



FINAL DECISION
Australian Gas Networks
Access Arrangement
2016 to 2021

Attachment 8 – Corporate
income tax

May 2016

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Note

This attachment forms part of the AER's final decision on the access arrangement for Australian Gas Networks South Australian distribution network for 2016–21. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 - Services covered by the access arrangement

Attachment 2 - Capital 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 carryover mechanism

Attachment 10 - Reference tariff setting

Attachment 11 - Reference tariff variation mechanism

Attachment 12 - Non-tariff components

Attachment 13 - Demand

Attachment 14 - Other incentive schemes

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Shortened forms

Shortened form	Extended form
AA	Access Arrangement
AAI	Access Arrangement Information
AER	Australian Energy Regulator
AGN	Australian Gas Networks
ATO	Australian Tax Office
capex	capital expenditure
CAPM	capital asset pricing model
CCP	Consumer Challenge Panel
CESS	Capital Expenditure Sharing Scheme
CPI	consumer price index
CSIS	Customer Service Incentive Scheme
DRP	debt risk premium
EBSS	Efficiency Benefit Sharing Scheme
ECM	Efficiency Carryover Mechanism
ERP	equity risk premium
Expenditure Guideline	Expenditure Forecast Assessment Guideline
gamma	value of imputation credits
GSL	Guaranteed Service Level
MRP	market risk premium
NECF	National Energy Customer Framework
NERL	National Energy Retail Law
NERR	National Energy Retail Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NIS	Network Incentive Scheme
NPV	net present value
opex	operating expenditure
PFP	partial factor productivity
PPI	partial performance indicators

Shortened form	Extended form
PTRM	post-tax revenue model
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RoLR	retailer of last resort
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	Service Target Performance Incentive Scheme
TAB	tax asset base
UAFG	unaccounted for gas
WACC	weighted average cost of capital
WPI	Wage Price Index

8 Corporate income tax

When determining the total revenue for AGN, we must estimate AGN's cost of corporate income tax.¹ AGN has adopted the post-tax framework to derive its revenue requirement for the 2016–21 access arrangement period.² Under the post-tax framework, a separate corporate income tax allowance is calculated as part of the building blocks assessment.

8.1 Final decision

We do not approve AGN's proposed corporate income tax allowance of \$44.6 million (\$nominal) for the 2016–21 access arrangement period. This is mainly a consequence of our adjustments to AGN's proposed value of imputation credits—(gamma)—(attachment 4) and other building block costs that affect revenues, such as the rate of return on capital (attachment 3) and forecast capex (attachment 6).³

Consistent with our draft decision, we accept AGN's proposed method to roll forward the tax asset base (TAB) because it is consistent with the AER's roll forward model (RFM) for electricity service providers and the approach previously approved in gas access arrangement decisions. In accepting the approach, however, we have updated AGN's opening TAB as at 1 July 2016 to \$608.0 million (\$nominal) because we updated the value of conforming capex over the roll forward period as discussed in attachment 2. Our final decision is \$0.4 million or 0.1 per cent (\$nominal) higher than AGN's revised proposed value of \$607.6 million (\$nominal).

Our adjustments result in an estimated cost of corporate income tax of \$8.7 million (\$nominal) for AGN for the 2016–21 access arrangement period as shown in Table 8.1.

We have revised the access arrangement having regard to our reasons for refusing to approve AGN's proposal and the further matters identified in the NGR section 64(2). Our revisions are reflected in the *Approved Access Arrangement for Australian Gas Networks' South Australian distribution network for 2016–21*, which gives effect to this decision.

¹ NGR, r. 76(c).

² AGN, *Revised access arrangement information, Attachment 11.10*, January 2016, p. 1.

³ Changes to other building block costs affect revenues, which also impact the tax calculation.

Table 8.1 AER’s final decision on corporate income tax allowance for AGN (\$million, nominal)

	2016–17	2017–18	2018–19	2019–20	2020–21	Total
Tax payable	3.7	3.0	2.7	3.7	1.4	14.5
Less: value of imputation credits	1.5	1.2	1.1	1.5	0.5	5.8
Net corporate income tax allowance	2.2	1.8	1.6	2.2	0.8	8.7

Source: AER analysis.

8.2 AGN’s revised proposal

AGN's revised proposal forecast a cost of corporate income tax of \$44.6 million (\$nominal) for the 2016–21 access arrangement period. AGN's methodology for determining its corporate income tax is unchanged from its initial proposal.

AGN adopted the methodology accepted in our draft decision to determine the revised proposed TAB at 1 July 2016. The TAB was updated for the 2014–15 actual capex and 2015–16 revised estimate of capex.

AGN’s revised proposed roll forward of its TAB over the 2011–16 access arrangement period is set out in Table 8.2.

Table 8.2 AGN’s revised proposed tax asset base roll forward over the current 2011–16 access arrangement period (\$million, nominal)

	2011–12	2012–13	2013–14	2014–15	2015–16
Opening tax asset base	270.3	311.3	375.5	451.7	525.3
Capex	55.8	81.5	98.4	102.2	118.6
Tax depreciation	–14.7	–17.4	–22.1	–28.7	–36.2
Closing tax asset base	311.3	375.5	451.7	525.3	607.6

Source: AGN, *Revised proposed RFM*, January 2016.

Note: Numbers may not add due to rounding.

Applying the same approach accepted in the draft decision, AGN's revised proposal calculated the corporate income tax over the 2016–21 access arrangement period using the following inputs:

- Revised opening TAB at 1 July 2016 of \$607.6 million (\$nominal) reflecting updates for 2014–15 actual capex and 2015–16 revised estimate of capex.
- An expected statutory income tax rate of 30 per cent per year.

- A value for the assumed utilisation of imputation credits (gamma) of 0.25 which is consistent with its initial proposal.
- The standard tax asset lives as approved in the 2011–16 access arrangement period.
- Revised remaining tax asset lives which are calculated using a weighted average remaining life approach as contained in its revised proposed RFM.
- Revised forecast capex.
- Revised forecast opex.

For the 2016–21 access arrangement period, AGN's revised proposal forecast a total corporate income tax cost of \$44.6 million (\$nominal) as set out in Table 8.3.

Table 8.3 AGN's revised proposed cost of corporate income tax for the 2016–21 access arrangement period (\$million, nominal)

	2016–17	2017–18	2018–19	2019–20	2020–21	Total
Tax payable	12.0	11.7	11.7	13.2	11.1	59.5
Less: Value of imputation credits	3.0	2.9	2.9	3.3	2.8	14.9
Net corporate income tax allowance	9.0	8.8	8.7	9.9	8.3	44.6

Source: AGN, *Revised proposed PTRM*, January 2016.

8.3 AER's assessment approach

We have not changed our assessment approach for the corporate income tax from our draft decision. Section 8.3 of our draft decision details that approach.⁴

8.4 Reasons for final decision

Our final decision on AGN's corporate income tax allowance is \$8.7 million (\$nominal), which is a reduction of \$35.9 million (\$nominal) or 80.5 per cent of AGN's revised proposal.

Consistent with our draft decision, we accept AGN's proposed approach for calculating the cost of corporate income tax for the 2016–21 access arrangement period. In accepting the approach, we have adjusted several inputs in AGN's revised proposed PTRM for calculating the cost of corporate income tax. These relate to:

- Changing the value of gamma to 0.4 from 0.25 (attachment 4).

⁴ AER, *Draft decision, attachment 8*, November 2015, pp. 8-10.

- Changes to other building block components including rate of return on capital (attachment 3) and forecast capex (attachment 6) that impact total revenues and therefore also impact the forecast corporate income tax allowance.⁵

In our draft decision we did not accept AGN's proposed tax treatment of revenue adjustments associated with the EBSS. AGN's revised proposal adopted our draft decision on the tax treatment.⁶

8.4.1 Opening tax asset base as at 1 July 2016

Consistent with the draft decision, we accept AGN's proposed method to roll forward the TAB. However, we do not approve the revised proposed opening TAB of \$607.6 million (\$nominal) as at 1 July 2016. We instead determined an opening TAB of \$608.0 million (\$nominal). This amendment is made because we updated the value of conforming capex for 2013–14, 2014–15 and 2015–16 as discussed in attachment 2.

In our draft decision, we accepted AGN's proposed approach to determine the opening TAB at 1 July 2016. This is because AGN's proposed approach is consistent with the AER's RFM for electricity service providers and the approach previously approved in gas access arrangement decisions. However, we did not accept the opening TAB value from AGN's initial proposal due to amendments we made to the remaining tax asset lives inputs in the proposed RFM. We noted that the capex inputs for 2014–15 and 2015–16 may be updated in the revised proposal based on more up to date information.

AGN's revised proposal adopted our draft decision adjustments to roll forward the opening TAB from 1 July 2011 to 30 June 2016. It also updated the capex inputs for 2014–15 with actuals and a revised estimate for 2015–16.

For this final decision, we updated AGN's revised proposed capex for 2013–14, 2014–15 and 2015–16. This is because AGN informed us that it had made a transcription error when its revised proposed RFM was updated for 2014–15 actual capex. AGN also made further updates to its revised proposed conforming capex for 2013–14, 2014–15 and 2015–16 to reflect the reclassification of the valve corrosion projects from capex to opex. As discussed in attachment 6, we accept these updates made by AGN. We have therefore included the updated capex in the TAB roll forward.

We note that the capex for 2015–16 is an estimate. We will assess whether the 2015–16 actual capex is conforming capex as part of the next access arrangement review.

Table 8.4 sets out our final decision on the roll forward of AGN's TAB values.

⁵ NGR, r. 87A.

⁶ AGN, *Revised access arrangement information, Attachment 11.10*, January 2016, p. 2.

Table 8.4 AER’s final decision on AGN's tax asset base roll forward for the 2011–16 access arrangement period (\$million, nominal)

	2011–12	2012–13	2013–14	2014–15	2015–16
Opening tax asset base	270.3	311.3	375.5	451.6	525.8
Capex	55.8	81.5	98.3	102.8	118.5
Tax depreciation	–14.7	–17.4	–22.1	–28.7	–36.3
Closing tax asset base	311.3	375.5	451.6	525.8	608.0

Source: AER analysis.

8.4.2 Standard tax asset lives

Consistent with our draft decision, we approve AGN's revised proposed standard tax asset lives assigned to each of its asset classes for the 2016–21 access arrangement period. This is because they are consistent with the statutory cap on the effective life of gas transmission assets under the *Income Tax Assessment Act (ITAA) 1997*, and with the standard tax asset lives prescribed in the Tax Ruling 2015/2.⁷ The proposed standard tax asset lives are also consistent with the approved standard tax asset lives in the 2011–16 access arrangement.⁸

Table 8.5 sets out our final decision on the standard tax asset lives for AGN.

8.4.3 Remaining tax asset lives as at 1 July 2016

Consistent with our draft decision, we accept AGN's proposed weighted average method to calculate remaining tax asset lives at 1 July 2016. In accepting the weighted average method, we have updated AGN's remaining tax asset lives as at 1 July 2016 for this final decision.

In our draft decision, we accepted AGN's proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2016 which is consistent with our preferred approach. We updated AGN's remaining tax asset lives as at 1 July 2016 to reflect our amendments to the remaining tax asset lives inputs as at 1 July 2010. AGN adopted these amendments in its revised proposal.⁹

We also noted in our draft decision that the remaining tax asset lives may be recalculated for the final decision because of updates to AGN's 2014–15 and 2015–16 capex estimates in the TAB roll forward. These capex values are inputs used to

⁷ ITAA 1997, s. 40.102(5); Australian Taxation Office, *Taxation Ruling Income tax: effective life of depreciating assets (applicable from 1 July 2015)*: <http://law.ato.gov.au/atolaw/view.htm?docid=%22TXR%2FTR20152%2FNAT%2FATO%2F00001%22>.

⁸ AER, *Envestra SA final decision PTRM (Tribunal varied)*, January 2012.

⁹ AGN, *Revised access arrangement information, Attachment 11.10*, January 2016, p. 2.

calculate the weighted average remaining tax asset lives.¹⁰ Based on revisions for 2013–14, 2014–15 and 2015–16 capex in the TAB roll forward as discussed in 8.4.1, we have updated AGNs remaining tax asset lives as at 1 July 2016 for this final decision.

Our final decision on AGN's remaining tax asset lives for each of its asset classes for the 2016–21 access arrangement period is set out in Table 8.5.

Table 8.5 AER's final decision on AGN's standard tax asset lives and remaining tax asset lives as at 1 July 2016 for the 2016–21 access arrangement period (year)

Tax asset class	Standard tax asset life	Remaining tax asset life as at 1 July 2016
Mains	20	18.8
Inlets	20	15.3
Meters	15	11.1
Telemetry	10	6.7
IT system	4	2.8
Other distribution system equipment	20	17.4
Other	10	8.2

Source: AER analysis.
n/a Not applicable.

¹⁰ AER, *Draft decision, attachment 8*, November 2015, p. 13.