



FINAL DECISION
Ergon Energy determination
2015–16 to 2019–20

Attachment 8 – Corporate
income tax

October 2015

© Commonwealth of Australia 2015

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the Director, Corporate Communications, Australian Competition and Consumer Commission, GPO Box 4141, Canberra ACT 2601 or publishing.unit@acc.gov.au.

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 Ergon Energy'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

Contents

Note	8-2
Contents	8-3
Shortened forms	8-4
8 Corporate income tax.....	8-6
8.1 Final decision.....	8-6
8.2 Ergon Energy's revised proposal.....	8-7
8.3 AER's assessment approach.....	8-7
8.4 Reasons for final decision	8-8
8.4.1 Opening tax asset base.....	8-8
8.4.2 Remaining tax asset lives.....	8-9
8.4.3 Standard tax asset lives	8-12

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 Ergon Energy'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 Ergon Energy 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 Ergon Energy'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 Ergon Energy's revised proposed cost of corporate income tax allowance of \$601.3 million (\$ nominal). Our final decision on the estimated cost of corporate income tax is \$179.6 million (\$ nominal) for Ergon Energy over the 2015–20 regulatory control period. This represents a reduction of \$421.7 million (or 70.1 per cent) from its revised proposal.

The reduction reflects our amendments to some of Ergon Energy'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 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 Ergon Energy over the 2015–20 regulatory control period.

Table 8.1 AER's final decision on Ergon Energy'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	72.9	51.0	48.3	60.3	66.7	299.3
Less: value of imputation credits	29.2	20.4	19.3	24.1	26.7	119.7
Net corporate income tax allowance	43.7	30.6	29.0	36.2	40.0	179.6

Source: AER analysis.

¹ NER, cl. 6.4.3(a)(4).

8.2 Ergon Energy's revised proposal

Ergon Energy's revised proposal forecast a cost of corporate income tax allowance of \$601.3 million (\$ nominal) for the 2015–20 regulatory control period. Ergon Energy's methodology for determining its corporate income tax is unchanged from its initial proposal. We accepted the approach in our preliminary decision.

Ergon Energy has revised its corporate income tax allowance using the AER's PTRM and included the following inputs:²

- a revised opening TAB at 1 July 2015 of \$6256.7 million (\$ nominal), reflecting updates for 2014–15 estimated capex
- remaining asset lives based on a revised approach to determining tax depreciation of existing tax assets. The revised approach provides for tax depreciation of capex for each regulatory control period individually, and is the same as the revised approach applying to its regulatory depreciation
- revised forecast capex
- revised forecast opex.

Ergon Energy also used the standard 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.³

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

Table 8.2 Ergon Energy'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	128.2	158.7	168.0	176.6	170.2	801.7
Less: value of imputation credits	32.1	39.7	42.0	44.1	42.5	200.4
Net corporate income tax allowance	96.2	119.1	126.0	132.4	127.6	601.3

Source: Ergon Energy, *Revised regulatory proposal*, July 2015, Attachment 03.01.04 (PTRM).

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.⁴

² Ergon Energy, *Revised regulatory proposal – Attachment 03.01.01*, July 2015, pp. 18–22.

³ Ergon Energy, *Revised regulatory proposal*, July 2015, p. 152.

8.4 Reasons for final decision

We do not accept Ergon Energy's revised proposed cost of corporate income tax allowance of \$601.3 million (\$ nominal). We instead determine a cost of corporate income tax allowance of \$179.6 million for the 2015–20 regulatory control period. This represents a reduction of \$421.7 million (or 70.1 per cent) from Ergon Energy'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 (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 Ergon Energy's opening TAB value as at 1 July 2015 to be \$6291.1 million (\$ nominal). This amount is \$34.3 million (or 0.5 per cent) higher than Ergon Energy's value of \$6256.7 million in its revised proposal.⁵ This increase is due to the adjustments made to the actual capex values and end of period asset adjustments in Ergon Energy's revised proposed RFM discussed in attachment 2. We have also corrected input errors for remaining tax asset lives at 1 July 2010 consistent with the preliminary decision.

In the preliminary decision, we accepted Ergon Energy'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 Ergon Energy's proposed opening TAB for adjustments made to the actual capex values in the RFM. We also amended the remaining tax asset lives at 1 July 2010 to be consistent with those approved at the 2010 determination. We noted the roll forward of Ergon Energy's TAB included estimated capex values for 2014–15. We stated we would update the 2014–15 estimated capex value for the final decision.

Ergon Energy's revised proposal RFM updated the capex estimate for 2014–15. As discussed in attachment 2, we have accepted Ergon Energy's revision to the net capex

⁴ AER, *Preliminary decision, Ergon Energy determination 2015–16 to 2019–20: Attachment 8 – Corporate income tax*, April 2015, pp. 7–9.

⁵ Ergon Energy, *Revised regulatory proposal – Attachment 03.01.01*, July 2015, p. 19.

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. Ergon Energy also adopted some of the other preliminary decision adjustments made to the actual capex values, although it did not implement these changes in its revised proposed RFM. For the reasons discussed in attachment 2, we have maintained our preliminary decision input changes that affect the TAB roll forward for this final decision. Table 8.3 sets out our final decision on Ergon Energy's TAB roll forward.

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

	2010–11	2011–12	2012–13	2013–14	2014–15
Opening TAB	3932.8	4483.2	4949.6	5478.5	5904.2
Capital expenditure	769.8	717.7	798.6	708.7	762.5
Less: Tax depreciation	219.4	251.3	269.7	282.9	293.4
Closing TAB	4483.2	4949.6	5478.5	5904.2	6373.4
Meters moved to alternative control services and unregulated assets removed					–82.3
Opening TAB as at 1 July 2015					6291.1

Source: AER analysis.

8.4.2 Remaining tax asset lives

Ergon Energy has proposed a different approach to determining remaining tax asset lives and depreciation associated with existing tax assets than the approach set out in its initial proposal.⁶ The revised approach is the same as outlined in attachment 5 for estimating RAB remaining asset lives used for depreciating existing assets. Under this approach, the capex for each regulatory control period will be depreciated individually for tax purposes.

Consistent with our decision for Ergon Energy's revised regulatory depreciation approach, we accept the revised approach for tax depreciation proposed by Ergon Energy. For the same reasons as discussed in attachment 5, the revised approach will result in each tax asset class having an expanding list of sub-assets to reflect the regulatory control period in which capital expenditures on those assets occurred.⁷ This extra data helps track remaining tax asset values and associated tax depreciation, and is therefore consistent with the NER. However, we have made some changes to Ergon Energy's implementation of the approach to correct errors. Section 5.4.2 of attachment 5 explains the method and implementation in greater detail.

⁶ Ergon Energy, *Revised regulatory proposal – Attachment 03.01.01*, July 2015, p. 31.

⁷ Ergon Energy, *Revised regulatory proposal*, July 2015, Attachment 03.01.04 (PTRM).

With our changes, we are satisfied the revised approach provides an estimate of the tax depreciation amount for a benchmark efficient service provider as required by the NER.⁸ Table 8.4 sets out our final decision on the remaining tax asset lives at 1 July 2015 for Ergon Energy.

Table 8.4 AER's final decision on Ergon Energy's remaining tax asset lives (years)

Asset class	Remaining tax asset life as at 1 July 2015
Overhead sub-transmission lines (pre July 2010)	8.9
Underground sub-transmission cables (pre July 2010)	27.8
Overhead distribution lines (pre July 2010)	17.1
Underground distribution cables (pre July 2010)	25.6
Distribution equipment (pre July 2010)	38.3
Substation bays (pre July 2010)	33.4
Substation establishment (pre July 2010)	30.1
Distribution substation switchgear (pre July 2010)	27.4
Zone transformers (pre July 2010)	12.2
Distribution transformers (pre July 2010)	12.4
Low voltage services (pre July 2010)	3.5
Communications – pilot wires (pre July 2010)	3.7
Generation assets (pre July 2010)	0.6
Other equipment (pre July 2010)	31.8
Control centre - SCADA (pre July 2010)	3.1
Land & easements (system) - combined ^a	n/a
IT systems (pre July 2010)	n/a
Office equipment & furniture (pre July 2010)	2.9
Motor vehicles (pre July 2010)	6.3
Plant & equipment (pre July 2010)	n/a

⁸ NER, cl. 6.5.3.

Asset class	Remaining tax asset life as at 1 July 2015
Buildings (pre July 2010)	20.2
Land & easements - combined ^a	n/a
Land improvements (pre July 2010)	33.5
Overhead sub-transmission lines (2010–15)	43.2
Underground sub-transmission cables (2010–15)	48.2
Overhead distribution lines (2010–15)	43.1
Underground distribution cables (2010–15)	48.0
Distribution equipment (2010–15)	44.3
Substation bays (2010–15)	38.0
Substation establishment (2010–15)	37.8
Distribution substation switchgear (2010–15)	37.8
Zone transformers (2010–15)	38.5
Distribution transformers (2010–15)	38.1
Low voltage services (2010–15)	38.5
Metering (2010–15)	22.3
Communications – pilot wires (2010–15)	6.8
Generation assets (2010–15)	14.9
Other equipment (2010–15)	40.0
Control centre - SCADA (2010–15)	7.6
Communications (2010–15)	7.9
IT systems (2010–15)	3.1
Office equipment & furniture (2010–15)	7.9
Motor vehicles (2010–15)	11.9
Plant & equipment (2010–15)	3.2
Buildings (2010–15)	37.9
Land improvements (2010–15)	38.0
Equity raising costs (2010–15)	1.0

Source: AER analysis.

n/a: not applicable

(a): The 'legacy' (pre July 2010) and 'capex 2010–15' (2010–15) values have been combined for these asset classes as they have a standard asset life of 'n/a'. There is no added benefit in separating non-depreciating asset classes by regulatory control period as they have no impact on the depreciation allowance.

8.4.3 Standard tax asset lives

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

- broadly consistent with the values prescribed by the Commissioner for taxation in tax ruling 2014/4⁹
- the same as the approved standard tax asset lives for the 2010–15 regulatory control period.

We are satisfied the standard tax asset lives in Ergon Energy'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.¹⁰

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

Table 8.5 AER's final decision on Ergon Energy's standard tax asset lives (years)

Asset class	Standard tax asset life
Overhead sub-transmission lines (2015–20)	45.0
Underground sub-transmission cables (2015–20)	50.0
Overhead distribution lines (2015–20)	45.0
Underground distribution cables (2015–20)	50.0
Distribution equipment (2015–20)	45.0
Substation bays (2015–20)	40.0
Substation establishment (2015–20)	40.0
Distribution substation switchgear (2015–20)	40.0
Zone transformers (2015–20)	40.0
Distribution transformers (2015–20)	40.0
Low voltage services (2015–20)	40.0

⁹ 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%2F0001%22>, accessed on 6 January 2015.

¹⁰ NER, cl. 6.5.3.

Asset class	Standard tax asset life
Metering (2015–20)	25.0
Communications – pilot wires (2015–20)	10.0
Generation assets (2015–20)	15.0
Other equipment (2015–20)	40.0
Control centre - SCADA (2015–20)	10.0
Land & easements (system) - combined	n/a
Communications (2015–20)	10.0
IT systems (2015–20)	4.0
Office equipment & furniture (2015–20)	10.0
Motor vehicles (2015–20)	13.5
Plant & equipment (2015–20)	5.0
Buildings (2015–20)	40.0
Land & easements - combined	n/a
Land improvements (2015–20)	40.0
Equity raising costs (2015–20)	5.0

Source: AER analysis.

n/a: not applicable