cost over the life of the asset, as an alternative to the Current Template. The cost to become a new customer would be less under a no-gross-up method. In essence, the tax paid by the utility would be recorded as a tax asset, would reduce accumulated deferred income taxes, and would reverse over the depreciable life of the asset funded by the Contribution or Advance. The time value associated with the lag between the utility's payment of income taxes on Contributions and Advances and future recovery of those amounts through depreciation deductions is recognized by the increase in rate base that results from treating the deferred amount as a deferred tax asset that offsets ADIT. The IRS's regulations require the tax-book timing difference to be normalized by reflecting the deferred amount in rate base. Several other states have permitted the no-gross up method whether through commission order or legislation, including Pennsylvania, New York, Missouri and Kentucky.²

New Jersey-American Water believes that in addition to reducing the cost of adding a new customer to the system, the no-gross-up method provides a net benefit to existing customers because as customers are added, utility expenses will be spread over the larger customer base.

To that point, New Jersey-American Water has conducted an analysis, attached hereto, showing that even if Contributions and Advances of up to \$19,410 are paid by the utility to add a new water customer to the system, the new customer is providing a net benefit to existing customers. As shown on the attachment, a new average residential water customer provides net revenue sufficient to fund \$5,766 in rate base. New Jersey-American Water's investment in the new plant needed to add that new customer would be \$2,045. The net benefit to New Jersey-American Water and its existing customers is \$4,076, which includes the effect of the depreciation deductions on the new plant funded by the Contribution or Advance. Based on that amount, New Jersey-American Water and its existing customers could receive up to \$19,410 in contributed property, absorb the income taxes on that amount and still break-even. Any contribution less than that amount is a net benefit to New Jersey-American Water and its existing customers because existing fixed costs are spread over a larger customer base, and the new customers are paying a level of fixed costs that exceed the amount of rate base installed to serve them. For wastewater customers, the benefit is even larger because New Jersey-American Water does not fund any portion of the facility extension for new applicants.

Additional Public Policy Implications

Public policy concerns also favor an alternative to the present-value gross-up method. As discussed above, the no-gross-up method decreases the cost of connecting new customers to a water or wastewater system while any gross-up method increases it. Board policies that increase the cost of connecting to such systems could make alternatives to public water and wastewater, such as individual on-lot wells, septic systems or small water/wastewater systems more attractive to potential customers. The Board has recognized in the

² See *Pa. HB 751; Proceeding on Motion of the Commission on Changes in Law that May Affect Rates*, Case No. 17-M-0815 (N.Y.P.S.C. Order, Aug. 9, 2018), pp. 32-33; *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates*, Case No. 2018-00358 (K.Y.P.S.C. Order, Nov. 28, 2019), pp. 13-14; and *In the Matter of the Proposed Missouri-American Water Company 2nd Revised Tariff Sheet No. R 65*, File No. WT-2019-0054 (Dec. 5, 2018).

Aida Camacho-Welch, Secretary
August 2, 2019
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past that consolidation of water and wastewater systems is in the public interest. New Jersey-American Water requests that the Board consider this policy implication in determining whether to provide an alternative approach to the Current Template.

In closing, New Jersey-American Water recognizes that its proposed method requires water and wastewater utilities to pay the federal income tax on Contributions and Advances upfront, which could have an adverse impact on its finances or customers. For that reason, New Jersey-American Water suggests that the no-gross-up method be made available as an alternative method of paying the tax on Contributions and Advances under the TCJA.

Thank you for your consideration.

Respectfully submitted,

A handwritten signature in blue ink that reads "Christine Soares". The signature is written in a cursive, flowing style.

Christine Soares
Corporate Counsel

New Jersey American Water Company
 Taxable CIAC and CAC
 Average Residential Water Customer Analysis

Exhibit A

<u>Line No.</u>				
1	Annual Revenue Per Customer *			\$ 676.08
2	Less: Production Costs (\$0.87 / 1,000 Gallons)			<u>\$ 62.55</u>
3	Annual Revenue less Production Costs (Line 1 - Line 2)			\$ 613.53
4	Divided by Pre-Tax ROR + Depreciation	Pre-Tax ROR	8.84%	
		Depreciation	<u>1.80%</u>	
				10.64%
5	Rate Base Funded by New Customer			\$5,766
6	Company Investment, Including Taxes Funded by Company (Line 7 + Line 8)			
7	2.5 Times Average Annual Revenues (Line 1 x 2.5)			\$1,690
8	Income Tax Funded by Company (Line 7 x 21.00%)	Tax Rate	21.00%	\$355
9	Company Investment, Including Taxes Funded by Company (Line 7 + Line 8)			\$2,045
10	Incremental Rate Base Benefit of New Customer (Line 5 - Line 9)			\$3,721
11	Reversal of Income Tax Funded by Company			\$355
12	Total Incremental Rate Base Benefit of New Customer (Line 10 + Line 11)			\$4,076
13	Additional Taxable CIAC / CAC Funded by New Customer (Line 12 / 21.00%)			\$19,410
14	Tax on Additional Taxable CIAC / CAC (Line 13 x 28.89%)	Tax Rate	21.00%	\$4,076

* Based upon rates effective 10/29/18 as authorized in most recent general rate case.