HOUSE BILL 344:
System Development Fees Update.

2021-2022 General Assembly

Committee:		**Date:**	February 14, 2022
Introduced by:		**Prepared by:**	Trina Griffin
Analysis of:	S.L. 2021-76		Staff Attorney

OVERVIEW: S.L. 2021-76 does the following:

- ***Clarifies certain minimum standards incorporated into the generally accepted accounting, engineering, and planning methodologies used to calculate system development fees imposed by local governments for public water and sewer systems.***
- ***Provides that the system development fee also applies to service provided under a wholesale arrangement between a water and sewer authority and a local governmental unit.***
- ***Provides that water and wastewater public utilities are solely responsible for funding the income taxes due on taxable contributions made to the utility by a developer and that the taxes be recovered through the rate base over the life of the asset.***

This act became effective July 2, 2021.

CURRENT LAW & BILL ANALYSIS:

SYSTEM DEVELOPMENT FEES UPDATE

Sections 1-3 of the act concern the methodology that a local government must use to calculate system development fees that it may charge to developers to help fund water and sewer infrastructure necessitated by a new development.

CURRENT LAW: A local governmental unit[1] may impose a system development fee on the owner of a new development within its territorial jurisdiction to fund the cost of water and sewer infrastructure necessitated by the new development, to recoup the costs of existing facilities serving the new development, or a combination of the two. A new development is defined as (1) the subdivision of land; (2) construction, or any change to an existing structure, that causes an increase in the need for service; or (3) any use or extension of the use of land which increases the need for service. The fee may not be assessed on an existing development.

A system development fee must be calculated based upon a written analysis prepared by either a qualified financial professional or professional engineer using either the buy-in, incremental cost, marginal cost, or combined cost methodology that calculates a final system development fee per service unit of new development covering a planning horizon of not less than 10 years nor more than 20 years. The local governmental unit must accept public comment on the written analysis and conduct a public hearing prior

[1] For purposes of this fee, local governmental units are counties, cities, sanitary districts, water and sewer authorities, metropolitan water districts, metropolitan sewerage districts, metropolitan water and sewerage districts, and county water and sewer districts.

Jeffrey Hudson
Director

Legislative Analysis Division
919-733-2578

to adoption of the system development fee. Fees involving the subdivision of land are collected either at the time of plat recording or when the local government unit commits to providing water and sewer service; fees for any other type of development are collected at the time of service connection. A local governmental unit must update the system development fee analysis at least every five years.

BILL ANALYSIS: Section 1 clarifies that:

- For purposes of assessing a system development fee, the term "facility" is limited to a facility that provides a general benefit to the area that it serves and does not extend, for example, to infrastructure that is unrelated to or not required for making the water and sewer services available in the area. This includes facilities for the reuse or reclamation of water and any land associated with the facility.
- The type of water and sewer service for which a system development fee may be assessed includes service provided pursuant to a wholesale arrangement between a water and sewer authority organized under Article 1 of Chapter 162A of the General Statutes and a local governmental unit.

Section 2 requires that the written analysis that serves as the basis for calculating a system development fee incorporate the gallons per day per service unit that the local governmental unit applies to its water or sewer system engineering or planning purposes for water or sewer. In other words, the amount of gallons per day per service unit that is used to determine the system's capacity must be the same amount used for purposes of establishing the fee.

Section 3 makes a technical change by deleting the phrase "water and sewer." The phrase is unnecessary because it is incorporated into the term "capital improvements" via the term "facility."

TREATMENT OF TAXABLE CONTRIBUTIONS TO WATER/WASTEWATER UTILITIES

Section 4 of the act concerns the treatment of the income tax paid by a privately-owned water or wastewater public utility on contributions in aid of construction made by a developer to the utility.

CURRENT LAW & BACKGROUND: Most private water and wastewater companies require developers to advance funds, known as "customer advances for construction" (CAC), or to make permanent contributions in the form of funds or property, known as "contributions in aid of construction" (CIAC), to connect a new development to an existing water system. These contributions may include connection or tap fees, capacity fees, meter installation fees, cash contributions used by a utility to construct a plant, a utility plant installed or paid for by the contributor and then conveyed to the utility, and land conveyed by the contributor to the utility.

The federal tax code has treated these advances and contributions inconsistently over the years. Prior to 1987, they were not taxed. From 1987 to 1996, they were considered taxable income. From 1996 to 2017, they were once again treated as nontaxable contributions to capital. The Tax Cuts and Jobs Act of 2017 reversed course yet again and, currently, these contributions are considered federal taxable income to the water and wastewater utilities that receive them. Moreover, under an order issued by the NC Utilities Commission in 2020, all water and wastewater companies must collect the income tax on CIAC from contributors (i.e. developers) using the full gross-up method.[2]

BILL ANALYSIS: Section 4 of the act provides that a water or wastewater public utility is solely responsible for funding the income taxes on taxable contributions in aid of construction and customer

[2] The "gross-up method" refers to the additional amount a developer must pay to the utility to cover the cost of the utility's income tax liability resulting from the contributions received by the utility. For North Carolina, the gross-up factor is slightly under 30%.

advances for construction, meaning that a utility may not seek reimbursement from or bill a developer for the amount of income tax the utility paid on the taxable contributions. It also requires the utility to record the income taxes paid in accumulated deferred income taxes for accounting and ratemaking purposes. Essentially, the utility finances the payment of the tax expense and gets reimbursed from rates over the life of the depreciating CIAC asset, eliminating the requirement that developers fund the utilities tax obligation up front.

EFFECTIVE DATE: This act became effective July 2, 2021.