



FINAL DECISION
United Energy distribution
determination
2016 to 2020

Attachment 8 – Corporate
income tax

May 2016

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Note

This overview forms part of the AER's final decision on United Energy'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

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 United Energy'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 United Energy 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 United Energy'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 United Energy's revised proposed cost of corporate income tax allowance of \$184.4 million (\$ nominal). Our final decision on the estimated cost of corporate income tax is \$112.7 million (\$ nominal) for United Energy over the 2016–20 regulatory control period. This represents a reduction of \$71.7 million (or 38.9 per cent) from its revised proposal.

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

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

	2016	2017	2018	2019	2020	Total
Tax payable	40.5	33.6	35.0	39.9	38.8	187.8
Less: value of imputation credits	16.2	13.4	14.0	16.0	15.5	75.1
Net corporate income tax allowance	24.3	20.2	21.0	24.0	23.3	112.7

Source: AER analysis.

¹ NER, cl. 6.4.3(a)(4).

8.2 United Energy's revised proposal

United Energy's revised proposal forecasts a cost of corporate income tax allowance of \$184.4 million (\$ nominal) for the 2016–20 regulatory control period. United Energy's revised proposal adopted the methodology approved in the preliminary decision for determining its corporate income tax.

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

- revised forecast capex
- revised forecast opex.

United Energy's revised proposal also used the opening TAB at 1 January 2016 and standard tax asset lives consistent with those approved in the preliminary decision.² United Energy adopted the approach approved in the preliminary decision to determining its revised proposed remaining tax asset lives. It also used a value for gamma of 0.25 consistent with its initial proposal.

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

Table 8.2 United Energy'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	43.2	44.0	48.9	53.9	56.0	245.9
Less: value of imputation credits	10.8	11.0	12.2	13.5	14.0	61.5
Net corporate income tax allowance	32.4	33.0	36.7	40.4	42.0	184.4

Source: United Energy, *Revised regulatory proposal*, January 2016, Post-tax revenue model.

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.³

² United Energy, *Revised regulatory proposal*, January 2016, p. 88 and Post-tax revenue model.

³ AER, *Preliminary decision, United Energy determination 2016 to 2020: Attachment 8 – Corporate income tax*, October 2015, pp. 7–10.

8.4 Reasons for final decision

We do not accept United Energy's revised proposed cost of corporate income tax allowance of \$184.4 million (\$ nominal). We instead determine a cost of corporate income tax allowance of \$112.7 million for the 2016–20 regulatory control period. This represents a reduction of \$71.7 million (or 38.9 per cent) from United 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 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 consistent with those approved in the preliminary decision (section 8.4.3).

8.4.1 Opening tax asset base

We determine United Energy's opening TAB value as at 1 January 2016 to be \$1369.7 million (\$ nominal). This amount is \$11.6 million (or 0.9 per cent) higher than United Energy's value of \$1358.1 million (\$ nominal) in its revised proposal. This is because we updated the capex inputs for 2015 using revised estimates from United Energy.

In the preliminary decision, we accepted United Energy'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 United Energy's proposed opening TAB for adjustments made to the capex values in the RFM. United Energy's revised proposal adopted our draft decision amendments.

We noted the roll forward of United Energy's TAB included an estimated capex value for 2015. We stated we would update the 2015 estimated capex value for the final decision. United Energy's revised proposal did not include an update for 2015 estimated capex, however, a revised estimate was provided following an information request.⁴ As discussed in attachment 2, we have accepted United Energy's revision to the capex estimate for 2015. This revised estimate is higher than in the initial proposal

⁴ United Energy, *RE: AER information request – United Energy - #038 – 2015 estimated capex update*, 29 January 2016.

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

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

	2011	2012	2013	2014	2015 ^a
Opening TAB	861.4	972.9	1097.2	1197.7	1313.5
Capital expenditure	185.9	204.9	192.1	210.1	222.1
Less: Tax depreciation	74.3	80.7	91.5	94.2	165.9
Closing TAB	972.9	1097.2	1197.7	1313.5	1369.7

Source: AER analysis.

(a) Based on updated estimated capex.

8.4.2 Remaining tax asset lives

Consistent with our preliminary decision, we accept United Energy'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 United Energy'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 United Energy's proposed approach to determine remaining tax asset lives provides reasonable estimates for its asset classes, subject to an adjustment.⁵ United Energy's revised proposal adopted our preliminary decision adjustment.

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 updated the remaining tax asset lives for United Energy 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.

⁵ This adjustment relates to using RAB remaining asset lives at 1 January 2016 instead of at 1 January 2011.

Table 8.4 sets out our final decision on the remaining tax asset lives at 1 January 2016 for United Energy. 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

8.4.3 Standard tax asset lives

Consistent with our preliminary decision, we accept United Energy's proposed standard tax asset lives because they are broadly consistent with the values prescribed by the Commissioner for taxation in tax ruling 2015/2.⁷

In the preliminary decision, we made a number of amendments to the proposed standard tax asset life to correct errors in the initial proposal. We changed the standard tax asset lives for the 'SCADA (5-year asset)' asset class to 5 years (from proposed 10 years) and the 'SCADA (10-year asset)' asset class to 10 years (from proposed 5 years). We also assigned a standard asset life of 'n/a' to the 'Land' asset class in place of the zero as proposed by United Energy to reflect the non-depreciating nature of land capex.⁸ United Energy's revised proposal adopted the preliminary decision amendments.

We are satisfied the standard tax asset lives in United 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.⁹

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

⁶ NER, cl. 6.5.3.

⁷ 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.

⁸ We note that United Energy did not propose any land capex over the 2016–20 regulatory control period, therefore this change has no impact over that period.

⁹ NER, cl. 6.5.3.

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

Asset class	Standard tax asset life	Remaining tax asset life as at 1 January 2016
Subtransmission	45.0	25.4
Distribution system assets	46.0	32.8
Metering	25.0	1.0 ^a
Public Lighting	15.0	n/a
SCADA (5-year asset)	5.0	2.3
Non network - IT	4.0	2.9
Non network - other	12.0	8.5
Neutral Screen Services	n/a	n/a
Distribution Transformers upgrades	n/a	n/a
SCADA (10-year asset)	10.0	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 '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.