



FINAL DECISION
Energex determination 2015–16
to 2019–20

Attachment 8 – Corporate
income tax

October 2015

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au

Note

This attachment forms part of the AER's final decision on Energex's 2015–20 distribution determination. 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 mechanism

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

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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

Shortened form	Extended form
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
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
TAB	tax asset base
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 Energex's 2015–20 regulatory control 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 Energex to recover the costs associated with the estimated corporate income tax payable during the 2015–20 regulatory control period.

This attachment presents our final decision on Energex's revised proposed corporate income tax allowance for the 2015–20 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 Energex's revised proposed cost of corporate income tax allowance of \$538.1 million (\$ nominal). Our final decision on the estimated cost of corporate income tax is \$275.3 million (\$ nominal) for Energex over the 2015–20 regulatory control period. This represents a reduction of \$262.8 million (or 48.8 per cent) from its revised proposal.

The reduction reflects our amendments to some of Energex's revised proposed inputs for forecasting the cost of corporate income tax such as the opening TAB (section 8.4.1), and the remaining tax asset lives (section 8.4.2). It also reflects our final decision on the value of imputation credits—gamma (attachment 4). Changes to the building block costs also affect revenues, which in turn 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 Energex over the 2015–20 regulatory control period.

Table 8.1 AER's final decision on Energex's cost of corporate income tax allowance for the 2015–20 regulatory control period (\$ million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Tax payable	79.9	87.1	92.5	96.4	103.0	458.9
Less: value of imputation credits	32.0	34.8	37.0	38.6	41.2	183.6
Net corporate income tax allowance	48.0	52.2	55.5	57.8	61.8	275.3

Source: AER analysis.

¹ NER, cl. 6.4.3(a)(4).

8.2 Energex's revised proposal

Energex's revised proposal forecasts a cost of corporate income tax allowance of \$538.1 million (\$ nominal) for the 2015–20 regulatory control period. Energex's methodology for determining its corporate income tax is unchanged from its initial proposal. We accepted the approach in our preliminary decision. Energex's revised proposal adopted our preliminary decision amendments to the standard and remaining tax asset life for the 'Equity raising costs' asset class of five years and one year, respectively. It also adopted our preliminary decision opening TAB value at 1 July 2015.²

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

- revised forecast capex
- revised forecast opex.

Energex also used the opening TAB at 1 July 2015, and 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.

Table 8.2 sets out Energex's revised proposed corporate income tax allowance for the 2015–20 regulatory control period.

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

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Tax payable	126.3	135.9	143.9	151.2	160.1	717.5
Less: value of imputation credits	31.6	34.0	36.0	37.8	40.0	179.4
Net corporate income tax allowance	94.8	102.0	107.9	113.4	120.1	538.1

Source: Energex, *Revised regulatory proposal*, July 2015, p. 132 and attachment 2.

8.3 AER's 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.³

² Energex, *Revised regulatory proposal*, July 2015, Attachment 2.

³ AER, *Preliminary decision, Energex determination 2015–16 to 2019–20: Attachment 2 – Corporate income tax*, April 2015, pp. 7–10.

8.4 Reasons for final decision

We do not accept Energex's revised proposed cost of corporate income tax allowance of \$538.1 million (\$ nominal). We instead determine a cost of corporate income tax allowance of \$275.3 million for the 2015–20 regulatory control period. This represents a reduction of \$262.8 million (or 48.8 per cent) from Energex'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 July 2015, updated for a revised estimate of 2014–15 capex (section 8.4.1)
- the remaining tax asset lives at 1 July 2015 (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 standard tax asset lives consistent with those approved in the preliminary decision (section 8.4.3).

8.4.1 Opening tax asset base

We determine Energex's opening TAB value as at 1 July 2015 to be \$6672.9 million (\$ nominal). This amount is \$57 million (or 0.9 per cent) lower than Energex's value of \$6729.9 million in its revised proposal. This is because we updated the capex inputs for 2014–15 using revised estimates from Energex.

In the preliminary decision, we accepted Energex's proposed method to establish the opening TAB at 1 July 2015 as it was based on the approach set out in our roll forward model (RFM). However, we amended Energex's proposed opening TAB for adjustments made to the actual capex values in the RFM. We noted the roll forward of Energex's TAB included estimated capex values for 2014–15. We stated we would update the 2014–15 estimated capex value for the final decision.

Energex's revised proposal adopted our preliminary decision adjustments to roll forward the opening TAB from 1 July 2010 to 30 June 2015. Following an information request from us, Energex provided a revised estimate of capex for 2014–15 (net of disposals).⁴ As discussed in attachment 2, we have accepted Energex's revision to the net capex estimate for 2014–15. This revised estimate is lower than in the initial proposal and reflects more up-to-date data, and therefore is the best forecast available.

⁴ Energex, E-mail: *AER Energex 058*, 17 July 2015.

Table 8.3 sets out our final decision on the roll forward of Energex's TAB values over the 2010–15 regulatory control period.

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

	2010–11	2011–12	2012–13	2013–14	2014–15 ^b
Opening TAB	3759.0	4578.7	5337.7	6024.7	6562.4
Capital expenditure ^a	955.6	926.2	880.2	751.7	728.0
Less: Tax depreciation	135.9	167.2	193.3	214.0	232.9
Closing TAB	4578.7	5337.7	6024.7	6562.4	7057.4
Meters moved to alternative control services and unregulated assets removed					–384.5
Opening TAB as at 1 July 2015					6672.9

Source: AER analysis.

(a) Net of disposals.

(b) Based on estimated capex.

8.4.2 Remaining tax asset lives

Consistent with our preliminary decision, we accept Energex's proposed weighted average method to calculate remaining tax asset lives at 1 July 2015.

In the preliminary decision, we accepted Energex's proposed weighted average method for calculating the remaining tax asset lives at 1 July 2015. The proposed method is consistent with our preferred approach. We noted that the remaining tax asset lives would be recalculated for the final decision because of updates to Energex's 2014–15 capex in the TAB roll forward. The 2014–15 capex values are inputs used to calculate the weighted average remaining tax asset lives.⁵ Based on the revisions for 2014–15 capex in the TAB roll forward as discussed in section 8.4.1, we have updated Energex's remaining tax asset lives at 1 July 2015 for this final decision.

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.⁶ Table 8.4 sets out our final decision on the remaining tax asset lives at 1 July 2015 for Energex.

⁵ AER, *Preliminary decision – Energex determination 2015–16 to 2019–20, Attachment 5 – Corporate income tax*, April 2015, p. 12.

⁶ NER, cl 6.5.3.

8.4.3 Standard tax asset lives

Consistent with our preliminary decision, we accept Energex's proposed standard tax asset lives because they are:

- broadly consistent with the values prescribed by the Commissioner for taxation in tax ruling 2014/4⁷
- the same as the approved standard tax asset lives for the 2010–15 regulatory control period.

In the preliminary 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 'n/a' for tax depreciation purposes.⁸ 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.⁹ Energex's revised proposal adopted our preliminary decision on the standard tax asset life for the 'Equity raising costs' asset class.¹⁰

We are satisfied the standard tax asset lives in Energex'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.¹¹

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

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

Asset class	Standard tax asset life	Remaining tax asset life as at 1 July 2015
OH Sub-transmission lines	45.0	33.0
UG Sub-transmission cables	50.0	38.5
OH Distribution lines	45.0	36.0
UG Distribution cables	50.0	35.7
Distribution equipment	45.0	39.3
Substation bays	40.0	31.2
Substation establishment	40.0	33.3

⁷ 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 06 January 2015.

⁸ Assigning 'n/a' in the PTRM means the value is not being depreciated.

⁹ ATO, *Guide to depreciating assets 2001-02: Business related costs—section 40-880 deductions*, ATO reference; NONAT7170, p. 25.

¹⁰ Energex, *Revised regulatory proposal*, July 2015, Attachment 2.

¹¹ NER, cl. 6.5.3.

Asset class	Standard tax asset life	Remaining tax asset life as at 1 July 2015
Distribution substation switchgear	40.0	35.4
Zone transformers	40.0	32.1
Distribution transformers	45.0	32.0
Low voltage services	40.0	16.4
Load control & network metering devices	25.0	23.5
Communications - pilot wires	10.0	11.3
Street lighting	15.0	6.3
Systems buildings	40.0	37.3
Systems easements	n/a	n/a
System land	n/a	n/a
Communications	10.0	1.0 ^a
Control centre - SCADA	10.0	3.5
IT systems	3.8	2.3
Office equipment & furniture	13.1	8.1
Motor vehicles	12.9	8.9
Plant & equipment	5.2	3.7
Research & development	n/a	n/a
Buildings	40.0	33.4
Easements	n/a	n/a
Land	n/a	n/a
Equity raising costs	5.0	1.0

Source: AER analysis.

n/a not applicable.

(a) Under the weighted average method, the remaining tax asset life is calculated as 'n/a'. However, the TAB roll forward produces a small residual value (negative) at 30 June 2015 and so assigning a remaining tax asset life of 1 year to fully depreciate (by way of writing off) the residual value is appropriate in this case. Applying 'n/a' means the residual value remains in the TAB and does not depreciate.