FINAL DECISION
Jemena Gas Networks (NSW) Ltd
Access Arrangement

2020 to 2025

Attachment 7
Corporate income tax

June 2020

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Note

This attachment forms part of the AER's final decision on the access arrangement that will apply to Jemena Gas Networks (NSW) Ltd ('JGN') for the 2020–25 access arrangement period. It should be read with all other parts of our final decision.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The final decision attachments have been numbered consistently with the equivalent attachments to our draft decision. In these circumstances, our draft decision reasons form part of this final decision.

Our final decision includes the following attachments:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Tax Office
Capex	Capital expenditure
CPI	Consumer price index
ITAA	Income Tax Assessment Act 1997
JGN	Jemena Gas Networks (NSW) Ltd
NGR	National Gas Rules
PTRM	Post-tax revenue model
RFM	Roll forward model
TAB	Tax asset base

7 Corporate income tax

Our determination of the total revenue for JGN includes the estimated cost of corporate income tax for JGN's 2020–25 access arrangement period.[1] Under the post-tax framework, a corporate income tax allowance is calculated as part of the building blocks assessment. This attachment presents our assessment of JGN's proposed corporate income tax allowance for the 2020–25 access arrangement period. It also presents our assessment of its proposed opening tax asset base (TAB), and the standard tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

7.1 Final decision

Our final decision on JGN's estimated cost of corporate income tax is $9.3 million over the 2020–25 access arrangement period. This decision represents an increase of $0.4 million (or 4.7 per cent) from JGN's revised proposed cost of corporate income tax allowance of $8.9 million ($ nominal).

The estimated corporate income tax is impacted by our decision on various building block components. The higher corporate income tax is mainly driven by a lower tax depreciation which resulted from the reduction we made to the forecast capex. All things being equal, the lower tax depreciation means a higher estimated taxable income, and therefore also a higher corporate income tax allowance for JGN in the 2020–25 period.

For this final decision, we determine an opening TAB value as at 1 July 2020 of $1228.1 million ($ nominal). This value is $0.4 million ($ nominal) higher than JGN's revised proposal of $1227.7 million ($ nominal). The marginal difference is due to our update to the 2019–20 actual inflation input in JGN's revised proposed roll forward model (RFM) which consequently updated the capital expenditure (capex) being rolled into the TAB.

Our final decision confirms our acceptance of JGN's approach to forecast its cost of corporate income tax for the 2020–25 access arrangement, which includes continuing with the use of the diminishing value method of tax depreciation applied in its previous access arrangements. We also accept JGN's revised proposed standard tax asset lives for all of its asset classes.

Table 7.1 sets out our final decision on the estimated cost of corporate income tax for JGN over the 2020–25 access arrangement period.

1 National Gas Rules (NGR), r. 76(c).

Table 7.1 AER's final decision on JGN's cost of corporate income tax for the 2020–25 access arrangement period ($million, nominal)

	2020–21	2021–22	2022–23	2023–24	2024–25	Total
Tax payable	3.0	4.5	5.8	7.4	1.7	22.5
Less: value of imputation credits	1.8	2.6	3.4	4.3	1.0	13.1
Net corporate income tax allowance	**1.3**	**1.9**	**2.4**	**3.1**	**0.7**	**9.3**

Source: AER analysis.

In the draft decision, we accepted JGN's proposed:[2]

- approach to calculate its forecast corporate income tax allowance for the 2020–25 access arrangement period, as it was based on our PTRM (version 4) for electricity service providers
- implementation of the findings from our 2018 review of the regulatory tax approach.[3] Specifically, we accepted JGN's proposal to apply the diminishing value method for tax depreciation to all new depreciable assets except for the forecast (capex) associated with buildings, leasehold improvements and in-house software
- standard tax asset lives for all of its existing asset classes as they were broadly consistent with the tax asset lives prescribed by the Australian Tax Office's (ATO) taxation ruling 2019/5
- standard tax asset lives of 40 years for the new 'Buildings' and 'Leasehold improvements' asset classes, and 5 years for the 'Software – Inhouse' asset class, as they were consistent with the tax law.[4]

Opening tax asset base as at 1 July 2020

For our final decision, we determine an opening TAB value as at 1 July 2020 of $1228.1 million ($ nominal). This value is $0.4 million ($ nominal) higher than JGN's revised proposal of $1227.7 million ($ nominal). The marginal difference is due to our update to the 2019–20 actual inflation input in JGN's revised proposed RFM which consequently updated the capex being rolled into the TAB. All things being equal, the increase to the opening TAB value slightly decreases the corporate income tax allowance.

In our draft decision, we accepted JGN's proposed method to establish the opening TAB as at 1 July 2020. However, we corrected some consumer price index (CPI) adjustment errors in the TAB roll-forward. We noted that the opening TAB may be

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2 AER, *JGN 2020–25 Access Arrangement – Draft Decision – Attachment 7 – Corporate income tax*, November 2019, p. 5.

3 AER, *Final report: Review of regulatory tax approach*, December 2018.

4 ITAA, sections 40.95(7), 43.15, 43.140, 43.210.

updated to reflect actual capex for 2018–19 and any revised 2019–20 capex estimates as part of the final decision.[5]

JGN's revised proposal adopted the amendments we made to the opening TAB value in the draft decision in full. It also updated the 2018–19 estimated capex with actuals and revised the 2019–20 estimate of capex with the latest figures. [6]

We have checked the 2018–19 actual capex in the revised proposal and are satisfied that it aligns with JGN's annual reporting regulatory information notice for that year. For the reasons discussed in Attachment 2, we accept the updated 2019–20 capex estimated in the revised proposal. This capex estimate is lower than the approved amount in our draft decision, reflecting more recent data. We will update this for actuals at the next access arrangement review.

As discussed in Attachment 2, JGN has identified in its revised proposal, $3.4 million ($2019–20) of assets in its capital base which are no longer used to provide pipeline services.[7] It has made a final year adjustment at the end of the 2015–20 access arrangement period to remove these assets from the TAB.[8] We consider this final year adjustment appropriate because assets that do not provide pipeline services should not be included in the TAB for the purposes of calculating the corporate income tax allowance. Our final decision therefore accepts this adjustment to the opening TAB at 1 July 2020. We have updated the adjustment for 2019–20 actual CPI, which is now available.[9]

Table 7.2 sets out our final decision on the roll forward of JGN's TAB values over the 2015–20 access arrangement period.

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5 AER, *JGN 2020–25 Access Arrangement – Draft Decision – Attachment 7 – Corporate income tax*, November 2019, p. 17.

6 JGN, *2020–25 Revised Proposal – Revised 2020 Plan,* January 2020, p. 27, Table 6.6.

7 JGN, *2020–25 Revised Proposal – Attachment 6.2 – Contaminated sites asset classes,* January 2020.

8 JGN, *2020–25 Revised Proposal – Attachment 6.1 – RFM,* January 2020.

9 The CPI update decreased the value of the final year adjustment by $0.01 million.

Table 7.2 AER's final decision on JGN's TAB roll forward for the 2015–20 access arrangement period

	2015–16	2016–17	2017–18	2018–19	2019–20[a]
Opening TAB	944.8	1023.5	1074.1	1130.1	1169.9
Capital expenditure[b]	204.6	181.7	189.1	174.7	198.8
Less: tax depreciation	125.9	131.1	133.1	134.9	137.2
Final year asset adjustment[c]					–3.4
Closing TAB	**1023.5**	**1074.1**	**1130.1**	**1169.9**	**1228.1**

Source: AER analysis.

(a) Based on estimated capex.

(b) Net of disposals.

(c) This adjustment relates to the removal of assets from the TAB that are no longer used to provide pipeline services at the end of the 2015–20 access arrangement period.

Standard tax asset lives

For this final decision, we accept JGN's revised proposed standard tax asset lives for all of its asset classes. They are consistent with our draft decision, and we confirm our position that the standard asset lives are broadly consistent with the values prescribed by the Commissioner for taxation in ATO ruling 2019/5 and the ITAA.[10]

Table 7.3 sets out our final decision on the standard tax asset lives for JGN. We are satisfied that the standard tax asset lives are appropriate for application over the 2020–25 access arrangement period. We are also satisfied the standard tax asset lives provide an estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.[11]

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[10] ATO, *Taxation Ruling TR2019/5 – Income tax: effective life of depreciating assets (applicable from 1 July 2019)*, p.180. They are also consistent with the statutory cap on the effective life of 20 years for gas pipeline assets under the ITAA.

[11] NGR, r. 87A(1).

Table 7.3 AER's final decision on JGN's standard tax asset lives (years)

Tax asset class	Standard tax asset life
Trunk Wilton-Sydney	20.0
Trunk Sydney-Newcastle	20.0
Trunk Wilton-Wollongong	20.0
Contract meters	15.0
Fixed plant - distribution	20.0
HP mains	20.0
HP services	20.0
MP mains	20.0
MP services	20.0
Meter reading devices	15.0
Country POTS	20.0
Tariff meters	15.0
Computers - IT infrastructure	4.0
Fixed plant	10.8
Furniture	10.8
Land	n/a
Low value assets	6.5
Mobile plant	6.5
Vehicles	7.5
Existing pigging and inspection costs	n/a
Leasehold improvements[a]	40.0
Buildings[a]	40.0
Software - Inhouse[a]	5.0
Equity raising costs[a]	5.0

Source: AER analysis.

(a) These are the only asset classes used for the straight-line method of tax depreciation. All other asset classes used the diminishing value method of tax depreciation.

n/a Not applicable. We have not assigned a standard tax asset life to the 'Land' asset class because it is a non-depreciating asset for tax purposes. We have not assigned a standard tax asset life to the 'Existing pigging and inspection costs' asset class as we do not expect any forecast capex to be allocated to it for the 2020–25 access arrangement period. This is because the pigging and inspection costs will be expensed going forward from the start of the 2020–25 period. Instead, the residual tax value for this asset class will be fully depreciated over the 2020–25 period.

7.2 Assessment approach

We did not change our assessment approach for the cost of corporate income tax from our draft decision. Attachment 7 (section 7.3) of our draft decision details that approach.[12]

[12] AER, *JGN 2020–25 Access Arrangement – Draft Decision – Attachment 7 – Corporate income tax*, November 2019, pp. 8–14.