

PUBLIC SERVICE COMMISSION OF WISCONSIN

INVESTIGATION INTO MUNICIPAL UTILITY PAYMENT IN LIEU OF TAXES (PILOT)

Staff Report

Docket 5-GF-215

September 28, 2012

Introduction

Municipally owned water and electric utilities in Wisconsin are subject to a payment in lieu of local general property taxes, or PILOT. In contrast, investor-owned utilities pay a gross receipts tax. For rate-making purposes, the Commission makes an allowance for PILOT as a component of a utility's total revenue requirements. Over time, the PILOT payments have become a substantial portion of the revenue requirements for municipal water utilities.

Commission staff and others have raised concerns about the PILOT payment's impact on utility costs and rates, primarily with respect to municipal water utilities. On January 25, 2012, the Commission opened an investigation on the PILOT calculation for municipal utilities and directed staff to investigate the following issues:

1. The statutory authority for municipalities to collect a PILOT from municipal utilities;
2. The Commission's procedures for calculating the PILOT amount;
3. Whether municipalities distribute PILOT revenues to other local taxing jurisdictions, including school districts;
4. The amount that municipal water and electric utilities paid in lieu of taxes in calendar years 2010 and 2011;
5. The percentage of municipal utility revenue requirements attributable to PILOT in 2010 and 2011;
6. An estimate of the amount that would have been paid as a gross receipts tax, had such a tax been in place, for municipal water and electric utilities in 2010 and 2011;

7. The number of utilities that paid less in PILOT to their municipality than the maximum authorized amount for 2010 and 2011;
8. The statutory exemption from PILOT for sewer utilities and town sanitary districts, and;
9. The capital intensity of municipal water and electric utilities in Wisconsin.

Issue 1: Statutory Authority for PILOT

In estimating a municipally owned water utility's operating expenses for rate-making purposes, the Commission has made an allowance for local taxes since 1918. See *Re Edgerton*, 1918B PUR 724 (December 31, 1917). See also *Re City of Milwaukee*, 1927B PUR 229 (December 9, 1926). In 1937, the Legislature codified the Commission's practice by amending Wis. Stat. § 66.06(11)(c), to include local and school tax equivalents among the valid expenses of a municipally owned utility that is tax exempt:

"The income of a public utility owned by a municipality shall first be used to meet operation, maintenance, depreciation, interest, and sinking-fund requirements, *local and school tax equivalents*, additions and improvements, and other necessary disbursements or indebtedness ..." (Emphasis added.)

Issue 2: Commission Procedures for Calculating PILOT

In 1955, the Commission established a rule for determining the tax equivalent for municipal utilities. *Re Tax Equivalent for Municipal Utilities*, Docket No. 2-U-4447 (July 11, 1955). In *Re Tax Equivalent*, the Commission adopted Wis. Admin. Code ch. PSC 125, providing in part:

PSC 125.01. Electric and/or water utilities; computing tax equivalent.
An acceptable 'tax equivalent' for all municipal electric and/or water utilities may be determined by either of the following methods:

(1) Apply the local and school tax rate to the gross book value of plant plus materials and supplies multiplied by the ratio of assessed value to full value as found by the Wisconsin Department of Taxation for the community involved; or

(2) Apply the local and school tax rate to the net book value of plant plus materials and supplies.

The Commission adopted ch. PSC 125, and later ch. PSC 109, which superseded ch. PSC 125, to govern calculation of the tax equivalent. By 1985, however, property taxes for privately owned utilities were replaced with a gross receipts tax.

PSC regulations establish a formula for the maximum allowable PILOT charge in Wis. Admin. Code § PSC 109.02 which provides:

PSC 109.02. Municipal utilities; computing tax equivalent. The maximum “tax equivalent” for any municipal utility (except a sewer utility) shall be determined by applying the local and school tax rates for the calendar year to the gross book value for the calendar year of plant plus materials and supplies multiplied by the assessment ratio for the municipality involved.

These regulations also give authority to the Commission to establish a charge in excess of the maximum allowable:

PSC 109.03. Municipal utilities; higher tax equivalent. If a tax equivalent greater than that obtained by the method in s. PSC 109.02 is desired, the written approval of the commission must be obtained.

In 1994, the Commission opened a docket to consider changes to Wis. Admin. Code ch. PSC 109 “[i]n order to return the tax equivalent to its original purpose of achieving rough equivalence with privately-owned utilities.” *Revisions of Chapter PSC 109, Tax Equivalent for Municipal Utilities*, Docket 1-AC-145, 1995 WL 867887 (Sept. 15, 1995). Because ch. PSC 109 remained unchanged since 1985 when property taxes for privately-owned utilities were replaced with the gross receipts tax, the tax equivalent under ch. PSC

109 substantially exceeded what would be calculated under the gross receipts tax. *Id.* “For some municipal utilities, the tax equivalent now comprises a substantial portion of the revenue requirement.” *Id.*

In 1995, the Legislature established a minimum PILOT payment because utilities’ tax equivalents were expected to decrease as a result of property tax relief provisions in 1995 Wis. Act 27. See COMPARATIVE SUMMARY OF BUDGET PROVISIONS ENACTED AS 1995 ACTS 27 AND 113, at 945 (WI Legislative Fiscal Bureau, 1995). Act 27 amended Wis. Stat. § 66.069(1)(c) (previously § 66.06(11)(c)), adding that “[b]eginning with taxes levied in 1995, payable in 1996, payments for local and school tax equivalents shall at least be equal to the payment made on the property for taxes levied in 1994, payable in 1995, unless a lower payment is authorized by the governing body of the municipality.” 1995 Wis. Act 27, § 3316m. Later, 1999 Wis. Act 150 renumbered Wis. Stat. § 66.069(1)(c) as § 66.0811(2).

All calculations of PILOT are based on the gross book value of total utility plant, which includes plant that is contributed by outside sources. The gross book value is calculated using the original cost of a utility’s investment in plant.

Issue 3: Municipalities’ Distribution of PILOT Revenues to Other Local Taxing Jurisdictions

The formula used to compute the maximum PILOT for municipal utilities is found in Wis. Admin. Code § PSC 109.02. This formula includes both a local and school tax component. The Commission expressed an interest in determining whether municipalities receiving PILOT revenues shared these revenues with the local school districts. Staff was unable to discover any instances of PILOT revenue sharing through conversations with interveners and other stakeholders. In general, staff found that revenues collected through

PILOT remain within the municipalities and are not distributed to school districts or to the other taxing jurisdictions included in the PILOT calculation. However, a more detailed analysis could reveal one or two exceptions to this general practice.

Issue 4: Amount of PILOT Paid

Municipal water utilities made PILOT payments totaling \$87.4 million in 2010 and \$92.9 million in 2011. During the same time period, municipal electric utilities made PILOT payments totaling \$18.4 million and \$19.3 million, respectively. Table 1 provides detailed PILOT amounts by utility class.

**TABLE 1
Total PILOT Amount Paid**

Utility Type	2010		2011	
	<u>Amount</u>	<u>No. of Utilities</u>	<u>Amount</u>	<u>No. of Utilities</u>
<u>Water</u>				
Class AB	\$62,916,059	96	\$67,137,268	97
Class C	16,898,934	139	17,765,683	138
Class D	<u>7,549,271</u>	<u>274</u>	<u>7,954,143</u>	<u>276</u>
Total	\$87,364,264	509	\$92,857,094	511
<u>Electric</u>				
Class AB	\$13,831,927	32	\$14,549,677	32
Class C	4,531,082	49	4,700,368	49
Class D	<u>11,025</u>	<u>1</u>	<u>11,025</u>	<u>1</u>
Total	\$18,374,034	82	\$19,261,070	82

Issue 5: Percentage of Total Revenue Requirements the PILOT Payment Represents

Table 2 displays the authorized PILOT as a percentage of the revenue requirement for municipal utilities, by class. Water utilities' PILOT payments amounted to, on average, 14.9 percent of the total revenue requirement in 2010 and 14.8 percent in 2011. This means that, on average, for every \$100 a municipal water utility customer is billed, roughly \$15 is transferred to the municipality to help pay for other local government services and programs. Ironton Water Utility in Sauk County paid the largest PILOT, by percentage, at approximately 66 percent of its total revenue requirement in both 2010 and 2011. At the other end of the range were those water utilities authorized by their municipalities to pay no PILOT, with 57 water utilities so authorized in 2010 and 62 in 2011, as shown in Table 3.

In contrast, municipal electric utilities' PILOT payments averaged 2.6 percent of their total revenue requirement in both 2010 and 2011. The maximum percentage paid was 7.0 percent in 2010 and 6.3 percent in 2011, with 1 municipal electric utility authorized to pay no PILOT in both years.

Detailed summaries of PILOT payments for each municipal water and electric utility in 2010 and 2011 are included as Appendices 1 and 2 (water) and 3 and 4 (electric).

TABLE 2
PILOT as Percentage of Total Revenue Requirement
 (All Numbers in %)

Utility Type	2010				2011			
<u>Water</u>	<u>Avg.</u>	<u>Min.</u>	<u>Max.</u>	<u>Median</u>	<u>Avg.</u>	<u>Min.</u>	<u>Max.</u>	<u>Median</u>
Class AB	14.5	0.0	27.9	15.2	14.3	0.0	27.9	15.0
Class C	16.2	0.0	33.1	16.9	16.7	0.0	43.5	17.2
Class D	15.2	0.0	65.6	16.4	16.0	0.0	66.2	16.5
All Utilities	14.9	0.0	65.6	16.2	14.8	0.0	66.2	16.3
<u>Electric</u>	<u>Avg.</u>	<u>Min.</u>	<u>Max.</u>	<u>Median</u>	<u>Avg.</u>	<u>Min.</u>	<u>Max.</u>	<u>Median</u>
Class AB	2.5	1.2	5.2	2.5	2.6	1.3	4.9	2.7
Class C	2.7	0.0	7.0	2.5	2.7	0.0	6.3	2.6
Class D	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
All Utilities	2.6	0.0	7.0	2.5	2.6	0.0	6.3	2.6

TABLE 3
Number of Utilities Authorized to Pay \$0 in PILOT

Utility Type	2010	2011
<u>Water</u>		
Class AB	1	1
Class C	3	3
Class D	<u>54</u>	<u>59</u>
All Utilities	57	62
<u>Electric</u>		
Class AB	0	0
Class C	1	1
Class D	<u>0</u>	<u>0</u>
All Utilities	1	1

Issue 6: Gross Receipts Tax Calculation

If municipally owned water and electric utilities were assessed taxes in the same manner as privately-owned utilities, they would pay a 3.19 percent gross receipts tax, as outlined in Wisconsin Stat. § 76.28(2)(c)2. The gross receipts tax is collected by the State, while PILOT is collected and retained locally. Table 4 examines what the gross receipts tax would have been in 2010 and 2011 for municipal utilities. To be consistent with the tax calculation method applied to privately-owned utilities, the revenues used to calculate the gross receipts tax exclude interdepartmental sales, interdepartmental rents, and deductions from sales and use taxes.

TABLE 4
Equivalent Gross Receipts Tax
(3.19% of Revenues)

Utility Type	2010	2011
<u>Water</u>		
Class AB	\$13,048,574	\$14,150,361
Class C	3,301,426	3,383,024
Class D	<u>1,573,737</u>	<u>1,585,895</u>
Total	\$17,923,738	\$19,119,280
<u>Electric</u>		
Class AB	\$17,334,681	\$17,952,251
Class C	5,291,255	5,593,502
Class D	<u>11,881</u>	<u>11,841</u>
Total	\$22,637,817	\$23,557,594

Had the gross receipts tax been in place, water utilities would have paid \$17.9 million in 2010 and \$19.1 million in 2011. In other words, municipal water ratepayers would have paid between \$69.4 million and \$73.7 million less had the municipal water

utilities paid taxes in the same manner as privately-owned utilities. In contrast, municipal electric customers would have paid approximately \$4.3 million more in both 2010 and 2011 had a gross receipts tax been in place.

Issue 7: Number of Municipal Utilities with PILOT Payments Lower Than the Maximum Authorized Amount

Wisconsin Stat. § 66.0811(2) provides a statutory formula for determining the minimum allowable amount of the PILOT. This statute does not explicitly identify who has the authority to set the minimum PILOT and does not contain any reference to the Commission's authority to review or adjust this amount. It does, however give explicit authority to the governing body of the municipality to set an amount lower than the statutory minimum. In *Revisions of Chapter PSC 109*, the Commission observed:

- The statutory change essentially provides the governing body of a municipality which owns a public utility the discretion as to the appropriate level of tax equivalent.
- This statutory language allows the municipality to 'freeze' the tax equivalent payment at the 1994 level. In application, future tax equivalents could be at the prior year's level, the level of the 1994 base amount or an amount equal to the current calculation under ch. PSC 109, Wis. Adm. Code. The choice is up to the municipality.
- Pursuant to s. 66.069(1)(c), Wis. Stats., the determination of the level of the municipal tax equivalent is the responsibility of the local municipal officials. Utility personnel will need to work with their municipal officials in establishing an appropriate level of tax equivalent for their situation. The utility will be responsible to report this dollar amount in the filing of all its financial statements, rate case applications and other miscellaneous reporting requirements before the Commission.

Table 5 displays the number of municipal utilities that received authorization to pay less than the maximum authorized amount of PILOT in 2010 and 2011. In

both years, approximately 23 percent of the municipal water utilities had a lower PILOT authorized, resulting in a reduction in total payments of \$5.8 million in 2010 and \$5.9 million in 2011. In 2010, four municipal electric utilities paid \$78,262 less than the calculated PILOT amount. In 2011, seven utilities paid \$123,987 less than the calculated PILOT amount. Table 5 includes those utilities that paid no PILOT in 2010 and 2011.

TABLE 5
Utilities With Lower Tax Equivalent Authorized

Utility Type	2010			2011		
	<u>Number</u>	<u>%</u>	<u>Difference</u>	<u>Number</u>	<u>%</u>	<u>Difference</u>
<u>Water</u>						
Class A/B	12	12.5	\$2,130,997	15	15.5	\$2,345,364
Class C	18	12.9	1,562,784	14	10.1	1,171,205
Class D	<u>86</u>	31.4	<u>2,113,161</u>	<u>89</u>	32.2	<u>2,359,788</u>
All Utilities	116	22.8	\$5,806,942	118	23.1	\$5,876,357
<u>Electric</u>						
Class A/B	1	3.1	\$24,337	3	9.4	\$65,909
Class C	3	6.1	53,925	4	8.2	58,078
Class D	<u>0</u>	0.0	<u>0</u>	<u>0</u>	0.0	<u>0</u>
All Utilities	4	4.9	\$78,262	7	8.5	\$123,987

Issue #8: Exemption From PILOT for Sewer Utilities and Sanitary Sewer Districts

Municipal sewer utilities are exempt from PILOT under Wis. Admin. Code § PSC 109.05, and town sanitary districts that own and operate water utilities are exempt under Wis. Admin. Code § PSC 109.06. Municipal sewer utilities are not subject to Commission jurisdiction, as the definition of a 'public utility' under Wis. Stat. § 196.01(5)(a)1. does not include a governmental unit, "who furnishes services by means of a sewerage system either directly or indirectly to or for the public." A combined water-sewer sanitary district may by ordinance be considered a single public utility subject to PSC jurisdiction under Wis. Stat. § 66.0819(2). However, the PSC is required to treat the water and sewer systems separately in terms of rates, accounting, extension rules, service standards or other regulations, unless the Commission finds that the public interest requires otherwise.

Issue #9: Capital Intensity of Municipal Water and Electric Utilities

In general, the municipal water industry is far more capital-intensive than the municipal electric industry. As a measure of capital intensity, Table 6 examines the dollars invested in gross utility plant for every dollar of gross utility revenue. For the 2010 and 2011 reporting years, water utilities had between \$2.76 and \$152.25 invested in plant for every dollar in revenue, with a median of \$10.66 invested per dollar of revenue. In contrast, the electric utility amounts ranged between \$0.62 and \$4.02, with a median of \$1.58 invested for every dollar in revenue.

TABLE 6
\$ Gross Plant per \$ Gross Revenues

Utility Type	2010				2011			
	<u>Avg.</u>	<u>Min.</u>	<u>Max.</u>	<u>Median</u>	<u>Avg.</u>	<u>Min.</u>	<u>Max.</u>	<u>Median</u>
Water								
Class A/B	\$9.16	\$3.69	\$17.00	\$9.22	\$8.80	\$3.52	\$16.63	\$9.22
Class C	10.82	2.76	21.11	10.23	10.66	2.98	21.13	10.22
Class D	11.79	3.35	152.25	11.76	12.40	0.00	147.85	11.86
All Utilities	\$9.67	\$2.76	\$152.25	\$10.62	\$9.40	\$0.00	\$147.85	\$10.71
Electric								
Class A/B	\$1.67	\$0.63	\$3.25	\$1.52	\$1.67	\$0.62	\$2.87	\$1.61
Class C	1.63	0.64	3.81	1.52	1.60	0.64	4.02	1.47
Class D	1.86	1.86	1.86	1.86	1.87	1.87	1.87	1.87
All Utilities	\$1.66	\$0.63	\$3.81	\$1.54	\$1.65	\$0.62	\$4.02	\$1.61

Conclusion

The cost of PILOT payments is passed on to ratepayers in the form of higher rates. PILOT payments can be a significant component of a municipal water utility's revenue requirement, meaning a large portion of a customer's water bill is actually being paid to support local government operations, not for water consumption. In contrast, PILOT is a much smaller component of the revenue requirement for municipal electric utilities. Because water utilities are capital-intensive, the current method for calculating PILOT may be a disincentive to replacing aging infrastructure and making improvements necessary to ensure adequate service and protect public health. In addition, while the original purpose of providing for a tax equivalent was to ensure that municipal utilities were treated on par with privately owned utilities that paid a property tax, property taxes for privately owned utilities were replaced with a gross receipts tax in 1985. As shown by this analysis, PILOT payments for

most municipal water systems exceed the amount that they would otherwise pay as a gross receipts tax.

DRAFT