



March 2, 2015

VIA ELECTRONIC FILING

Honorable Kathleen Burgess, Secretary
New York State Public Service Commission
3 Empire State Plaza, 19th Floor
Albany, New York 12223

Re: Case 13-W-0295 – Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of United Water New York Inc. for Water Service

Dear Secretary Burgess:

Ordering Paragraph 9 of the New York State Public Service Commission's ("Commission") Order Establishing Rates issued in Case 13-W-0295 ("Rate Order") directs United Water New York Inc. ("UWNY" or "Company") to "file a report, no later than 60 days after adoption of the rules and regulations implementing the tax law changes discussed in the body of the order. The report shall quantify any resulting excess deferred taxes and explain whether it qualifies as a New York Manufacturer and if so provide a quantification of the projected impact on the revenue requirement in this case. The Commission will institute a proceeding to determine whether reduced cost for New York income taxes and Metropolitan Transportation Authority Business Tax Surcharges should be permanently reflected in rates and whether any excess deferred taxes should be returned to ratepayers."¹

Pursuant to Ordering Paragraph 9, the Company, through this letter and appendix, hereby reports on its status as a Qualified New York Manufacturer ("QNYM") and provides the resultant impact on the revenue requirement in the above-referenced case. As set forth below, the Company has asserted that it is a QNYM, effective January 1, 2014.²

¹ Case 13-W-0295 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of United Water New York Inc. for Water Service, Order Establishing Rates (June 26, 2014).

² The Company has made estimated payments for 2014 as if the QNYM did not apply to the Company. While the Company has asserted it has such status, the Company's assertion may be subject to challenge by the relevant governmental authorities.

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QNYM status also extends to the United Water Westchester Inc., and United Water Owego Nichols Inc.

Background

Beginning in taxable years starting on or after January 1, 2014, QNYMs are eligible for a 0% Corporation Franchise Tax rate on their “business income base.” N.Y. Tax Law § 210 (McKinney). The Tax Law defines “manufacturer” broadly to include any taxpayer that is *principally engaged* in the “production of goods by manufacturing, process, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing.” *Id.* The law specifically excludes the distribution of natural gas, electricity and production of steam for electricity from qualifying as manufacturing activities. *Id.* The law does not, however, exclude the production of public water.

To be “principally engaged” in the manufacture of goods, at least 50% of the taxpayer or combined group’s gross receipts must be from the sale of goods produced by the manufacturing activities described above. *Id.* The law also requires that all the manufacturer’s real and personal property must be located in New York. *Id.* Furthermore the property must be principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture or commercial fishing. *Id.*

Discussion

A. Determination of Status

United Water’s New York operating utilities, including UWNY, are principally engaged in the sale of clean potable water through a production process designed to refine surface/ground water into a usable public water supply that meets federal and state regulatory health standards. United Water uses equipment to process raw material (ground/surface water) into potable water that is safe for household use. The equipment and property discussed above is used in the production of a public water supply are located in New York State. In addition, all of the receipts of United Water’s New York operating utilities are from the sale of the processed public water supply and more than 50% of the group’s receipts are from the sale of the processed public water supply. Based on the foregoing, United Water believes and has asserted that it’s New York operating utilities are QNYMs.

In order to receive a more definitive answer as to whether United Water’s New York operating utilities are QNYMs, Ernst & Young, a public accounting firm, requested, on United Water’s behalf, a private letter ruling from the New York State Department of Taxation and Finance (“NYDTF”). In response to this request, the NYDTF, in December 2014, verbally

agreed that United Water would be considered a QNYM and therefore would be entitled to the manufacturing exemption delineated in the New York tax reform (see N.Y. Tax Law § 210 (McKinney)). The Company understands that the NYSDT has received numerous such requests and will soon provide additional general guidance which will further clarify this issue. Since the effective date of the QNYM exemption is January 1, 2014, the impact of the QNYM exemption will be reflected in the Company's 2014 year-end financial statements.

B. Key Points Arising From QNYM Status

Listed below are key points regarding QNYM status:

1. The effective date for the QNYM qualification – January 1, 2014.
2. The New York State income tax rate to apply to New York State taxable income is 0% for QYNM entities.
3. The New York State Alternative Minimum Tax (“AMT”) rate of 1.36% applies to 2014 taxable income as well as the applicable New York Metropolitan Transportation Authority (“MTA”) tax calculated based upon on the AMT amount.
4. The Company is subject to the New York State Capital Tax of \$350,000.

C. Impact of Property Tax Credit

The Company's property taxes will not be reduced directly as a result of the QNYM legislation. A property tax credit of up to 20% of the amount of property taxes paid on manufacturing property may be utilized to offset other state income taxes paid, including any applicable MTA tax, AMT, or Capital Tax but is not a refundable credit. The property tax credit specifically relates only to real property taxes paid on assets which are utilized for manufacturing.

D. Accounting and Ratemaking Results

As a result of its determination that it has QNYM status, the Company has reviewed its books and records and, as of December 31, 2014, has reclassified New York State deferred income taxes to a regulatory liability with the expectation that the Commission will commence a proceeding as indicated above. The amount of that liability is approximately \$5.7 million for UWNY as of December 31, 2014. In addition, the Company has recorded a deferred tax asset in the amount of approximately \$2.0 million for the Company which represents the federal income tax applicable to the liability.

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Until such time as the Company's tariff rates are changed to reflect the QNYM status (application of the 0% state income tax rate), the Company will continue to increase the regulatory liability held for the benefit of customers.

As shown in the attachment to this letter, the Company has determined that, as a result of its QNYM status, the revenue requirement in the above-referenced case would decrease by approximately \$1.3 million per year, provided that the full impacts of the change in income tax rate, AMT, MTA, and Capital Tax are realized and the existing regulatory liability is eliminated.³ The exact amount of the change in revenue requirement is interdependent with the determination of the ratemaking treatment of the current regulatory liability.

As described in the Order, the Commission will institute a proceeding to determine whether reduced cost for New York income taxes and Metropolitan Transportation Authority Business Tax Surcharges should be permanently reflected in rates and whether any excess deferred taxes should be returned to ratepayers.

The Company believes that the reduction in state income taxes based on the Company's QNYM should be reflected in the ongoing rates of the Company. The excess deferred taxes, now held as a regulatory liability should also be returned to ratepayers. To that effect, the Company believes there are three primary treatments which could be adopted. The first would address the regulatory liability within the Company's next rate filing. The second would establish a sur-credit for the benefit of ratepayers. The third would net the resulting QNYM regulatory liability with other existing regulatory assets which have arisen from the Company's revenue and cost reconciliation mechanisms, thereby resulting in an overall reduction of the existing surcharge percentages. It is the Company's belief that the third option is the most logical and potentially provides a more immediate benefit to customers.

Should you have any questions about this filing, please contact me.

Respectfully submitted,



Brian T. FitzGerald

Enclosure
cc: DMM Party List (via e-mail)
Honorable David Van Ort (via e-mail)
Honorable Rafael Epstein (via e-mail)

³ The Company has established the above-mentioned regulatory liability in reliance on the Rate Order and with the expectation that the Commission will approve such accounting treatment.

United Water New York Inc.
 Computation of the Revenue Requirement
 Impact of QNYM Status

Line No.	Description	Commission Order Revenue Requirement	Adjustment for State Income Taxes and SADIT	Adjusted Revenue Requirement Calculation
	Total Operating Revenue	84,621,397	(1,290,000)	83,331,397
	Operating & Maintenance Expense	27,613,000	(7,278)	27,605,721
	Depreciation Expense	9,207,114		9,207,114
	Taxes Other Than Income Taxes	21,791,321	(4,644)	21,786,677
	Total Operating Expenses	58,611,435	(11,922)	58,599,512
	Operating Income Before Income Taxes	26,009,963	(1,278,078)	24,731,885
	State Income Taxes	1,579,713	(1,579,713)	-
	Federal Income Taxes	5,262,799	66,313	5,329,112
	Net Income Available for Return	19,167,451	235,322	19,402,772
	Rate Base	278,444,414	3,758,971	282,203,385
	Rate of Return	6.88%		6.88%