Australian Pipeline Limited ACN 091 344 704
Level 25, 580 George Street, Sydney NSW 2000
PO Box R41, Royal Exchange NSW 1225
P: +61 2 9693 0000 | F: +61 2 9693 0093
APA Group | apa.com.au

27 September 2018

Mr Warwick Anderson
General Manager
Network Finance and Reporting
Australian Energy Regulator
PO Box 3131
Canberra ACT 2601

By email: warwick.anderson@aer.gov.au TaxReview2018@aer.gov.au

Voluntary provision of tax information to the AER tax review

Dear Mr Anderson

Thank you for your letter of 17 August 2018 requesting that APA provide certain tax-related information to the AER to assist in its review of its approach in setting the regulatory tax allowance.

APA is committed to working with the AER in the ongoing development and improvement of the regulatory framework, and to this end is pleased to voluntarily provide much of the information requested. This letter may be placed on the public record.

Ownership structure

You would be aware that APA provided a detailed corporate structure diagram to the AER in a meeting on 1 August 2018, prior to the AER's request.

Network Service Provider tax returns

APA operates as a tax consolidated entity. As a result, the regulated Network Service Providers do not lodge individual tax returns. However, we provide alternate information that is more directly relevant to the AER's review, as discussed more fully below.

Tax Fixed Asset Register and tax capitalisation policies

This information is provided, confidentially, attached to this letter.

Statements of taxable income

As discussed in the consultation process to this review, APA is financed at the corporate level – APA does not allocate particular debt issues to particular assets or operating businesses. While it does allocate some intercompany interest among the businesses in the corporate group, this allocation does not have regard to the amount of debt financing deemed through the regulatory framework. In addition, for financial reporting purposes, APA reports its corporate costs only at the consolidated level – it does not allocate its corporate costs to individual businesses. Also, as discussed above, APA lodges its tax returns as a consolidated tax entity – it does not lodge tax returns for individual businesses. This means that it is not possible to extract meaningful stand-alone tax and financial information for each individual entity.

However, in order to assist the AER in its review and to contribute to the ongoing improvement of the regulatory framework, APA has provided the attached, for each of the price-regulated businesses, statements of regulatory taxable income, identifying the permanent and timing differences that would apply for each price-regulated business as if it were a stand-alone taxable entity, set in a regulatory context.

You will recall that APA has consistently held that an analysis of financial accounting information, reflecting assets valued under the Australian Accounting Standards, would not be helpful to the AER in assessing the reasonableness of regulatory tax allowances based on assets valued in a regulatory context.

APA has therefore provided a "side-by-side" Statement of Taxable Income, with one side showing information drawn from APA's financial records (such as financial accounting depreciation and tax depreciation), and the other showing information in a regulatory context (such as depreciation and indexation of the regulatory asset base, and tax depreciation of the regulatory tax asset base).

One of the key areas to be adjusted for is the impact of the business' response to the incentive regulation framework. As APA has repeatedly commented in both the Review of Profitability Reporting and this Review of Tax Allowance, businesses should be expected to outperform as they respond to regulatory incentives – the benefits of this outperformance will be delivered to customers in subsequent regulatory periods. This applies equally to the AER's formal incentive mechanisms, such as the EBSS and STPIS, as those incentives for volume, revenue and operating expenditure outperformance inherent in the fabric of the National Gas Access Regime.

This is particularly important in the Tax Allowance review – where a business has successfully responded to incentives, and been more profitable as a result, it will, as a consequence, incur a larger tax bill. The impact of the enhanced incentive-driven tax payment must be excised from the analysis in order to be able to make a valid comparison between the tax payable and the tax allowance. The Statements of Taxable Income provided include a transparent adjustment for this incentive-based outperformance.

Using information drawn from the AER's relevant Post Tax Revenue Models and Asset Base Roll Forward Models, and our annual regulatory accounts, these "Regulatory Statements of Taxable Income" report:

- regulatory net income before interest and tax, including an assignment of corporate costs;
- the impact of the business' responses to the incentives inherent in the regulatory regime;
- interest expense, calculated as the proportion of debt funding of the capital base, multiplied by the rate of return on debt allowed in the regulatory determination;
- straight line nominal depreciation as provided for in the AER's Asset Base Roll Forward Model, as updated for actual capital expenditure;
- the indexation of the capital base as provided for in the AER's Asset Base Roll Forward Model, as updated for actual capital expenditure and inflation;
- regulatory tax depreciation of the regulatory Tax Asset Base as provided for in the relevant PTRM;
- other permanent and timing difference as drawn from the APA financial tax accounts; and
- regulatory taxable income and tax payable thereon.

These schedules then report the tax allowance that has been included in the building block revenue requirement calculation, for comparison purposes.

This analysis has been undertaken for the last five years for the Amadeus and Roma Brisbane Pipelines, and for three of the last five years for the Victorian Transmission System (noting that the VTS reports for regulatory purposes on a calendar year basis). As the AER does not price-regulate, or determine a tax allowance for the Central Ranges Pipeline and Network, the analysis has not been undertaken for these assets.

There are some limitations to this analysis. Amounts drawn from the PTRM are, by necessity, based on forecast capex. Moreover, the reported timing and permanent differences in the Statements of Taxable Income are based on accounting and tax records, rather than on regulatory information. The results are indicative rather than absolute.

However, this analysis should highlight the matters that the AER has indicated are important to its review, including differences in depreciation between tax and regulatory tax allowance purposes, and timing differences such as immediate deductibility of expenditure for tax purposes against capitalisation for regulatory purposes. Again APA cautions that some of these differences are caused by differences in asset valuation between regulatory and financial accounting purposes. This will particularly be the case where the regulatory Tax Asset Base (TAB) was historically set to be equal to the Regulatory Asset Base (RAB) in the transition to a post-tax regulatory framework.

In about half the cases analysed, the tax payable under the regulatory tax calculation framework is greater than the regulatory tax allowance, and in about half the cases the tax payable under the regulatory tax calculation framework is lower than the allowance.

Comparison of tax payable and tax allowance

Roma Brisbane Pipeline ($m)	2013	2014	2015	2016	2017
Tax payable	1.7	(0.4)	0.2	2.1	2.6
AER tax allowance	0.4	1.9	2.1	2.1	2.1
Victorian Transmission System ($m)	**2013**	**2014**	**2015**	**2016**	**2017**
Tax payable	n/a	7.0	0.05	(3.3)	n/a
AER tax allowance	n/a	3.8	3.5	3.6	n/a
Amadeus Gas Pipeline ($m)	**2013**	**2014**	**2015**	**2016**	**2017**
Tax payable	2.4	2.2	2.4	(1.7)	(0.04)
AER tax allowance	1.5	1.6	1.7	1.0	0.3

In the context of the AER's review of regulatory tax allowances, this analysis indicates that the AER's tax allowance is about as likely to under-compensate as over-compensate the business for the amount of tax payable on its allowed return on capital. Moreover, there is no systemic directional bias; an over- or under-compensation in one year does not appear to influence the outcome in the following year.

APA considers that this analysis suggests that there is not a compelling reason for the AER to consider changes to its current approach to setting the regulatory tax allowance.

APA looks forward to further engaging with the AER to assist in its review of the regulatory tax allowance. We would value the opportunity to meet with the AER staff to discuss the analysis in more detail.

Yours sincerely

Scott Young
Manager Regulatory