FINAL DECISION
Jemena Gas Networks (NSW) Ltd
Access Arrangement 2015-20

Attachment 8 − Corporate income tax

June 2015

AUSTRALIAN ENERGY REGULATOR

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

AER reference: 51741

Note

This attachment forms part of the AER's final decision on Jemena Gas Networks' 2015–20 access arrangement. It should be read with 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

Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CAPM	capital asset pricing model
CCP	Consumer Challenge Panel
Code	National Third Party Access Code for Natural Gas Pipeline Systems
CPI	consumer price index
DRP	debt risk premium
ERP	equity risk premium
JGN	Jemena Gas Networks (NSW) Ltd (ACN 003 004 322)
MRP	market risk premium
NGL	national gas law
NGO	national gas objective
NGR	national gas rules
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SLCAPM	Sharpe-Lintner capital asset pricing model
WACC	weighted average cost of capital

8 Corporate income tax

When determining the total revenue for JGN, we must estimate JGN's cost of corporate income tax.[1] JGN has adopted the post-tax framework to derive its revenue requirement for the 2015–20 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 JGN's revised proposed corporate income tax allowance of $105.9 million ($nominal) for the 2015–20 access arrangement period.[3] This is mainly a consequence of our adjustments to JGN'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), forecast capex (attachment 6) and opex (attachment 7).[4]

Our adjustments result in an estimated corporate income tax allowance of $42.4 million ($nominal) for JGN as shown in Table 8-1. We have made all amendments necessary to give effect to this final decision in the *Approved Access Arrangement, JGN's NSW gas distribution networks 1 July 2015 – 30 June 2020* (June 2015).[5]

Table 8-1 AER's final decision on corporate income tax allowance for JGN ($million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Tax payable	9.7	11.6	15.2	19.0	15.2	70.6
Less: value of imputation credits	–3.9	–4.6	–6.1	–7.6	–6.1	–28.2
Net corporate income tax allowance	**5.8**	**6.9**	**9.1**	**11.4**	**9.1**	**42.4**

Source: AER analysis.

1 NGR, r. 76(c).

2 JGN, *Revised access arrangement proposal, Appendix 10.1 Revenue model - updated,* February 2015.

3 JGN updated its proposed corporate income tax after the submission of its revised proposal. JGN, *Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model*, 27 March 2015.

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

5 NGR, rr. 64(1) & (4).

8.2 JGN's revised proposal

JGN's revised proposal forecast a cost of corporate income tax of $105.9 million ($nominal).[6] JGN's methodology for determining its corporate income tax is unchanged from its initial proposal.

JGN adopted the methodology accepted in our draft decision to determine the revised proposed tax asset base (TAB) at 1 July 2015. The TAB at 1 July 2015 was updated for 2013–14 actual conforming capex and 2014–15 revised estimate of capex.[7]

JGN's revised proposed TAB roll forward over the 2010–15 access arrangement period is set out in Table 8-2.[8]

Table 8-2 JGN's revised proposed tax asset base roll forward over the 2010–15 access arrangement period ($million, nominal)

	2010–11	2011–12	2012–13	2013–14	2014–15
Opening tax asset base	600.1	679.3	753.5	786.7	840.1
Capex	159.9	169.3	132.2	153.6	256.3
Tax depreciation	–80.6	–95.1	–99.1	–100.2	–114.1
Closing tax asset base	**679.3**	**753.5**	**786.7**	**840.1**	**982.3**

Source: JGN, *Revised access arrangement proposal, Appendix 10.1, Revenue model - updated*, February 2015. JGN, *Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model*, 27 March 2015.

Using the same approach accepted in the draft decision, JGN's revised proposal calculated the corporate income tax over the 2015–20 access arrangement period using the following inputs:[9]

- revised TAB at 1 July 2015 of $982.3 million reflecting updates for 2013–14 actual conforming capex and 2014–15 estimated capex
- diminishing value rates for tax depreciation accepted in the draft decision
- revised forecast capex
- revised forecast opex

6 JGN updated its proposed corporate income tax after the submission of its revised proposal. JGN, *Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model*, 27 March 2015.

7 JGN, *Revised access arrangement proposal, Appendix 10.1 Revenue model - updated,* February 2015.

8 JGN, *Revised access arrangement proposal, Appendix 10.1 Revenue model - updated,* February 2015. JGN updated the proposed projection of tax asset base after the revised proposal. JGN, *Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model*, 27 March 2015.

9 JGN, *Revised access arrangement proposal, Appendix 10.1 Revenue model - updated,* February 2015.

- a value for gamma of 0.25, consistent with its initial proposal.

For the 2015–20 access arrangement period, JGN's revised proposal forecast a total corporate income tax allowance of $105.9 million ($nominal) as set out in Table 8-3.[10]

Table 8-3 JGN's revised proposal corporate income tax allowance for the 2015–20 access arrangement period ($million, nominal)

	2015–16	2016–17	2017–18	2018–19	2019–20	Total
Tax payable	23.2	25.5	29.5	33.5	29.5	141.2
Less: value of imputation credits	5.8	6.4	7.4	8.4	7.4	35.3
Net cost of corporate tax	**17.4**	**19.2**	**22.1**	**25.1**	**22.1**	**105.9**

Source: JGN, *Revised access arrangement proposal, Appendix 10.1, Revenue model - updated*, February 2015. JGN, *Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model*, 27 March 2015.

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.[11]

8.4 Reasons for final decision

Our final decision on JGN’s corporate income tax allowance is $42.4 million ($nominal), which is a reduction of $63.5 million ($nominal) or 60 per cent of JGN's revised proposal.

Consistent with our draft decision, we accept the method used by JGN to calculate the revised proposed corporate income tax allowance, including the updated opening TAB as at 1 July 2015. However, we adjusted several inputs proposed by JGN for calculating the corporate income tax allowance for the 2015–20 access arrangement period. These relate to:

- changing the value of gamma to 0.4 from 0.25 (attachment 4)
- changes to other building block components including the rate of return on capital (attachment 3), forecast capex (attachment 6) and opex (attachment 7) that impact total revenues, and therefore also impact the forecast corporate income tax allowance.[12]

10 JGN, *Revised access arrangement proposal, Appendix 10.1 Revenue model - updated,* February 2015.

11 AER, *Draft decision, attachment 2*, November 2014, pp. 13–14.

12 NGR, r. 87A.

8.4.1 Opening tax asset base as at 1 July 2015

We accept JGN's revised proposed opening TAB value of $982.3 million ($nominal) as at 1 July 2015.

In the draft decision, we accepted JGN's proposed inputs such as capex, disposals and tax depreciation rates over the 2010–15 access arrangement used by JGN to calculate its opening TAB at 1 July 2015. We noted the capex inputs for 2013–14 and 2014–15 would be updated in the revised proposal using latest actual/available data.

JGN's revised proposal updated the values for these inputs.[13]

We assessed the updated inputs including actual conforming capex for 2013–14 and the resulting tax depreciation for that year, and the revised forecast data for 2014–15. We are satisfied the updated capex over the 2010–15 access arrangement period reflects the requirements of rule 79 of the NGR. Our detailed assessment of this conforming capex is set out in attachment 6.

Table 8-4 sets out our final decision on the roll forward of JGN's TAB values for the 2010–15 access arrangement period.

Table 8-4 AER's final decision on JGN's tax asset base roll forward for the 2010–15 access arrangement period ($million, nominal)

Details	2010–11	2011–12	2012–13	2013–14	2014–15
Opening tax asset base	600.1	679.3	753.5	786.7	840.1
Capex	159.9	169.3	132.2	153.6	256.3
Tax depreciation	–80.6	–95.1	–99.1	–100.2	–114.1
Closing tax asset base	**679.3**	**753.5**	**786.7**	**840.1**	**982.3**

Source: AER analysis; JGN, *Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model*, 27 March 2015.

8.4.2 Tax depreciation method

Consistent with our draft decision, we accept JGN's revised proposal to use the diminishing value method for estimating tax depreciation for the 2015–20 access arrangement period. JGN's revised proposal adopted the diminishing value rates—used to calculate the forecast tax depreciation for each asset class—approved in our draft decision. We therefore maintain our draft decision position on this issue for this final decision.

---

13 JGN, *Revised access arrangement proposal, Appendix 10.1 Revenue model - updated,* February 2015. These were updated in JGN, *Submissions on draft decision*, *Attachment N - updated appendix 10.1 - JGN revenue forecast model*, 27 March 2015.

Table 8-5 sets out our final decision on JGN's diminishing value rates for tax depreciation over the 2015–20 access arrangement period.

Table 8-5 AER's final decision on JGN's diminishing value rates for tax depreciation calculation (per cent)

Asset class	Diminishing value rate for tax depreciation
Trunk Wilton-Sydney	10 per cent
Trunk Sydney-Newcastle	10 per cent
Trunk Wilton-Wollongong	10 per cent
Contract meters	10 per cent
Fixed Plant - distribution	10 per cent
HP mains	10 per cent
HP services	10 per cent
MP mains	10 per cent
MP services	10 per cent
Meter reading devices	10 per cent
Country POTS	10 per cent
Tariff meters	10 per cent
Building	3 per cent
Computers	40 per cent
Software	50 per cent
Fixed plant	20 per cent
Furniture	20 per cent
Land	n/a
Leasehold improvements	3 per cent
Low value assets	60 per cent
Mobile plant	20 per cent
Vehicles	25 per cent
Equity raising costs	11 per cent

Source: AER analysis; JGN, *Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model*, 27 March 2015.