



FINAL DECISION
Ausgrid distribution
determination
2015–16 to 2018–19

Attachment 8 – Corporate
income tax

April 2015

© Commonwealth of Australia 2015

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the:

Director, Corporate Communications
Australian Competition and Consumer Commission
GPO Box 4141, Canberra ACT 2601

or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444

Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

AER reference: 52294

Note

This attachment forms part of the AER's final decision on Ausgrid's revenue proposal 2015–19. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 - Annual revenue requirement

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 - Demand management incentive scheme

Attachment 13 - Classification of services

Attachment 14 - Control mechanism

Attachment 15 - Pass through events

Attachment 16 - Alternative control services

Attachment 17 - Negotiated services framework and criteria

Attachment 18 - Connection methodology

Attachment 19 - Pricing methodology

Attachment 20 - Analysis of financial viability

Contents

Note	8-2
Contents	8-3
Shortened forms	8-4
8 Corporate income tax.....	8-6
8.1 Final decision.....	8-6
8.2 Ausgrid’s revised proposal.....	8-7
8.3 AER’s assessment approach.....	8-8
8.4 Reasons for final decision	8-9
8.4.1 Opening tax asset base.....	8-9
8.4.2 Standard tax asset lives	8-12
8.4.3 Remaining tax asset lives.....	8-13
8.4.4 Tax treatment of incentive scheme revenues	8-16

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	expenditure forecast assessment Guideline for electricity distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
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
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

8 Corporate income tax

We are required to make a decision on the estimated cost of corporate income tax for Ausgrid in the 2014–19 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 enables Ausgrid to recover the costs associated with the estimated corporate income tax payable during the 2014–19 period.

This attachment presents our final decision on Ausgrid's revised proposed corporate income tax allowances for the 2014–19 period in respect of its distribution and transmission networks. It also presents our final decision on its revised proposed opening tax asset bases (TABs), the standard and remaining tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses, and the tax treatment of incentive scheme rewards and penalties.

8.1 Final decision

We do not accept Ausgrid's revised proposed cost of corporate income tax allowances of \$745.8 million and \$81.1 million (\$ nominal) for its distribution and transmission networks respectively. Our final decision on the estimated cost of corporate income tax is \$304.3 million and \$28.9 million (\$ nominal) for Ausgrid's distribution and transmission networks respectively over the 2014–19 period. This represents a reduction of \$441.5 million (or 59.2 per cent) for its distribution network and a reduction of \$52.2 million (or 64.4 per cent) for its transmission network compared to its revised proposal.

These reductions reflect:

- our final decision not to accept Ausgrid's proposal to alter the tax treatment of revenue adjustments arising from incentive schemes (such as the efficiency benefit sharing scheme—EBSS)
- our final decision on the value of imputation credits—gamma (attachment 4)
- our final decision not to accept Ausgrid's proposed building block costs, which affect revenues and therefore impact the tax calculation. The changes affect revenues are discussed in attachment 1.

Table 8.1 and Table 8.2 set out our final decision on the estimated cost of corporate income tax allowances for Ausgrid's distribution and transmission networks respectively.

¹ NER, cl. 6.4.3(a)(4).

Table 8.1 AER's final decision on Ausgrid's cost of corporate income tax allowance for 2014–19 period (\$ million, nominal) – distribution

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
Tax payable	86.0	97.5	109.3	112.1	102.4	507.2
Less: value of imputation credits	34.4	39.0	43.7	44.8	41.0	202.9
Corporate income tax allowance	51.6	58.5	65.6	67.2	61.4	304.3

Source: AER analysis.

Table 8.2 AER's final decision on Ausgrid's cost of corporate income tax allowance for 2014–19 period (\$ million, nominal) – transmission

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
Tax payable	8.6	9.1	10.4	10.2	9.8	48.1
Less: value of imputation credits	3.4	3.7	4.2	4.1	3.9	19.2
Corporate income tax allowance	5.2	5.5	6.3	6.1	5.9	28.9

Source: AER analysis.

8.2 Ausgrid's revised proposal

Ausgrid's revised proposal forecasts costs of corporate income tax of \$745.8 million for its distribution network and \$81.1 million (\$ nominal) for its transmission network. Ausgrid's methodology for determining its corporate income tax is unchanged from its initial proposal. We accepted the approach in our draft decision. Ausgrid's revised proposal adopted our draft decision amendment to the standard tax asset life for the 'Equity raising costs' asset class of five years.²

Ausgrid adopted our draft decision adjustments to roll forward the opening TABs from 1 July 2009 to 30 June 2014. However, its revised proposal adjusted the closing distribution TAB for a change in the allocation of metering assets to be removed from standard control services, due to classification changes of these assets to providing alternative control services.³

Ausgrid revised its corporate income tax allowances for its distribution and transmission networks using the AER's PTRM and included the following inputs:⁴

- the revised opening TABs as at 1 July 2014
- revised forecast capex

² Ausgrid, *Revised regulatory proposal*, January 2015, p. 63.

³ Ausgrid, *Revised regulatory proposal*, January 2015, p. 63.

⁴ Ausgrid, *Revised regulatory proposal, Attachment 4.08 and Attachment 4.09*, January 2015.

- revised forecast opex.

Ausgrid also used the standard and remaining tax asset lives consistent with those approved in the draft decision, and a value for gamma of 0.25 consistent with its initial proposal.

In addition, Ausgrid amended the AER's PTRM so that revenue adjustments arising from three incentive schemes (EBSS, D-factor carryover and demand management innovation allowance (DMIA) carryover) were not included as expenses for tax purposes.

Table 8.3 and Table 8.4 set out Ausgrid's revised proposed cost of corporate income tax allowances for its distribution and transmission networks respectively over the 2014–19 period.

Table 8.3 Ausgrid's revised proposed cost of corporate income tax allowance for the 2014–19 period (\$ million, nominal) – distribution

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
Tax payable	180.9	199.4	206.9	234.0	173.3	994.5
Less: value of imputation credits	45.2	49.8	51.7	58.5	43.3	248.6
Corporate income tax allowance	135.7	149.5	155.1	175.5	130.0	745.8

Source: Ausgrid, *Revised regulatory proposal, Attachment 4.08*, January 2015.

Table 8.4 Ausgrid's revised proposed cost of corporate income tax allowance for the 2014–19 period (\$ million, nominal) – transmission

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
Tax payable	20.1	21.1	22.2	24.3	20.4	108.1
Less: value of imputation credits	5.0	5.3	5.6	6.1	5.1	27.0
Corporate income tax allowance	15.1	15.9	16.7	18.2	15.3	81.1

Source: Ausgrid, *Revised regulatory proposal, Attachment 4.09*, January 2015.

8.3 AER's assessment approach

We did not change our assessment approach for the cost of corporate income tax from our draft decision. Section 8.3 of our draft decision details that approach.⁵ All tax expenses (including other expenses such as opex) are offset against the service provider's forecast revenue to estimate the taxable income. To date, revenue adjustments arising from incentive schemes (such as an EBSS) have been included

⁵ AER, *Draft decision - Ausgrid distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 9-11.

both as taxable income and as a tax expense. Therefore incentive amounts will not alter the underlying taxable income used to calculate the cost of corporate tax allowance based on the efficient costs of the network service provider

8.4 Reasons for final decision

We do not accept Ausgrid's proposed cost of corporate income tax allowances. We instead determine estimated corporate income tax allowances of \$304.3 million and \$28.9 million (\$nominal) for its distribution and transmission networks respectively. These represent reductions of \$441.5 million (or 59.2 per cent) for Ausgrid's distribution network and \$52.2 million (or 64.4 per cent) for Ausgrid's transmission network.

We have accepted the following revised proposed inputs to the distribution and transmission PTRMs for tax purposes:

- the opening TAB values as at 1 July 2014 (section 8.4.1)
- standard and remaining tax asset lives consistent with those approved in the draft decision (sections 8.4.2 and 8.4.3).

However, we have adjusted the following proposed inputs to the distribution and transmission PTRMs that impact the estimated corporate income tax allowance:

- the treatment of revenue adjustments arising from incentive schemes (such as the EBSS) for tax purposes (section 8.4.4)
- the value of gamma (attachment 4)
- other building block components which affect the calculation of taxable income. These include forecast opex (attachment 7) and forecast capex (attachment 6).

8.4.1 Opening tax asset base

We accept Ausgrid's revised proposed opening TABs as at 1 July 2014 of \$8559.3 million for its distribution network and \$1502.1 million (\$ nominal) for its transmission network. Ausgrid updated its revised proposal TAB for actual capex and disposals incurred during 2013-14.

In the draft decision, we made a number of adjustments to Ausgrid's roll forward of its opening distribution and transmission TABs over the 2009–14 regulatory control period. These adjustments included:⁶

- correcting various capex inputs
- correcting a formula error in the calculation of tax depreciation for IT systems assets

⁶ AER, *Draft decision - Ausgrid distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 11-15.

- updating the estimates of capex for 2013–14 to reflect actual capex. We noted in our draft decision that we would review these updates with the audited annual reporting RIN to be submitted after the draft decision
- updating the amount of distribution assets to be transferred to the alternative control services metering TAB as at 1 July 2014.

Ausgrid adopted all of our draft decision adjustments to the opening TABs for its distribution and transmission network, except for the value of assets to be transferred to the metering TAB.⁷

As discussed in attachment 2 we reconciled the 2013–14 actual capex in the revised proposal against Ausgrid's audited annual RIN for 2013–14. We therefore accept Ausgrid's actual capex for 2013–14 in the revised opening TABs as at 1 July 2014 for its distribution and transmission networks. We also accept Ausgrid's revised proposal adjustment to remove metering assets from its distribution TAB as at 1 July 2014, discussed below.

Removal of metering assets as at 1 July 2014

We accept Ausgrid's proposed adjustment of \$245.9 million (\$ nominal) to remove metering assets from the closing distribution TAB as at 30 June 2014. This removal is due to the change in classification of metering services to alternative control services.

In the draft decision, we adjusted Ausgrid's distribution TAB for the removal of metering assets using the same allocation percentages proposed by Ausgrid for its RAB.⁸ This resulted in removing metering assets of \$242.8 million (\$ nominal) from the closing distribution TAB.

Ausgrid's revised proposal submitted an alternative approach to calculate the adjustment for the removal of metering assets from the closing distribution TAB.⁹ The revised approach to allocate the metering assets for the TAB is aligned with the allocation process applied to the RAB.¹⁰ It provides for a different allocation percentage to that applied in the draft decision because the unadjusted RAB and TAB values differ due to:

- differences in the values of the approved RAB and TAB for rolling forward from 1 July 2009
- application of different assumptions and depreciation profiles used to calculate regulatory depreciation and tax depreciation
- differences in the addition of capex for RAB and TAB roll forwards¹¹

⁷ Ausgrid, *Revised regulatory proposal*, January 2015, pp. 63–64.

⁸ AER, *Draft decision - Ausgrid distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 13-16.

⁹ Ausgrid, *Revised regulatory proposal*, January 2015, p. 63.

¹⁰ Ausgrid, *Regulatory proposal, Attachment 8.17*, May 2014.

¹¹ In each year the TAB is increased by capex inclusive of capital contributions.

We have reviewed Ausgrid's revised proposed methodology and financial model used to calculate the adjustment to the TAB for the allocation of metering assets from standard control services to alternative control services. Ausgrid's adjustment to its RAB and TAB for the allocation of assets to be moved to alternative control services is based on:

- The direct allocation of Type 5–6 metering assets based on the category of services the assets provide.
- The allocation of indirect assets partially attributed to standard control services and alternative control services using the ratio of assets directly attributable to metering for these services.

We are satisfied Ausgrid's revised allocation of metering assets results in the proportion of the distribution TAB used to calculate the estimate of cost of corporate tax that is attributable to standard control services.¹²

Table 8.5 and Table 8.6 sets out our final decision on the roll forward of Ausgrid's TABs over the 2009–14 regulatory control period for its distribution and transmission network respectively.

Table 8.5 AER's final decision on Ausgrid's TAB roll forward (\$ million, nominal) – distribution

	2009–10	2010–11	2011–12	2012–13	2013–14
Opening TAB	4659.4	5485.1	6573.8	7709.3	8487.6
Capital expenditure ^a	1124.5	1313.3	1398.1	1077.8	634.2
Less: tax depreciation	298.8	224.6	262.6	299.5	316.7
Closing TAB	5485.1	6573.8	7709.3	8487.6	8805.2
Meters moved to alternative control services					245.9
Opening TAB as at 1 July 2014					8559.3

Source: AER analysis.

(a) Net of disposals.

¹² NER, cl. 6.2.2(5).

Table 8.6 AER's final decision on Ausgrid's TAB roll forward (\$ million, nominal) – transmission

	2009–10	2010–11	2011–12	2012–13	2013–14
Opening TAB	570.9	761.9	1001.8	1296.5	1463.8
Capital expenditure	223.9	264.6	325.9	206.3	82.1
Less: tax depreciation	32.9	24.7	31.2	39.0	43.8
Closing TAB	761.9	1001.8	1296.5	1463.8	1502.1

Source: AER analysis.

(a) Net of disposals.

8.4.2 Standard tax asset lives

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

- broadly consistent with the values prescribed by the Commissioner for taxation in tax ruling 2014/4¹³
- the same as those approved standard tax asset lives for the 2009–14 regulatory control period.

In the draft decision, we made one amendment to the proposed standard tax asset life. We changed the standard tax asset life for the 'Equity raising costs' asset class to 5 years from Ausgrid's proposed 47.3 years (distribution) and 45.7 years (transmission) for tax depreciation purposes. This was because the Australian Taxation Office (ATO) requires equity raising costs to be amortised over a five-year period on a straight-line basis.¹⁴ Ausgrid's revised proposal adopted our draft decision on the standard tax asset life for the 'Equity raising costs' asset class.

We are satisfied the standard tax asset lives in Ausgrid's 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.¹⁵

Table 8.7 and Table 8.8 present our draft decision on the standard tax asset lives for Ausgrid's distribution and transmission networks respectively.

¹³ ATO, *Taxation Ruling Income tax: effective life of depreciating assets (applicable from 1 July 2014)*, August 2014, <http://law.ato.gov.au/atoLaw/view.htm?docid=%22TXR%2FTR20144%2FNAT%2FATO%2F00001%22>, accessed on 17 February 2015.

¹⁴ AER, *Draft decision - ActewAGL distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 13-14.

¹⁵ NER, cl. 6.5.3.

8.4.3 Remaining tax asset lives

Consistent with our draft decision, we accept Ausgrid's revised proposed remaining tax asset lives as at 1 July 2014. No further revisions are required for this final decision.

In the draft decision, we accepted Ausgrid's proposed approach to establish remaining tax asset lives for its distribution and transmission networks as at 1 July 2014.¹⁶ In accepting Ausgrid's approach, we updated the proposed remaining tax asset lives to reflect our adjustments to the RAB remaining asset lives as at 1 July 2014. This was because Ausgrid's approach to calculate the remaining tax asset life uses the ratio of the RAB remaining asset life to the RAB standard asset life.¹⁷

Ausgrid's revised proposal adopted our draft decision updates to the remaining tax asset lives. No further updates to the roll forward of Ausgrid's RABs and TABs are required for this final decision. Accordingly, there is no consequential change to the remaining tax asset lives. We therefore accept Ausgrid's revised proposed remaining tax asset lives for its distribution and transmission networks.¹⁸

Table 8.7 and Table 8.8 present our final decision on the remaining tax asset lives for Ausgrid's distribution and transmission networks as at 1 July 2014 respectively.

¹⁶ AER, *Draft decision - Ausgrid distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 13-16.

¹⁷ Our 2009 determination for Ausgrid did not contain remaining tax asset lives for depreciating its opening TAB as at 1 July 2009. Instead, we approved the use of specific forecast tax depreciation amounts for the 2009–14 regulatory control period. Ausgrid proposed remaining tax asset lives as at 1 July 2014 calculated based on the standard tax asset life for an asset class multiplied by the ratio of the RAB remaining asset life to the RAB standard asset life.

¹⁸ Having established the remaining tax asset lives as at 1 July 2014 for this determination process, we consider that when rolling forward these remaining tax asset lives to 1 July 2019 at the next reset our preferred weighted average method should be used.

Table 8.7 AER's final decision on Ausgrid's standard and remaining tax asset lives as at 1 July 2014 (years) – distribution

Asset class	Standard tax asset life	Remaining tax asset life as at 1 July 2014
Sub-transmission lines and cables	47.5	33.7
Cable tunnel (dx)	40.0	38.5
Distribution lines and cables	48.7	39.3
Substations	40.0	29.7
Transformers	42.0	27.9
Low voltage lines and cables	45.8	35.2
Customer metering and load control	25.0	14.5
Communications (digital) - dx	10.0	5.6
Total communications	7.4	2.2
System IT (dx)	7.0	4.9
Ancillary substations equipment (dx)	15.0	12.4
Land and easements	n/a	n/a
Furniture, fittings, plant and equipment	10.60	7.6
Land (non-system)	n/a	n/a
Other non-system assets	10.5	2.7
IT systems	4.0	2.6
Motor vehicles	20.0	12.3
Buildings	40.0	33.4
Equity raising costs	5.0	43.4

Source: AER analysis.

n/a: not applicable.

Table 8.8 AER final decision on Ausgrid's standard and remaining tax asset lives as at 1 July 2014 (years) – transmission

Asset class	Standard tax asset life	Remaining tax asset life as at 1 July 2014
Transmission & Zone land & easements	n/a	n/a
Transmission buildings	40.0	30.6
Zone buildings 132/66kV	40.0	33.3
Transmission transformers 132/66kV	40.0	29.5
Zone transformers 132/66kV	45.0	30.6
Transmission substation equip 132/66kV	40.0	30.3
Zone substation equip 132/66kV	40.0	33.5
Ancillary substation equipment (tx)	15.0	13.9
132kV tower lines	47.6	33.7
132kV concrete & steel pole lines	47.6	40.5
132kV wood pole lines	47.6	31.9
132kV feeders underground	47.0	38.2
Cable tunnel (tx)	47.6	40.9
Network control & com systems	37.2	17.5
Communications (digital) - tx	10.0	7.9
System IT (tx)	7.0	4.8
IT systems	4.0	2.6
Furniture, fittings, plant and equipment	10.6	7.6
Motor vehicles	20.0	12.3
Buildings	40.0	33.4
Land (non-system)	n/a	n/a
Other non-system assets	10.5	2.7
Equity raising costs	5.0	41.7

Source: AER analysis.

n/a: not applicable.

8.4.4 Tax treatment of incentive scheme revenues

We do not accept Ausgrid's revised proposal to alter the tax treatment of the revenue adjustment arising from the operation of its EBSS over the 2009–14 regulatory control period. This is a change from its initial proposal and what was accepted by us for the draft decision.¹⁹

Ausgrid's revised proposal altered the tax treatment of proposed revenue adjustments arising from three incentive schemes: EBSS, D-factor carryover and DMIA carryover (as distinct from the DMIA forecast payments).²⁰ It referred to a recent submission that Ausgrid made (via Networks NSW) on amendments to the PTRM. That submission stated that because achieving efficiencies in the previous regulatory control period which gives positive carry-over amounts would result in an uncompensated tax liability in that period, the carry-over amounts should provide for a tax allowance in the next regulatory control period.²¹

We consider that the EBSS revenue adjustments should be included in our assessment of expenses for tax purposes because:²²

- It is consistent with the implementation of the EBSS in the 2009 regulatory determination for Ausgrid.²³
- It is consistent with our recently published guidelines on incentive schemes,²⁴ and our application of incentive schemes for other network service providers.²⁵
- It means that the service provider faces a constant incentive to pursue efficiency gains across the regulatory control period. That is, the service provider obtains the

¹⁹ Our draft decision accepted Ausgrid's proposal and treated the EBSS revenue adjustment as both taxable income and a tax expense. *Ausgrid, Regulatory proposal, 1 July 2014 to 30 June 2019*, 30 May 2014, attachments 4.01 and 4.02; AER, *Draft decision, Ausgrid distribution determination 2015-16 to 2018-19*, 27 November 2014, PTRMs (distribution and transmission) and pp. 8-7 (Attachment 8: Corporate income tax) and 9-7 (Attachment 9: Efficiency benefit sharing scheme).

²⁰ *Ausgrid, Revised regulatory proposal and preliminary submission, 1 July 2014 – 30 June 2019*, 20 January 2015, p. 67 (footnote 110) and Attachments 4.08 and 4.09 (PTRMs for distribution and transmission).

²¹ *Networks NSW, Letter re: Networks NSW submission on changes to the Distribution Post-Tax Revenue Model (PTRM)*, 17 November 2014, pp. 2–3.

²² It is common ground that the revenue adjustments should also be included as taxable income. Being included as both income and expense for tax purposes means that the incentive payments (or decrements) will net out and taxable income will be unaffected by the incentive scheme, all things being equal.

²³ AER, *Final decision, Efficiency benefit sharing scheme for the ACT and NSW 2009 distribution determinations*, February 2008, p. 24.

²⁴ AER, *Better regulation, Efficiency benefit sharing scheme for electricity network service providers*, November 2013; AER, *Better regulation, Capital expenditure incentive guideline for electricity network service providers*, November 2013; and AER, *Better regulation, Shared asset guideline*, November 2013.

²⁵ AER, *Final decision, New South Wales Distribution determination 2009–10 to 2013–14*, 28 April 2009, p. 208; AER, *Final decision, Australian Capital Territory distribution determination*, 28 April 2009, p. 88; AER, *Final decision, Victorian electricity distribution network service providers distribution determination 2011–2015, October 2010*, p. 520; AER, *Final decision, Queensland distribution determination 2010–11 to 2014–15*, May 2010, p. 229; AER, *Final decision, South Australia distribution determination 2010–11 to 2014–15*, May 2010, p. 163; AER, *Final distribution determination, Aurora Energy Pty Ltd 2012–13 to 2016–17*, April 2012, p. 251.

same benefit (or detriment) from a given expenditure decrease (increase), regardless of which year of the regulatory control period it occurs.²⁶

In February 2008, we determined the EBSS framework that would apply to Ausgrid over the 2009–14 regulatory control period.²⁷ Our decision document describes how the EBSS is designed to share the benefits of efficiency gains between the service provider (which retains incremental cost savings for an additional five years) and consumers (who benefit from lower costs from year seven onwards).²⁸ No separate tax adjustment was contemplated in that decision document.

Treating the EBSS revenue adjustment as a tax expense is consistent with the EBSS schemes we apply to other service providers. This will include upcoming distribution and transmission regulatory determinations made under our new *EBSS* guideline (released in November 2013 as part of our Better Regulation reform program). We consider that this regulatory consistency across determinations is desirable.

During the development of our November 2013 EBSS guideline, several stakeholders made submissions on the tax treatment of EBSS revenue.²⁹ These submissions noted that the pre-tax specification of the EBSS would result in lower post-tax returns to the service provider. Consistent with Ausgrid's revised proposal, these stakeholder submissions proposed an increase in the proportion of net benefit retained by service providers to achieve a 30:70 sharing ratio in post-tax terms. Our explanatory statement accompanying the EBSS guideline considered the issue:³⁰

We consider there is not a strong rationale to amend the EBSS to a post-tax scheme. When a NSP underspends opex, with or without an EBSS, it is not funded for the additional tax incurred resulting from the additional profit. We see no reason why EBSS carryovers, which allow the NSP to keep those underspends for longer, should be treated any differently. Further, all our incentive schemes reward NSPs on a pre-tax basis. We see no reason to increase the complexity of the EBSS to simply increase the share of efficiency gains retained by NSPs. The scheme, as it is, increases the share of efficiency gains NSPs will retain for improving opex efficiency.

Our approach to the tax treatment of Ausgrid's EBSS revenue is consistent with our approach to other incentive schemes and revenue adjustments set out in our *Capital*

²⁶ In contrast, Ausgrid's revised proposal would distort this incentive by providing a greater reward (penalty) to the business for expenditure decreases (increases) in later years of the regulatory control period.

²⁷ AER, *Efficiency benefit sharing scheme for the ACT and NSW 2009 distribution determinations*, February 2008.

²⁸ AER, *Final decision, Efficiency benefit sharing scheme for the ACT and NSW 2009 distribution determinations*, February 2008. All calculations in this February 2008 EBSS decision, including the worked example and benefit ratio calculation, are in pre-tax terms.

²⁹ CitiPower, Powercor Australia and SA Power Networks, *Response to the draft Capital Expenditure Incentives Guidelines and proposed Efficiency Benefit Sharing Scheme*, 20 September 2013, pp. 11–12; Victorian DNSPs, *Draft Capital Expenditure Incentives Guidelines and Proposed EBSS*, 20 September 2013, p. 6.

³⁰ AER, *Better regulation, Explanatory statement, Efficiency benefit sharing scheme for electricity network service providers*, November 2013, p. 23.

expenditure incentive and *Shared asset* guidelines.³¹ It is important to apply a consistent approach across the EBSS and capital expenditure sharing scheme (CESS) to prevent these incentive regimes distorting the service provider's preference between opex and capex.

If applied going forward, Ausgrid's proposed tax treatment would also remove the constant incentive to pursue efficiency gains across each year of the regulatory control period.³² This undermines one of the key aims of the EBSS.³³ Within the initial period, a given opex efficiency gain (that is, a reduction in opex costs below forecast) will lead to higher profit but no explicit increase in the regulatory tax assessment.³⁴ Under Ausgrid's approach, each year of EBSS carryover from this efficiency gain that extends into the following period will additionally include an explicit increase in the tax building block. A service provider will then have an incentive to delay implementing opex efficiency gains until later in the period, so the benefits of the tax adjustment are held for longer by the service provider.³⁵ Therefore, we do not accept Ausgrid's revised proposal to alter the tax treatment of the revenue adjustment arising from the operation of its 2009–14 EBSS.

As set out in attachment 14, we have determined that the D-factor and DMIA carryover amounts will instead be dealt with via the annual pricing mechanism. The removal of these revenue amounts from the PTRM means that we do not need to make an assessment in this final decision about Ausgrid's revised proposal to alter the tax treatment for these matters.

³¹ AER, *Better regulation, Explanatory statement, Capital expenditure incentive guideline for electricity network service providers*, November 2013; and AER, *Better regulation, Explanatory statement, Shared asset guideline*, November 2013.

³² 'Constant incentive' means the benefit to the service provider is not arbitrarily altered by the timing of the regulatory control period (for example, whether it is the first year or last year of the period). Since any payment has greater value in net present terms the earlier it occurs, this means the service provider always seeks to implement efficiency gains as soon as possible.

³³ See AER, *Final decision, Efficiency benefit sharing scheme for the ACT and NSW 2009 distribution determinations*, February 2008, p. 3; and AER, *Better regulation, Explanatory statement, Efficiency benefit sharing scheme for electricity network service providers*, November 2013, pp. 7–8.

³⁴ This is why it is incorrect for Ausgrid (through Networks NSW) to state that opex efficiency gains create an 'uncompensated tax liability' within this period. The increase in profit is much larger than the increase in tax, by construction. As a basic illustration, with a corporate tax rate of 30 per cent and a gamma of 0.4, a \$100 reduction in opex will leave revenue unchanged, decrease expenses by \$100, increase tax liability (net of gamma) by \$18 and therefore increase net profit (return to equity holders) by \$82. Networks NSW, *Letter re: Networks NSW submission on changes to the Distribution Post-Tax Revenue Model (PTRM)*, 17 November 2014, pp. 2–3.

³⁵ For each year of EBSS carryover in the next regulatory control period, the business retains the benefit of the reduced expenses. In isolation, this would lead to the same higher profit and higher taxes as in the initial period. In the next period (but not the initial period) there would be further increase to regulated revenues reflecting the additional tax payable arising from the exclusion of EBSS carry-over from the estimate of tax expenses. Total profit will be even higher as a result.