# FINAL DECISION
# Jemena distribution determination 2016 to 2020

# Attachment 8 – Corporate income tax

May 2016

AUSTRALIAN ENERGY REGULATOR

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# Note

This attachment forms part of the AER's final decision on Jemena'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

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Attachment 14 – Control mechanisms

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Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – f-factor scheme

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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 Jemena's 2016–20 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 Jemena 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 Jemena'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 Jemena's revised proposed cost of corporate income tax allowance of $128.8 million ($ nominal). Our final decision on the estimated cost of corporate income tax is $76.8 million ($ nominal) for Jemena over the 2016–20 regulatory control period. This represents a reduction of $52.0 million (or 40.4 per cent) from its revised proposal.

The reduction reflects our amendments to some of Jemena'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 Jemena over the 2016–20 regulatory control period.

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

| | 2016 | 2017 | 2018 | 2019 | 2020 | Total |
|---|---|---|---|---|---|---|
| Tax payable | 29.4 | 23.9 | 23.6 | 25.2 | 25.9 | 127.9 |
| *Less:* value of imputation credits | 11.7 | 9.5 | 9.5 | 10.1 | 10.4 | 51.2 |
| **Net corporate income tax allowance** | **17.6** | **14.3** | **14.2** | **15.1** | **15.5** | **76.8** |

Source: AER analysis.

[1] NER, cl. 6.4.3(a)(4).

## 8.2 Jemena's revised proposal

Jemena's revised proposal forecasts a cost of corporate income tax allowance of $128.8 million ($ nominal) for the 2016–20 regulatory control period. Jemena's revised proposal adopted the methodology approved in the preliminary decision for determining its corporate income tax.

Jemena has revised its corporate income tax allowance using the AER's PTRM and included the following inputs:[2]

- revised opening TAB value at 1 January 2016[3]
- revised forecast capex
- revised forecast opex
- tax remaining and standard asset lives updated for revised forecast capex.[4]

Jemena's revised proposal adopted our preliminary decision to allocate the tax value of its land assets to a separate non-depreciating asset class, and our amendments to the tax standard asset life for the 'SCADA/Network control' and 'Equity raising costs' asset classes. However, Jemena used a value for gamma of 0.25 consistent with its initial proposal.

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

### Table 8.2 Jemena's revised proposed cost of corporate income tax allowance for the 2016–20 regulatory control period ($ million, nominal)

| | 2016 | 2017 | 2018 | 2019 | 2020 | Total |
|---|---|---|---|---|---|---|
| Tax payable | 37.4 | 31.5 | 33.4 | 34.1 | 35.3 | 171.7 |
| *Less:* value of imputation credits | 9.3 | 7.9 | 8.4 | 8.5 | 8.8 | 42.9 |
| **Net corporate income tax allowance** | **28.0** | **23.6** | **25.1** | **25.6** | **26.5** | **128.8** |

Source: Jemena, *Revised regulatory proposal*, *Attachment 5–2 PTRM,* January 2016..

## 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.[5]

2 Jemena, *Revised regulatory proposal*, *Attachment 5–2 PTRM*, January 2016.

3 Jemena's revised proposal reallocated some of its 2015 estimated tax capex across asset classes from the preliminary decision. In a subsequent submission Jemena provided a further update to tax capex.

4 Jemena, *Revised regulatory proposal*, *Attachment 5–4 Asset base roll forward*, January 2016, pp. 14–16.

## 8.4 Reasons for final decision

We do not accept Jemena's revised proposed cost of corporate income tax allowance of $128.8 million ($ nominal). We instead determine a cost of corporate income tax allowance of $76.8 million for the 2016–20 regulatory control period. This represents a reduction of $52.0 million (or 40.4 per cent) from Jemena'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 (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 rate of return (attachment 3) that affect revenues, and therefore also impact the forecast corporate income tax allowance.

We accept the revised proposed 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 Jemena's opening TAB value as at 1 January 2011 to be $746.8 million ($ nominal). This amount is $7.7 million (or 1.0 per cent) lower than Jemena's value of $754.6 million ($ nominal) in its revised proposal. This is because we updated the capex inputs for 2015 using revised estimates from Jemena.[6]

In the preliminary decision, we accepted Jemena's proposed method to establish the opening TAB at 1 January 2016 as it was based on the approach approved at the 2010 determination. However, we amended Jemena's proposed opening TAB for adjustments made to the capex values in the RFM. Jemena's revised proposal adopted our draft decision amendments.

We noted the roll forward of Jemena's TAB included an estimated capex value for 2015. We stated we would update the 2015 estimated capex value for the final decision. Jemena's revised proposal did not include an update for 2015 estimated capex; however, a revised estimate was provided following an information request.[7] As discussed in attachment 2, we have accepted Jemena's revision to the capex estimate for 2015. This revised estimate is lower than in the initial proposal reflecting more up-

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5 AER, *Preliminary decision, Jemena determination 2016 to 2020: Attachment 8 – Corporate income tax*, October 2015, pp. 7–10.

6 Jemena, *RE: AER information request – Jemena - #028 – 2015 estimated capex update* [email to AER], 1 February 2016.

7 Jemena, *RE: AER information request – Jemena - #028 – 2015 estimated capex update* [email to AER], 1 February 2016.

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 Jemena's TAB values over the 2011–15 regulatory control period.

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

| | 2011 | 2012 | 2013 | 2014 | 2015[a] |
|---|---|---|---|---|---|
| Opening TAB | 445.4 | 514.3 | 572.1 | 614.9 | 678.1 |
| Capital expenditure | 129.8 | 122.6 | 122.7 | 132.4 | 134.8 |
| *Less:* Tax depreciation | 60.9 | 64.8 | 79.9 | 69.1 | 66.1 |
| **Closing TAB** | **514.3** | **572.1** | **614.9** | **678.1** | **746.8** |

Source: AER analysis.

(a) Based on updated estimated capex.

## 8.4.2 Remaining tax asset lives

Consistent with our preliminary decision, we accept Jemena's proposed approach to calculate remaining tax asset lives at 1 January 2016. 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 Jemena'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 Jemena's proposed approach to determine remaining tax asset lives provides reasonable estimates for 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. We also amended two of Jemena's revised proposal standard asset lives to correct a number of input errors (attachment 5). We have therefore updated the remaining tax asset lives for Jemena due to the resulting change in RAB standard asset lives and 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 Jemena. 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.[8]

### 8.4.3 Standard tax asset lives

Consistent with our preliminary decision, we accept Jemena's proposed approach to determining standard tax asset lives because it reflects the mix of capex forecast for the 2016–20 regulatory control period. This approach breaks the value of forecast capex down by the required component assets. Each group of component assets is assigned a standard tax asset life consistent with the relevant tax categories from the ATO tax rulings. We consider this approach will generally result in standard tax asset lives consistent with the values prescribed by the Commissioner for taxation in tax ruling 2015/2.[9] We therefore accept Jemena's revised proposed standard tax asset lives.

In the preliminary decision, we made a number of amendments to the proposed standard tax asset lives proposed by Jemena. We changed the standard tax asset lives for the ‘SCADA/network control' asset class to 10 years (from proposed 5 years). This was consistent with the approach for RAB standard asset lives and tax standard asset lives determined for distributors in other jurisdictions for SCADA related asset classes. We also changed the standard tax asset life for the 'Equity raising costs' asset class to 5 years, consistent with ATO requirements and created a new non-depreciating 'Land' asset class.[10] Jemena's revised proposal adopted the preliminary decision amendments.[11]

We are satisfied the standard tax asset lives in Jemena'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.[12]

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

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8 NER, cl. 6.5.3.

9 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 29 July 2015.

10 AER, *Preliminary decision, Jemena determination 2016 to 2020: Attachment 8 – Corporate income tax*, October 2015, pp. 12–13.

11 Jemena, *Revised regulatory proposal*, *Attachment 5–4 Asset base roll forward*, January 2016, pp. 14–16.

12 NER, cl. 6.5.3.

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

| Asset class | Standard tax asset life | Remaining tax asset life as at 1 January 2016 |
|---|---|---|
| Subtransmission | 43.0 | 26.6 |
| Distribution system assets | 45.2 | 28.2 |
| Metering | n/a | 1.0[a] |
| Public Lighting | n/a | 1.3 |
| SCADA | 10.0 | 7.8 |
| Non network - IT | 4.4 | 2.4 |
| Non network - other | 17.4 | 11.2 |
| 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 '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 Jemena's revised proposal adopted our preliminary decision on the tax treatment of the revenue adjustments arising from shared assets and the close out of the ESCV's previous S-factor scheme. Consistent with the preliminary decision, our final decision is that the shared assets and S-factor revenue adjustments should be given identical income and expense tax status in the PTRM.[13]

[13] 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).