FINAL DECISION
AusNet Services transmission determination 2017−2022

Attachment 8 – Corporate income tax

April 2017

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165

Email: AERInquiry@aer.gov.au

AER reference: 56417

Note

This attachment forms part of the AER's final decision on AusNet Services' revenue proposal 2017–22. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – maximum allowed revenue

Attachment 2 – regulatory asset base

Attachment 3 – rate of return

Attachment 4 – value of imputation credits

Attachment 5 – regulatory depreciation

Attachment 6 – capital expenditure

Attachment 7 – operating expenditure

Attachment 8 – corporate income tax

Attachment 9 – efficiency benefit sharing scheme

Attachment 10 – capital expenditure sharing scheme

Attachment 11 – service target performance incentive scheme

Attachment 12 – pricing methodology

Attachment 13 – pass through events

Attachment 14 – negotiated services

Contents

Shortened forms

Shortened form	Extended form
AARR	aggregate annual revenue requirement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ASRR	annual service revenue requirement
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
MAR	maximum allowed revenue
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider

Shortened form	Extended form
NTSC	negotiated transmission service criteria
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
TUoS	transmission use of system
WACC	weighted average cost of capital

8 Corporate income tax

Our revenue determination includes the estimated cost of corporate income tax for AusNet Services' 2017–22 regulatory control period.[1] Under the post-tax framework, a corporate income tax allowance is calculated as part of the building block assessment using our post-tax revenue model (PTRM). This amount allows AusNet Services to recover the costs associated with the estimated corporate income tax payable during the 2017–22 regulatory control period.

This attachment sets out our final decision on AusNet Services' revised proposed corporate income tax allowance for the 2017–22 regulatory control period. It also presents our final decision on the revised proposed opening tax asset base (TAB), and the standard and remaining tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

8.1 Final decision

We do not accept AusNet Services' revised proposed cost of corporate income tax allowance of $112.6 million ($ nominal).[2] Our final decision on the estimated cost of corporate income tax is $59.5 million ($ nominal) over the 2017–22 regulatory control period. This represents a reduction of $53.1 million (or 47.2 per cent) from AusNet Services' revised proposal.

This reduction is mainly driven by our determination on AusNet Services' proposed value of imputation credits (gamma) as discussed in attachment 4. Our determinations on other building block components including forecast capex (attachment 6) and forecast opex (attachment 7) also affect revenues, which impact the tax calculation. The changes affecting revenues are discussed in attachment 1.

Table 8.1 sets out our final decision on the estimated cost of corporate income tax allowance for AusNet Services over the 2017–22 regulatory control period.

Table 8.1 AER's final decision on AusNet Services' corporate income tax allowance for the 2017–22 regulatory control period ($ million, nominal)

	2017–18	2018–19	2019–20	2020–21	2021–22	Total
Tax payable	22.1	17.7	20.6	23.3	15.4	99.2
Less: value of imputation credits	8.8	7.1	8.2	9.3	6.2	39.7
Net corporate income tax allowance	**13.2**	**10.6**	**12.4**	**14.0**	**9.2**	**59.5**

Source: AER analysis.

1 NER, cl. 6A.5.4(a)(4).

2 AusNet Services *Revised revenue proposal*, September 2016, p. 19.

8.2 AusNet Services' revised proposal

AusNet Services revised its corporate income tax allowance using the AER's PTRM with the following changes from our draft decision:[3]

- Opening TAB at 1 April 2017, reflecting additional amendments to reflect historical capex allocation issues and updated for 2015–16 actual capex.
- Value for gamma of 0.25, consistent with its initial proposal.
- Revised forecast capex.
- Revised forecast opex.
- Revised rate of return.
- The addition of two new asset classes to accelerate depreciation of connection assets related to the Yallourn Power Station.

AusNet Services used the standard tax asset lives consistent with those approved in the draft decision. It adopted our draft decision to accelerate the TAB value of assets which have been removed from service, consistent with the RAB depreciation profile for these assets. AusNet Services also adopted our draft decision on the updated remaining tax asset lives for its Group 3 assets.

AusNet Services also adopted our draft decision on the tax treatment of the revenue adjustments arising from the operation of the EBSS over the 2014–17 regulatory control period.

Due to the revised inputs, AusNet Services' revised proposed corporate income tax allowance is $112.6 million, a reduction of $55.3 million (or 32.9 per cent) compared to its initial proposal of $167.9 million.

Table 8.2 sets out AusNet Services' revised proposed corporate income tax allowance for the 2017–22 regulatory control period.

Table 8.2 AusNet Services' revised proposed corporate income tax allowance for the 2017–22 regulatory control period ($ million, nominal)

	2017–18	2018–19	2019–20	2020–21	2021–22	Total
Tax payable	32.9	28.1	30.9	33.4	24.8	150.2
Less: value of imputation credits	8.2	7.0	7.7	8.4	6.2	37.5
Net corporate income tax allowance	**24.7**	**21.1**	**23.1**	**25.1**	**18.6**	**112.6**

Source: AusNet Services, *Revised revenue proposal*, p. 19.

3 AusNet Services, *Revised revenue proposal*, September 2016, pp. 198–2013; AusNet Services, *Revised proposed PTRM*, September 2016.

8.3 AER's assessment approach

We did not change our assessment approach for the corporate income tax allowance from our draft decision. Section 8.3 of our draft decision details that approach.

8.4 Reasons for final decision

We do not accept AusNet Services' revised proposed estimated cost of corporate income tax. We instead determine a cost of corporate income tax allowance of $59.5 million for the 2017–22 regulatory control period. This represents a reduction of $53.1 million (or 47.2 per cent) from AusNet Services' revised proposal.

This is because we adjusted the following revised proposed inputs to the PTRM for tax purposes by AusNet Services:

- the opening TAB value at 1 April 2017 (section 8.4.1)
- the remaining tax asset lives (section 8.4.3)
- the accelerated tax depreciation of assets related to the Yallourn Power Station (attachment 5)
- the value of gamma (attachment 4)
- other building block components including forecast opex (attachment 7), forecast capex (attachment 6) and rate of return (attachment 3) that impact revenues, and therefore also impact the forecast corporate income tax allowance.

We accept AusNet Services' revised proposed standard tax asset lives (section 8.4.2), consistent with those approved in the draft decision.

8.4.1 Opening tax asset base at 1 April 2017

We determine an opening TAB value at 1 April 2017 of $2477.5 million ($ nominal), a reduction of $0.6 million from the revised proposed value. This is because we have updated 2016–17 as-commissioned capex with the estimate in our final decision capex model.[4] Our final decision on the opening TAB is $55.0 million (or 2.2 per cent) lower than that approved in the draft decision.

In the draft decision, we accepted AusNet Services' proposed method to establish the opening TAB at 1 April 2017 as it was based on the approach set out in our roll forward model (RFM). However, we amended AusNet Services' proposed opening TAB for adjustments made to the actual capex values in the RFM. We also noted the roll forward of AusNet Services' TAB included estimated capex values for 2015–16 and 2016–17. We stated we would update the 2015–16 estimated capex value with actual capex for the final decision, and update the estimate for 2016–17 capex.[5]

---

[4] AER, *Final decision capital expenditure model*, April 2017, worksheet: '5.2(a)_Total_Fcast'.

[5] AER, *Draft decision - Attachment 8 - Corporate income tax,* July 2016, p. 8–11.

In its revised proposal, AusNet Services adopted our draft decision amendments to the value of asset disposals, and updated 2015–16 and 2016–17 capex values. It also provided further clarification on the issues of capitalised provisions and allocation of inventory capex raised in the draft decision.

Consistent with the reasons discussed in attachment 2, our final decision accepts AusNet Services' revised proposed actual capex for 2015–16.[6] We have updated AusNet Services' revised proposed 2016–17 as-commissioned capex estimate with that calculated in our final decision capex model.[7] The impact of this update is an opening TAB at 1 April 2017 of $2477.5 million ($ nominal), a small reduction ($0.6 million) to AusNet's Services' revised proposal.

Table 8.3 sets out our final decision on the roll forward of AusNet Services' TAB values over the 2014–17 regulatory control period.

Table 8.3 AER's final decision on AusNet Services TAB roll forward for the 2014–17 regulatory control period ($ million, nominal)

	2014–15	2015–16	2016–17[b]
Opening TAB	2249.8	2315.3	2330.3
Capital expenditure[a]	169.7	128.2	180.9
Less: tax depreciation	104.2	113.1	122.3
Closing TAB	2315.3	2330.3	2388.9
Group 3 asset roll-in			88.6
Opening TAB as at 1 April 2017			**2477.5**

Source: AER analysis.

(a) As commissioned, net of disposals.

(b) Based on estimated capex.

8.4.2 Standard tax asset lives

Consistent with our draft decision, we accept AusNet Services' proposed standard tax asset lives because they are:

- broadly consistent with the values prescribed by the Commissioner for taxation in tax ruling 2016/1[8]

---

6 AusNet Services *Revised revenue proposal RFM*, September 2016.

7 AER, *Final decision capital expenditure model*, April 2017, worksheet: '5.2(a)_Total_Fcast'.

8 ATO, *Taxation Ruling Income tax: effective life of depreciating assets (applicable from 1 July 2016),* July 2016, http://law.ato.gov.au/atolaw/view.htm?docid=%22TXR%2FTR20152%2FNAT%2FATO%2F00001%22, accessed on 6 December 2016.

- the same as those approved standard tax asset lives for the 2014–17 regulatory control period.

We are satisfied that the standard tax asset lives in AusNet Services' revised proposal are likely to provide an appropriate estimate of the tax depreciation amount for a benchmark efficient service provider as required by the NER.[9]

Table 8.4 sets out our final decision on AusNet Services’ standard tax asset lives for the 2017–22 regulatory control period.

8.4.3 Remaining tax asset lives

Consistent with our draft decision we accept AusNet Services' weighted average approach to determining remaining tax asset lives at 1 April 2017. We noted in the draft decision that the remaining tax asset lives would be recalculated for the final decision because of updates to AusNet Services’ 2015–16 and 2016–17 capex in the TAB roll forward. These capex values are inputs used to calculate the weighted average remaining tax asset lives.[10] Based on the revisions for capex in the TAB roll forward as discussed in section 8.4.1, we have updated AusNet Services’ remaining tax asset lives at 1 April 2017 for this final decision.[11] We do not accept the remaining tax asset lives relating to the proposed accelerated tax depreciation of the Yallourn Power Station assets.

In its initial proposal, AusNet Services proposed to accelerate the depreciation of the RAB value of assets that have been removed from service (or are expected to be removed from service over the 2017–22 regulatory control period). In our draft decision, we considered that the depreciation profile of these assets should be treated consistently for both RAB and TAB purposes.[12] As such, we also accelerated the depreciation of the TAB value of assets that have been removed from service (or are expected to be removed from service over the 2017–22 regulatory control period). AusNet Services’ revised proposal adopted our draft decision to accelerate the TAB value of these assets.

AusNet Services’ initial proposal also contained some inconsistencies between the standard tax asset lives and remaining tax asset lives for the Group 3 assets.[13] We

---

9 NER, cl. 6A.6.4.

10 AER, *Draft Decision - Attachment 8 - Corporate Income Tax,* July 2016, p. 13

11 Due to the magnitude of our update to 2016–17 capex, the changes to AusNet Services’ revised remaining tax asset lives are less than 0.1 year for each asset class.

12 AER, *Draft Decision - Attachment 8 - Corporate Income Tax,* July 2016, pp. 8–12.

13 During a regulatory control period, AEMO or a distribution business may request AusNet Services to provide augmentations to the transmission network or distribution connection services. While the assets constructed due to these requests provide prescribed transmission services, the forecast capex associated with these assets sit outside of the revenue determination. This is because AusNet Services is not responsible for the planning of these capex. AusNet Services and AEMO refer to the assets that provide these services as ‘Group 3’ assets. Group 3 assets sit outside of the TAB and are governed by commercial contracts until such time as they are rolled into the TAB, usually at the next revenue reset. See: AusNet Services, *Revenue proposal*, October 2015, p. 23.

identified this and following an information request, AusNet Services provided updated remaining tax asset lives for the Group 3 assets which we accepted in our draft decision.[14] The updated remaining tax asset lives for the Group 3 assets have been adopted in AusNet Services' revised proposal.

In its revised proposal, AusNet Services also proposed two new asset classes to accelerate tax depreciation of connection assets related to the Yallourn Power Station. It proposed to depreciate the tax value of these assets ($12.8 million) over eight years, consistent with the proposed RAB treatment.

Consistent with our final decision to reject the accelerated depreciation of the RAB value of these assets, we do not accept AusNet Services' revised proposal to accelerate the tax depreciation of these assets. This issue is discussed further in our consideration of AusNet Services' regulatory depreciation (attachment 6). Consequently, we have not accepted the tax remaining asset lives associated with the two new asset classes for accelerated tax depreciation of these assets.

We are satisfied our final decision on AusNet Services' remaining tax asset lives are likely to provide an appropriate estimate of the tax depreciation amount for a benchmark efficient service provider as required by the NER.[15]

Table 8.4 sets out our final decision on the remaining tax asset lives as at 1 April 2017 for AusNet Services.

Table 8.4 AER's final decision on AusNet Services' standard and remaining tax asset lives as at 1 April 2017 (years)

Asset class	Standard tax asset life	Remaining tax asset life as at 1 April 2017
Secondary	12.5	11.6
Switchgear	40.0	28.8
Transformers	40.0	27.6
Reactive	40.0	21.4
Towers and conductor	47.5	25.1
Establishment	40.0	32.9
Communications	12.5	9.5
Inventory	n/a	n/a
IT	3.5	2.9
Vehicles	8.0	5.5

14 AER, *Draft Decision - Attachment 8 - Corporate Income Tax,* July 2016, p. 8–12.

15 NER, cl. 6A.6.4.

Asset class	Standard tax asset life	Remaining tax asset life as at 1 April 2017
Other (non-network)	10.0	6.0
Premises	20.0	13.1
Land	n/a	n/a
Easements	n/a	n/a
Equity raising costs (2003-08)	5.0	2.0
Inventory adjustment (other non-network)[a]	n/a	1.0
Accelerated depreciation	n/a	5.0

Source: AER analysis.

n/a Not applicable.

a) This is an adjustment to return the value of depreciation that AusNet Services was incorrectly allowed due to an issue with the historical allocation of its as-commissioned inventory movements. Further details are in attachment 5.

8.4.4 Tax treatment of revenue adjustment

We note AusNet Services' revised proposal adopted our draft decision on the tax treatment of the revenue adjustments arising from the operation of the EBSS over the 2014–17 regulatory control period. Consistent with the draft decision, our final decision is that these revenue adjustments should be given identical income and expense tax status for tax calculations in the PTRM.[16]

8.4.5 Tax allowance for Hazelwood assets payment

AusNet Services made a late submission to its revised proposal setting out additional information regarding developments in the Latrobe Valley.[17] In its submission, AusNet Services withdrew its proposed accelerated depreciation of Yallourn Power Station assets from its revised proposal due to the planned closure of the Hazelwood Power Station. However, in light of this development AusNet Services submitted that it intended to seek payment from Engie (the power station owner) to recover the remaining value of the connection assets at Hazelwood Power Station. In doing so, AusNet Services noted that this would result in it incurring a tax liability, which would need to be included as an allowance in the tax building block for the 2017–22 regulatory control period.

[16] That is, the revenue adjustments relating to EBSS are both tax income and tax expense.

[17] AusNet Services, *Submission to revised proposal*, 20 December 2016, p. 3.

AusNet Services submitted an amended PTRM in January 2017 incorporating the proposed change to the tax allowance.[18] We reviewed the amended PTRM and identified that it did not account for any reduction to the RAB for the value of the assets expected to be removed from service. In effect, this meant that AusNet Services would to continue receiving the return on capital and regulatory depreciation allowances for these assets, while also getting an additional tax allowance for the expected payment of the assets. We do not consider this modelling approach to be appropriate.

In consultation with AusNet Services, we corrected the modelling to take account of the expected payment and the removal of the value from the RAB. Even after having regard for possible delays to the payment, the results of the preliminary modelling showed that there would be minimal impact on the overall net cash flows for AusNet Services. This is because the reduction to the returns on and of capital building blocks generally offset the increase to the tax building block. In light of this—and because there is uncertainty about the actual timing and value of the payment—we consider there is no benefit to proceed with making the detailed PTRM changes for this final decision. We also consider that this issue would be better addressed on an ex-post basis when the actual details are available. AusNet Services agreed with our assessment and revoked the Hazelwood tax payment amendments made to its revised proposal.[19] We note that the actual payment for the Hazelwood Power Station assets when it has been recovered by AusNet Services would be accounted for at the next reset under the standard roll forward process for establishing the opening RAB at 1 April 2022.[20]

18 AusNet Services, *Submission to revised proposal*, 25 January 2017, Revised PTRM and HWPS connection asset values spreadsheets.

19 AusNet Services, *Email - RE: AusNet TRR - HWPS payment further info*, 16 February 2017.

20 NER, cl. S6A.2.1(f)(6).