



FINAL DECISION
Endeavour Energy distribution
determination
2015–16 to 2018–19

Attachment 8 – Corporate
income tax

April 2015

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Note

This attachment forms part of the AER's final decision on Endeavour Energy'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 policy

Attachment 19 - Analysis of financial viability

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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 |

| Shortened form | Extended form |
|----------------|---|
| 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 Endeavour Energy 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 Endeavour Energy to recover the costs associated with the estimated corporate income tax payable during the 2014–19 period.

This attachment presents our final decision on Endeavour Energy's revised proposed corporate income tax allowance for the 2014–19 period. It also presents our final decision on its 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 Endeavour Energy's revised proposed cost of corporate income tax allowance of \$349.2 million (\$ nominal). Our final decision on the estimated cost of corporate income tax is \$187.4 million (\$ nominal) for Endeavour Energy over the 2014–19 period. This represents a reduction of \$161.8 million (or 46.3 per cent) from its revised proposal.

This reduction reflects our final decision on the value of imputation credits—gamma—(attachment 4), and changes to the building block costs affecting revenues, which also 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 Endeavour Energy.

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

| | 2014–15 | 2015–16 | 2016–17 | 2017–18 | 2018–19 | Total |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|--------------|
| Tax payable | 60.4 | 57.8 | 64.5 | 63.8 | 65.8 | 312.3 |
| Less: value of imputation credits | 24.2 | 23.1 | 25.8 | 25.5 | 26.3 | 124.9 |
| Corporate income tax allowance | 36.2 | 34.7 | 38.7 | 38.3 | 39.5 | 187.4 |

Source: AER analysis.

¹ NER, cl. 6.4.3(a)(4).

8.2 Endeavour Energy's revised proposal

Endeavour Energy's revised proposal forecasts a cost of corporate income tax allowance of \$349.2 million (\$ nominal). Endeavour Energy's methodology for determining its corporate income tax is unchanged from its initial proposal. We accepted the approach in our draft decision. Endeavour Energy'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 Endeavour Energy has revised its corporate income tax allowance using the AER's PTRM and included the following inputs:

- the revised opening TAB at 1 July 2014, reflecting updates for 2013–14 actual capex
- revised forecast capex
- revised forecast opex.

Endeavour Energy also used the standard tax asset lives consistent with those approved in the draft decision and remaining tax asset lives reflecting updates for 2013–14 actual capex, and a value for gamma of 0.25 consistent with its initial proposal.

Table 8.2 sets out Endeavour Energy's revised proposed cost of corporate income tax allowance over the 2014–19 period.

Table 8.2 Endeavour Energy's revised proposed cost of corporate income tax allowance for the 2014–19 period (\$ million, nominal)

| | 2014–15 | 2015–16 | 2016–17 | 2017–18 | 2018–19 | Total |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|--------------|
| Tax payable | 87.8 | 86.9 | 95.6 | 96.0 | 99.3 | 465.6 |
| Less: value of imputation credits | 22.0 | 21.7 | 23.9 | 24.0 | 24.8 | 116.4 |
| Corporate income tax allowance | 65.9 | 65.2 | 71.7 | 72.0 | 74.5 | 349.2 |

Source: Endeavour Energy, *Revised regulatory proposal*, January 2015, Attachment 4.01a.

8.3 AER's assessment approach

We did not change our assessment approach for the cost of corporate income tax allowance from our draft decision. Section 8.3 of our draft decision details that approach.³

² Endeavour Energy, *Revised regulatory proposal*, January 2015, Attachment 4.01a.

³ AER, *Draft decision - Endeavour Energy distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 8–10.

8.4 Reasons for final decision

We do not accept Endeavour Energy's revised proposed cost of corporate income tax allowance. We instead determine a cost of corporate income tax allowance of \$187.4 million (\$ nominal) for the 2014–19 period. This represents a reduction of \$161.8 million (or 46.3 per cent) from Endeavour Energy's revised proposal.

We have accepted the following revised proposed inputs to the PTRM for tax purposes:

- the opening TAB value and the remaining tax asset lives at 1 July 2014, updated to reflect Endeavour Energy's actual capex for 2013–14 (sections 8.4.1 and 8.4.3)
- standard tax asset lives consistent with those approved in the draft decision (section 8.4.2).

However, we have adjusted the following proposed inputs to the PTRM that impact the estimated corporate income tax allowance:

- the value of gamma (attachment 4)
- other building block components which affect the calculation of the taxable income. These include forecast opex (attachment 7) and the rate of return (attachment 3).

8.4.1 Opening tax asset base

We accept Endeavour Energy's revised proposed opening TAB value of \$4576.6 million (\$ nominal) at 1 July 2014.

In the draft decision, we amended Endeavour Energy's proposed opening TAB for adjustments made to the net capex values in the roll forward model (RFM). We also noted the roll forward of Endeavour Energy's TAB included estimated capex values for 2013–14.⁴ Endeavour Energy's revised proposal adopted our draft decision adjustments to the net capex values and updated the TAB calculation for 2013–14 actual capex.⁵ As discussed in attachment 2, we have reconciled the 2013–14 actual capex in the revised proposal against Endeavour Energy's audited annual RIN for 2013–14. We therefore accept the actual capex for 2013–14, and the revised proposed opening TAB for Endeavour Energy.

Table 8.3 sets out our final decision on the roll forward of Endeavour Energy's TAB over the 2009–14 regulatory control period.

⁴ AER, *Draft decision - Endeavour Energy distribution determination attachment 8 - Corporate income tax*, November 2014, p. 8.

⁵ Endeavour Energy, *Revised regulatory proposal*, January 2015, Attachment 4.02.

Table 8.3 AER's final decision on Endeavour Energy's TAB roll forward for the 2009–14 regulatory control period (\$ million, nominal)

| | 2009–10 | 2010–11 | 2011–12 | 2012–13 | 2013–14 |
|--|---------|---------|---------|---------|---------------|
| Opening TAB | 2382.7 | 2703.4 | 3129.0 | 3676.4 | 4156.5 |
| Capital expenditure ^a | 442.0 | 535.6 | 677.3 | 623.7 | 601.3 |
| Less: tax depreciation | 121.3 | 110.0 | 129.9 | 143.5 | 156.4 |
| Closing TAB | 2703.4 | 3129.0 | 3676.4 | 4156.5 | 4601.4 |
| Meters moved to alternative control services | | | | | -24.7 |
| Opening TAB as at 1 July 2014 | | | | | 4576.6 |

Source: AER analysis.

(a) Net of disposals.

8.4.2 Standard tax asset lives

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

- broadly consistent with the values prescribed by the Commissioner for taxation in tax ruling 2014/4⁶
- 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 Endeavour Energy's proposed 42.6 years 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.⁷ Endeavour Energy's revised proposal adopted our draft decision on the standard tax asset life for the 'Equity raising costs' asset class.⁸

We are satisfied the standard tax asset lives in Endeavour Energy'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.⁹

⁶ 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 24 February 2015.

⁷ AER, *Draft decision - ActewAGL distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 13-14.

⁸ Endeavour Energy, *Revised regulatory proposal*, January 2015, Attachment 4.01a.

⁹ NER, cl. 6.5.3.

Table 8.4 sets out our final decision on the standard tax asset lives for Endeavour Energy.

8.4.3 Remaining tax asset lives

We accept Endeavour Energy's revised proposed remaining tax asset lives as at 1 July 2014, which reflect the updates made in the TAB roll forward for 2013–14 actual capex as discussed in section 8.4.1.

In the draft decision, we accepted Endeavour Energy's proposed weighted average method for calculating the remaining tax asset lives as at 1 July 2014. The proposed method is consistent with our preferred approach. We noted that the remaining tax asset lives would be updated for the final decision because Endeavour Energy's revised proposal would include revisions for 2013–14 actual capex. This is because the 2013–14 capex values are used to calculate the remaining tax asset lives. We did not accept Endeavour Energy's proposed adjustment to the remaining tax asset life for its 'Customer metering and load control' asset class.

Endeavour Energy's revised proposal adopted our draft decision adjustment to the remaining tax asset life for the 'Customer metering and load control' asset class and updated the calculation of its remaining tax asset lives for actual 2013–14 capex.¹⁰ We are satisfied that the updates to the 2013–14 actual capex have been reflected in the revised proposed remaining tax asset lives.

Table 8.4 sets out our final decision on the remaining tax asset lives as at 1 July 2014 for Endeavour Energy.

¹⁰ Endeavour Energy, *Revised regulatory proposal*, January 2015, Attachment 4.02.

Table 8.4 AER's final decision on Endeavour Energy's standard and remaining tax asset lives (years)

| Asset class | Standard tax asset life | Remaining tax asset life as at 1 July 2014 |
|--|-------------------------|--|
| Sub-transmission lines and cables | 46.8 | 38.0 |
| Distribution lines and cables | 47.9 | 39.0 |
| Substations | 40.0 | 33.8 |
| Transformers | 40.0 | 27.5 |
| Low Voltage lines and cables | 47.8 | 34.5 |
| Customer metering and load control | 25.0 | 18.0 |
| Communication | 10.0 | 8.3 |
| Land | n/a | n/a |
| Easements | n/a | n/a |
| Emergency spares (major plant, excludes inventory) | 40.0 | 26.9 |
| Information & communication technology | 2.9 | 2.0 |
| Furniture, fittings, plant and equipment | 8.6 | 4.5 |
| Motor vehicles | 12.1 | 7.1 |
| Buildings | 40.0 | 33.3 |
| Land (non-system) | n/a | n/a |
| Other non-system assets | n/a | n/a |
| Equity raising costs | 5.0 | 37.0 |

Source: AER analysis.

n/a: not applicable.