



**FINAL DECISION**  
**CitiPower distribution**  
**determination**  
**2016 to 2020**

**Attachment 8 – Corporate**  
**income tax**

May 2016

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## Note

This attachment forms part of the AER's final decision on CitiPower's distribution determination for 2016–20. It should be read with all 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 mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

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## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMI	Advanced metering infrastructure
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

Shortened form	Extended form
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 CitiPower's 2016–20 regulatory control period.<sup>1</sup> 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 CitiPower to recover the costs associated with the estimated corporate income tax payable during the 2016–20 regulatory control period.

This attachment presents our final decision on CitiPower's revised proposed corporate income tax allowance for the 2016–20 regulatory control 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 CitiPower's revised proposed cost of corporate income tax allowance of \$160.5 million (\$ nominal).<sup>2</sup> Our final decision on the estimated cost of corporate income tax is \$96.9 million (\$ nominal) for CitiPower over the 2016–20 regulatory control period. This represents a reduction of \$63.6 million (or 39.6 per cent) from its revised proposal.

The reduction reflects our amendments to CitiPower's proposed inputs for forecasting the cost of corporate income tax such as the opening TAB (section 8.4.1) and the value of imputation credits—gamma—(attachment 4). Changes to the building block costs also affect revenues, which in turn impacts 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 CitiPower over the 2016–20 regulatory control period.

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<sup>1</sup> NER, cl. 6.4.3(a)(4).

<sup>2</sup> To accurately reflect the corporate income tax allowance proposed by CitiPower, the revised proposal tax amounts presented in this attachment are calculated using the rate of return from the revised proposal. These amounts are different from the amounts set out on page 390 of CitiPower's revised proposal which are calculated using the rate of return from our preliminary decision. See CitiPower, *Revised regulatory proposal*, 6 January 2016, pp. 10, 251 and attachment 1.10 (*CP PUBLIC RRP MOD 1.10 CP 2016-20 PTRM.xlsx*); and CitiPower, *Letter re: Impact of rate of return on allowed revenues*, 20 January 2016.

**Table 8.1 AER's final decision on CitiPower's cost of corporate income tax allowance for the 2016–20 regulatory control period (\$ million, nominal)**

	2016	2017	2018	2019	2020	Total
Tax payable	33.6	33.7	31.0	30.9	32.4	161.5
Less: value of imputation credits	13.4	13.5	12.4	12.4	12.9	64.6
<b>Net corporate income tax allowance</b>	<b>20.1</b>	<b>20.2</b>	<b>18.6</b>	<b>18.5</b>	<b>19.4</b>	<b>96.9</b>

Source: AER analysis.

## 8.2 CitiPower's revised proposal

CitiPower's revised proposal forecasts a cost of corporate income tax allowance of \$160.5 million (\$ nominal) for the 2016–20 regulatory control period. CitiPower's revised proposal adopted the methodology approved in the preliminary decision for determining its corporate income tax.

CitiPower has revised its corporate income tax allowance using the AER's PTRM and included the following inputs:

- revised forecast capex<sup>3</sup>
- revised forecast opex.

CitiPower's revised proposal also used the opening TAB at 1 January 2016, standard and remaining tax asset lives consistent with those approved in the preliminary decision. However, it used a value for gamma of 0.25 consistent with its initial proposal.<sup>4</sup>

Table 8.2 sets out CitiPower's revised proposed corporate income tax allowance for the 2016–20 regulatory control period.

**Table 8.2 CitiPower's revised proposed cost of corporate income tax allowance for the 2015–20 regulatory control period (\$ million, nominal)**

	2016	2017	2018	2019	2020	Total
Tax payable	42.9	43.7	41.5	42.1	43.8	214.1
Less: value of imputation credits	10.7	10.9	10.4	10.5	10.9	53.5
<b>Net corporate income tax allowance</b>	<b>32.2</b>	<b>32.8</b>	<b>31.2</b>	<b>31.6</b>	<b>32.8</b>	<b>160.5</b>

Source: CitiPower, *Revised regulatory proposal*, January 2016, p. 390.

<sup>3</sup> This includes some reallocation of forecast capex from the 'Victorian Bushfire Royal Commission' asset class to the 'Distribution System Assets' asset class. This issue is considered by us in attachment 5 of this final decision.

<sup>4</sup> CitiPower, *Revised regulatory proposal*, January 2016, p. 453.



## 8.3 Assessment approach

We have not changed our assessment approach for the cost of corporate income tax from our preliminary decision. Section 8.3 of our preliminary decision details that approach.<sup>5</sup>

## 8.4 Reasons for final decision

We do not accept CitiPower's revised proposed cost of corporate income tax allowance of \$160.5 million (\$ nominal). We instead determine a cost of corporate income tax allowance of \$96.9 million for the 2016–20 regulatory control period. This represents a reduction of \$63.6 million (or 39.6 per cent) from CitiPower's revised proposal.

This is because we adjusted the following proposed inputs to the PTRM for tax purposes:

- the opening TAB value as at 1 January 2016, updated for a revised estimate of 2015 capex (section 8.4.1)
- the remaining tax asset lives at 1 January 2016 (section 8.4.2)
- the value of gamma (attachment 4)
- other building block components including forecast opex (attachment 7) and forecast capex (attachment 6) that affect revenues, and therefore also impact the forecast corporate income tax allowance.

We accept the revised proposed standard tax asset lives (section 8.4.3) consistent with those approved in the preliminary decision.

### 8.4.1 Opening tax asset base

We determine CitiPower's opening TAB value as at 1 January 2016 to be \$1215.8 million (\$ nominal). This amount is \$29.8 million (or 2.4 per cent) lower than CitiPower's value of \$1245.7 million (\$ nominal) in its revised proposal. This is because we updated the capex inputs for 2015 using revised estimates from CitiPower.

In the preliminary decision, we accepted CitiPower's proposed method to establish the opening TAB at 1 January 2016 as it was based on the approach approved at the 2010 determination.<sup>6</sup> However, we noted the roll forward of CitiPower's TAB included an estimated capex value for 2015. We stated we would update the 2015 estimated capex value for the final decision. CitiPower's revised proposal did not include an update for

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<sup>5</sup> AER, *Preliminary decision, CitiPower determination 2015–16 to 2019–20: Attachment 8 – Corporate income tax*, April 2015, pp. 7–10.

<sup>6</sup> The only amendment we made in our preliminary decision is to reallocate the TAB value for land at 1 January 2016 to its own non-depreciating asset class from the 'Subtransmission' and 'Distribution system asset' asset classes. CitiPower's revised proposal adopted our preliminary decision. See CitiPower, *Revised regulatory proposal*, January 2015, p. 453.

2015 estimated capex. However, a revised estimate was provided following an information request.<sup>7</sup> As discussed in attachment 2, we have accepted CitiPower's revision to the capex estimate for 2015. This revised estimate is lower than in the initial proposal reflecting more up-to-date data, and therefore is the best forecast available. We will update the TAB for 2015 actual capex at the next reset.

Table 8.3 sets out our final decision on the roll forward of CitiPower's TAB values over the 2011–15 regulatory control period.

**Table 8.3 AER's final decision on CitiPower's TAB roll forward (\$ million, nominal)**

	2011	2012	2013	2014	2015 <sup>a</sup>
Opening TAB	775.2	874.1	946.3	1030.8	1128.6
Capital expenditure	155.8	130.2	156.1	171.2	167.2
Less: Tax depreciation	56.8	58.1	71.5	73.5	80.0
<b>Closing TAB</b>	<b>874.1</b>	<b>946.3</b>	<b>1030.8</b>	<b>1128.6</b>	<b>1215.8</b>

Source: AER analysis.

(a) Based on estimated capex.

## 8.4.2 Remaining tax asset lives

Consistent with our preliminary decision, we accept CitiPower's proposed approach to calculate remaining tax asset lives at 1 January 2016.<sup>8</sup> The approach calculates the remaining tax asset life for each asset class at 1 January 2016 using the standard tax asset life for that asset class multiplied by the ratio of the RAB remaining asset life to the RAB standard asset life.

In the preliminary decision, we accepted CitiPower's proposal to transition to our preferred straight-line tax depreciation approach to calculate the corporate income tax allowance for the 2016–20 regulatory control period. This required us to determine remaining tax asset lives for depreciating the opening TAB at 1 January 2016. We considered CitiPower's proposed approach to determine remaining tax asset lives provides reasonable estimates for the majority of its asset classes.

We noted the remaining tax asset lives at 1 January 2016 may be updated using the approved approach for any revision to the RAB remaining asset lives, which in turn depends on any changes in 2015 capex. As discussed in attachment 2, we have updated the 2015 capex estimate for this final decision. Therefore, we have also

<sup>7</sup> CitiPower, *RE: AER information request - CitiPower #033 and Powercor #034 – 2015 estimated capex update*, 3 March 2016.

<sup>8</sup> AER, *Preliminary decision, CitiPower determination 2015–16 to 2019–20: Attachment 8 – Corporate income tax*, April 2015, pp. 13–14.

updated the remaining tax asset lives for CitiPower due to the resulting change in RAB remaining asset lives. We have used revised RAB remaining asset lives calculated from the weighted average approach in the RFM, consistent with the preliminary decision.

Table 8.4 sets out our final decision on the remaining tax asset lives at 1 January 2016 for CitiPower. We are satisfied the remaining tax asset lives provide an appropriate estimate of the tax depreciation amount for a benchmark efficient service provider as required by the NER.<sup>9</sup>

### 8.4.3 Standard tax asset lives

Consistent with our preliminary decision, we accept CitiPower's proposed standard tax asset lives because they are broadly consistent with the values prescribed by the Commissioner for taxation in tax ruling 2015/2.<sup>10</sup>

In the preliminary decision, we considered that the opening TAB value for land as at 1 January 2016 should be allocated to its own asset class as land assets do not depreciate. We therefore created a new non-depreciating 'Land' asset class. CitiPower's revised proposal adopted the preliminary decision amendment.

We are satisfied the standard tax asset lives in CitiPower'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.<sup>11</sup>

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

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<sup>9</sup> NER, cl. 6.5.3.

<sup>10</sup> ATO, *Taxation Ruling Income tax: effective life of depreciating assets (applicable from 1 July 2015)*, July 2015, <http://law.ato.gov.au/atolaw/view.htm?docid=%22TXR%2FTR20152%2FNAT%2FATO%2F00001%22>, accessed on 9 March 2016.

<sup>11</sup> NER, cl. 6.5.3.

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

Asset class	Standard tax asset life	Remaining tax asset life as at 1 January 2016
Subtransmission	43.0	32.5
Distribution system assets	49.0	25.3
Standard metering	n/a	1.0 <sup>a</sup>
Public lighting	n/a	n/a
SCADA/Network control	10.0	6.3
Non-network general assets - IT	4.0	3.5
Non-network general assets - other	12.0	8.0
VBRC	45.0	n/a
Supervisory cables	n/a	n/a
Old SWER ACRs	n/a	n/a
Land	n/a	n/a
Equity raising costs	5.0	n/a

Source: AER analysis.

n/a not applicable.

a: The remaining tax asset life as at 1 January 2016 for the 'Standard metering' asset class is set to 1 year in order to fully depreciate the small residual TAB value for this asset class within the 2016–20 regulatory control period.

#### 8.4.4 Tax treatment of other revenue adjustments

We note CitiPower's revised proposal adopted our preliminary decision on the tax treatment of the revenue adjustments arising from the operation of the EBSS over the 2011–15 regulatory control period and the close out of the ESCV's previous S-factor scheme.<sup>12</sup> Consistent with the preliminary decision, our final decision is that the EBSS and S-factor revenue adjustments should be given identical income and expense tax status in the PTRM.<sup>13</sup>

<sup>12</sup> This is reflected in the revised proposal PTRM. CitiPower, *Revised regulatory proposal, attachment 1.10 Revised proposal PTRM*, January 2015.

<sup>13</sup> That is, the revenue adjustments are either both tax income and tax expense (EBSS, shared assets); or neither tax income nor tax expense (S-factor).