FINAL DECISION

Jemena
Distribution Determination
2021 to 2026

Attachment 7
Corporate income tax

April 2021

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the Australian Energy Regulator (AER)'s final decision on the distribution determination that will apply to Jemena for the 2021–26 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Not applicable to this distributor

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Negotiating framework

Contents

7 Corporate income tax

Our distribution determination includes the estimated cost of corporate income tax for Jemena's 2021–26 regulatory control period. Under the post-tax framework, the cost of corporate income tax is calculated as part of the building block assessment using our post-tax revenue model (PTRM).

This attachment sets out our final decision on Jemena's revised proposed cost of corporate income tax for the 2021–26 regulatory control period. It presents our assessment of the inputs required in the PTRM for the calculation of the cost of corporate income tax.

7.1 Final decision

Our final decision on Jemena's estimated cost of corporate income tax is $33.6 million over the 2021–26 regulatory control period. This represents an increase of $8.0 million (or 31.4 per cent) from Jemena's revised proposed cost of corporate income tax of $25.6 million ($ nominal). The key reasons for this change are:

- Our final decision to increase the regulatory depreciation (attachment 4).[1]
- Our final decision to increase the rate of return on equity (attachment 3).[2]
- Our final decision to change the tax treatment of gifted assets, consistent with a recent ruling by the Full Federal Court of Australia made after the draft decision.[3]

We accept the revised proposed opening tax asset base (TAB) value as at 1 July 2021 of $1272.9 million.[4] We also accept Jemena's revised proposal on the standard and remaining tax asset lives for all of its asset classes, consistent with our draft decision.

For this final decision, we confirm our acceptance in the draft decision that Jemena has no forecast for immediately expensing of capex for the 2021–26 regulatory control period. We are satisfied that Jemena has not immediately expensed capex for tax purposes historically and therefore its forecast of zero over the 2021–26 regulatory control period is in line with its current practice. We will collect actual data relating to this expenditure in our annual reporting regulatory information notice to further inform our decision on the amount of forecast immediate expensing of capex in the next regulatory determination for Jemena.

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1 All else equal, a higher regulatory depreciation amount will increase the cost of corporate income tax because it increases the taxable income.

2 All else equal, a higher rate of return on equity will increase the cost of corporate income tax because it increases the return on equity, a component of the taxable income.

3 Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169*, 21 October 2020.

4 Subject to minor input updates for equity raising costs for the 2021 half year. These changes are minor and do not have a material impact on the TAB (less than $0.01 million).

Table 7.1 sets out our final decision on the estimated cost of corporate income tax for Jemena over the 2021–26 regulatory control period.

Table 7.1 AER's final decision on Jemena's cost of corporate income tax for the 2021–26 regulatory control period ($ million, nominal)

	2021–22	2022–23	2024–24	2024–25	2025–26	Total
Tax payable	17.8	15.0	12.9	17.8	17.4	80.9
Less: value of imputation credits	10.4	8.8	7.5	10.4	10.2	47.3
Net cost of corporate income tax	**7.4**	**6.2**	**5.3**	**7.4**	**7.2**	**33.6**

Source: AER analysis.

In the draft decision, we made the following changes to Jemena's modelling of its cost of corporate income tax:[5]

- We revised the opening TAB as at 1 July 2021 to update the roll forward model (RFM) for 2019 actual capex.[6]
- We accepted Jemena's proposed standard tax asset lives, with the exception of adjusting the life for ‘Non network - IT’ asset class from 4.4 years to 4 years. We also determined standard tax asset lives of 40 years and 5 years respectively for the two new asset classes of 'Buildings - capital works'[7] and 'In-house software'[8] that are subject to the straight-line method of tax depreciation.[9]
- While we accepted Jemena's proposed approach to calculating its remaining tax asset lives as at 1 July 2021, we updated these lives to reflect our adjustments to the opening TAB value.[10]

Jemena's revised proposal adopted the changes required by the draft decision in full.[11]

5 AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 4–5.

6 AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 15–16.

7 This is consistent with the number of years required to completely depreciate a capital works asset such as buildings under the Income Tax Assessment Act 1997 (ITAA), ss. 43.15, 43.140 and 43.210.

8 This is consistent with the ITAA, s. 40.95(7).

9 AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 17–18.

10 AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 16–17.

11 Jemena, *Att 03-01 Annual revenue requirement - revised,* December 2020, pp. 20–21.

Opening tax asset base as at 1 July 2020

For this final decision, we accept Jemena's revised proposed opening TAB value as at 1 July 2021 of $1272.9 million ($ nominal).[12] This is $3.6 million (or 0.3 per cent) lower than the value of $1276.5 million determined in our draft decision.

In our draft decision, we accepted Jemena's proposed method to establish the opening TAB as at 1 July 2021. However, we amended some of the proposed inputs used for the TAB roll forward—specifically, we made adjustments for actual and estimated capex and a reallocation for accelerated tax depreciation. We noted that the opening TAB may be updated as part of the final decision to reflect:

- any revised 2020 capex estimates
- any revised capex estimates for the six month period between 1 January to 30 June 2021.

Jemena's revised proposal adopted our draft decision changes.[13] It provided a revised estimate for 2020 capex and 2021 half year capex in its response to our information request.[14]

For the reasons discussed in attachment 2, we accept the updated 2020 and 2021 half year capex estimate for this final decision. The capex estimate for 2020 is lower and the capex estimate for 2021 half year is higher compared to what we approved in our draft decision, reflecting more recent data. We will update the 2020 and the six month period estimated capex for actuals at the next revenue reset (2026–31).

Table 7.2 sets out our final decision on the roll forward of Jemena's TAB values over the 2016–21 period.

Table 7.2 AER's final decision on Jemena's TAB roll forward for the 2016–21 period ($ million, nominal)

	2016	2017	2018	2019	2020[a]	2021[b]
Opening TAB	746.7	831.2	941.5	1041.5	1132.9	1215.1
Capital expenditure[c]	125.7	155.7	149.4	144.8	143.5	91.0
Less: tax depreciation	41.2	45.4	49.4	53.4	61.3	33.2
Closing TAB	**831.2**	**941.5**	**1041.5**	**1132.9**	**1215.1**	**1272.9**

Source: AER analysis.

(a) Based on estimated capex. We expect to update the TAB roll forward for actual capex in the final decision.

[12] Subject to minor input updates for equity raising costs for the 2021 half year. These changes are minor and do not have a material impact on the TAB (less than $0.01 million).

[13] Jemena, *Att 03-01 Annual revenue requirement - revised,* 03 December 2020, pp. 20–21.

[14] Jemena, *Response to AER Information Request #065*, 22 January 2021.

(b) The half year period of 1 January to 30 June 2021. Based on estimated capex. We expect to update the TAB roll forward with a revised capex estimate in the final decision,

(c) Net of disposals.

Treatment of gifted assets in customer contributions

For this final decision, we have changed the tax treatment of gifted assets for Jemena. We have therefore excluded the value of gifted assets from the cash flow modelling in the PTRM for the purposes of calculating the corporate income tax building block.

In our draft decision, we applied the usual treatment as adopted by the Australian Taxation Office where gifted assets (along with cash customer contributions) were included as assessable income in the cash flow modelling in the PTRM.

On 21 October 2020, the Full Federal Court of Australia published its determination on the tax treatment of customer contributions.[15] The determination:

- Confirmed an earlier Court ruling that cash contributions were ordinary income and should be treated as assessable income for tax purposes.
- Overturned an earlier Court ruling and determined that while a gifted asset was a 'non-cash business benefit' there was effectively nil income for tax purposes.

We consider the Court's ruling on gifted assets require us to change the tax treatment in our cash flow modelling in the PTRM. As such, the cost of construction of these assets has to be removed from Jemena's revised proposed gross capex and customer contributions.[16] While this results in no change to net capex, this tax treatment change results in a decrease to the cost of corporate income tax building block. Jemena submitted its revised gross capex and customer contributions in response to our information request to exclude the value of gifted assets.[17] The impact of this change in approach for gifted assets will reduce Jemena's cost of corporate income tax, all else being equal.

We have assessed Jemena's revisions and are satisfied that it implements the Court's ruling on the tax treatment of gifted assets.

Standard and remaining tax asset lives

For this final decision, we accept Jemena's revised proposed standard and remaining 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 the Australian Tax Office ruling 2020/3 and the Income Tax Assessment Act 1997. Jemena’s revised proposed

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15 Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169*, 21 October 2020.

16 Any associated rebates would remain being included in net capex and therefore treated as a tax depreciating asset.

17 Jemena, *Response to AER Information Request #061*, 13 January 2021.

approach to calculate the remaining tax asset lives as at 1 July 2021 for tax depreciation purposes of its existing assets is consistent with the approach accepted in our draft decision.

Table 7.3 sets out our final decision on the standard and remaining tax asset lives as at 1 July 2021 for Jemena. We are satisfied that the standard and remaining tax asset lives are appropriate for application over the 2021–26 regulatory control period. We are also satisfied that the standard and remaining 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.[18]

Table 7.3 AER's final decision on Jemena's standard and remaining tax asset lives (years)

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2021[b]
Subtransmission	43.0	32.4
Distribution system assets	45.2	33.6
SCADA/Network control	10.0	7.0
Non network - IT	4.0	3.1
Non network - other	10.3	10.3
Land	n/a	n/a
Buildings - capital works	40.0[a]	n/a
In-house software	5.0[a]	n/a
Equity raising costs	5.0[a]	2.9

Source: AER analysis.

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

(b) Used for straight-line method of tax depreciation.

n/a not applicable. We have not assigned a standard tax asset life and remaining tax asset life to the 'Land' asset class because the assets allocated to it are non-depreciating assets. We also have not assigned a remaining tax asset life to the 'Buildings - capital works' and 'In-house software' asset classes prescribed for SL tax depreciation because they have no opening TAB values as at 1 July 2021.

18 National Electricity Rules, cl. 6.5.3.

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.[19]

[19] AER, *Draft decision: Jemena distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 6–13.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
ITAA	Income Tax Assessment Act 1997
PTRM	post-tax revenue model
RFM	roll forward model
TAB	tax asset base