

FINAL Determination

Tax change event pass-through for

AusNet Services

15 October 2015

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# Overview

On 22 July 2014, SPI Electricity Pty Ltd (now, AusNet Electricity Services Pty Ltd) (AusNet Services) submitted a cost pass–through application to the Australian Energy Regulator (AER). The application related to costs incurred as a consequence of a direction issued by Energy Safe Victoria (ESV) requiring it to amend its Bushfire Mitigation Plan (BMP) to undertake a specified program of works in high bushfire risk areas. The cost of those projects was the subject of grant funding by the Victorian Government's Powerline Replacement Fund (PRF). Ordinarily, the receipt of grant money is taxable in the hands of the recipient. AusNet Services' application for a pass–through of these additional tax costs to consumers was granted by the AER on 12 September 2014.

Subsequently, AusNet Services made an application to the Australian Tax Office for a 'Private Ruling' which was successful. The effect of this ruling is that AusNet Services will not be subject to taxation on the grant monies received from the PRF. On 15 September 2015 AusNet Services applied to the AER for a negative tax change event pass–through determination. On the basis of the favourable private tax ruling, this application is to return to consumers the $5.72 million ($2015) previously granted by the AER.

The role of the AER, as the economic regulator of Distribution Network Service Providers (DNSPs) in the National Electricity Market (NEM), is to assess AusNet Services' application against the cost pass–through requirements in chapter 6 of the National Electricity Rules (NER). Specifically, if a positive or negative change event occurs, we must determine the required pass–through amount and how much of that amount should be passed through to network users in each regulatory year. This decision addresses those requirements, which are set out in clause 6.6.1 of the NER.

We have determined that AusNet Services' pass–through application satisfies the requirements of a tax change event. The tax change event, being the ATO Private Ruling, has the effect of deeming that grant money received under the PRF in 2014 and 2015 is not taxable. As a result, AusNet Services costs in providing direct control service are reduced by the amount of $5.72 million ($2015). This is the amount previously determined by the AER on 12 September 2014 and passed through by AusNet Services to cover its tax liability.

As AusNet Services has applied to the AER for a negative pass–through the AER must now make a determination on AusNet Services' application. We must consider, with reference to the factors specified in the rules[[1]](#footnote-2), whether the pass–through is justified and whether the relevant amounts have been correctly calculated.

We have assessed AusNet Services' application under the framework provided by the rules. In particular, we have considered:

* The provisions of NER cl 6.6.1;
* The material provided in AusNet Services' application;
* The AER cost pass–through determination for the powerline bushfire safety program 2014;[[2]](#footnote-3) and
* AusNet Services' 2011–15 revenue determination.

We determine that AusNet Services has correctly identified the pass–through amount as $5.72 million ($2015). However, this amount will be returned to customers in 2016. AusNet Services did not adjust the positive pass–through amount to account for the time cost of money. We have adjusted the amount to be returned to customers to account for the time cost of money.

We have based this calculation on the allowed rate of return of 9.75 per cent which applies in the 2011–15 determination. The calculation is 5.723×(1+0.0975)=6.281.[[3]](#footnote-4) We have determined that the negative pass–through amount is $6.28 million ($nominal).

AusNet Services can adjust its maximum allowed revenue in 2016 by this amount, via the price control formula, in accordance with AusNet Services' 2016–20 distribution determination.

# Determination

We consider that AusNet Services has established that a negative change event has occurred. The negative change event is a tax change event, and is a result of the actual tax payments required to be made by AusNet Services being lower than the allowance made for such payments in its 2011–2015 revenue determination adjusted to include the positive tax change event granted in September 2014.

The rules require us to determine the amount that should be passed through to customers.[[4]](#footnote-5) We base our decision on an assessment of the factors set out in clause 6.6.1(j) of the rules. We consider that AusNet Services has accurately calculated the effect of the negative change event on its business. Further, the pass–through amount that it proposes to pass on to customers is appropriate and meets the rule requirements. However, AusNet Services did not adjust the pass–through amount to account for the time cost of money. We have adjusted the amount to be returned to customers to account for the time cost of money.[[5]](#footnote-6)

For this decision we have based this calculation on the allowed rate of return of 9.75 per cent which applies in the 2011–15 determination. We have determined that the negative pass–through amount is $6.28 million ($nominal). This will be passed through in the 2016 regulatory year, via the price control formula, in accordance with AusNet Services' 2016–20 distribution determination.

# AusNet Services' application

AusNet Services' application was submitted on 15 September 2015. The application and its attachments are available on our website.[[6]](#footnote-7)

## Background

AusNet Services' application relates to the return to customers of money collected in the expectation that grant money received under the Victorian Government Powerline Replacement Fund in 2014 and 2015 would be taxable. Following the receipt of a favourable private ruling from the Australian Taxation Office on 8 May 2015, AusNet Services is no longer liable for taxation on this grant money.

## Calculation of the pass–through amount

On 12 September 2014 the AER approved a positive pass–through amount of $5.72 million ($2015). This has been included in AusNet Services' prices in 2015. Since this determination, AusNet Services has successfully obtained a private ruling from the Australian Taxation Office. The ruling absolves AusNet Services of the whole of the liability for taxation on grant money received from the PRF. The amount granted by the AER as the positive pass–through amount assumed the whole of that money was taxable.

Therefore, the amount to be returned to customers is also $5.72 million ($2015). However, as prices for 2015 have already been set, this amount must be recovered in 2016. Given the additional year of delay before this amount is returned to customers, we also need to adjust for the time cost of money.[[7]](#footnote-8) This calculation is based on the allowed rate of return. The relevant rate is the weighted average cost of capital (WACC) applying to AusNet Services. The nominal vanilla WACC is currently 9.75 per cent.[[8]](#footnote-9) We calculate the adjusted amount to be recovered in 2016 as $6.28 million ($nominal).[[9]](#footnote-10)

AusNet Services proposed to implement the negative pass through as a revenue adjustment in the PTRM, concurrent with our preliminary determination for AusNet Services' 2016–20 regulatory control period. We have not adopted this implementation. We consider that the two regulatory processes should be kept separate, and note that they have different timelines and assessment steps under the NER.[[10]](#footnote-11) Instead, we will implement the pass–through using AusNet Services' price control formula, which will be applied in accordance with AusNet Services' 2016–20 distribution determination.

# AER Assessment

## Relevant dates

The rules provide that, for a negative change event, an application to us for a negative pass–through amount must be made within 90 business days of the relevant event occurring.[[11]](#footnote-12) We must make a determination on the event within 40 business days of the business providing details of the event and supporting evidence to us.[[12]](#footnote-13)

AusNet Services was issued with its private ruling on 8 May 2015. AusNet Services made its pass–through application on 15 September 2015, which is within the set timeframe.

Therefore, we consider that the potential tax change event occurred on 8 May 2015, as proposed by AusNet Services.

## Tax change event

The NER defines a tax change event to have occurred if any of the following occurs during the course of a regulatory control period for a … Distribution Network Service Provider:

(i) a change in a relevant tax, in the application or official interpretation of a relevant tax, in the rate of a relevant tax, or in the way a relevant tax is calculated;

(ii) the removal of a relevant tax;

(iii) the imposition of a relevant tax; and

(b) in consequence, the costs to the service provider of providing prescribed transmission services or direct control services are materially increased or decreased.

We consider that the private ruling obtained by AusNet Services has the effect of changing the application or official interpretation of a relevant tax or the way a relevant tax is calculated when applied to AusNet Services circumstances. We calculate the impact on 2015 revenue will be 1.18 per cent. As this exceeds the materiality threshold of 1 per cent defined in the NER, the amount is material.[[13]](#footnote-14) We agree that a tax change event has occurred.

## Negative change event

In order to approve an amount of money to be passed through to energy consumers, we must determine that a negative change event has occurred. The rules define a negative change event as[[14]](#footnote-15):

…a pass–through event which entails the Distribution Network Service Provider incurring materially lower costs in providing direct control services than it would have incurred but for that event.

The tax change event, being the ATO Private Ruling identified above, has the effect of deeming that grant money received under the PRF in 2014 and 2015 is not taxable. As a result, AusNet Services costs in providing direct control service are reduced by the amount of $5.72 million ($2015) passed through to cover its tax liability as determined on 12 September 2014.

Since the difference will result in a lesser revenue requirement, we are satisfied that it is a negative change event.

## Calculation of the pass–through amount

The details of the calculation are provided in section 2.2 above.

We consider that AusNet Services has correctly calculated the pass–through amount, that is, it has incurred lower costs in providing direct control services than it would have incurred in the absence of the tax change event. However, we adjusted AusNet Services' calculated amount to reflect the delay in returning this amount to customers.

We consider that the entire 2014-15 pass–through amount should be passed through to consumers, since the entirety of the cost relates to the decreased liability of AusNet Services relative to the adjusted allowance set out in the revenue determination, following the earlier positive cost pass–through decision. This difference should be recovered in the 2016 regulatory year.

## Other considerations

Clause 6.6.1(j) of the rules sets out a number of matters that we are required to take into account when determining:

* whether a negative change event has occurred
* the approved pass–through amount
* the amount of the approved pass–through amount that should be passed through to distribution network users.

Sections 3.1, 3.2 and 3.3 above set out our considerations of those matters relevant to clauses 6.6.1(j)(1) and (2A). We consider the remainder of the matters listed by clause 6.6.1(j) below[[15]](#footnote-16):

* We consider that the time cost of money does need to be taken into account by this decision, as the costs are passed through to users in the next regulatory year following the year in which those costs occur.
* We consider that the costs to be repaid by AusNet Services due to this pass–through event are solely attributable to the tax change event.
* We do not consider there to be any changes in the way other taxes are calculated, or any other taxes that have been removed or imposed which are complementary to this tax change event.
* The costs of the pass–through event are, by definition, not factored into AusNet Services' aggregate revenue requirement for the 2011–15 regulatory control period.
* We consider that the costs incurred relating to the pass–through event under consideration are the subject of a previous determination made by us on 12 September 2014 under clause 6.6.1.
* We do not consider any other matters to be relevant.
1. NER cl 6.6.1(j). [↑](#footnote-ref-2)
2. See: <http://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/cost-pass-throughs/ausnet-services-cost-pass-through-powerline-bushfire-safety-program-2014> [↑](#footnote-ref-3)
3. Note that the amounts in this decision have been rounded to two decimal places for readability. [↑](#footnote-ref-4)
4. NER clause 6.6.1(g) [↑](#footnote-ref-5)
5. NER clause 6.6.1(j)(4) [↑](#footnote-ref-6)
6. http://www.aer.gov.au [↑](#footnote-ref-7)
7. We also adjusted for the time value of money when we calculated the value of the 2015 positive pass through. AER, Determination, 2014–15 Powerline replacement program cost pass through for AusNet Services, September 2014, p. 23. [↑](#footnote-ref-8)
8. AER, AusNet Services Australia Ltd, Distribution determination 2011–2015, Pursuant to Orders of the Australian Competition Tribunal in in SPI Electricity Pty Ltd v Australian Competition Tribunal [2012] FCAC 186, August 2013, p.27. [↑](#footnote-ref-9)
9. The calculation is $5.723×\left(1+0.0975\right)=6.281$. [↑](#footnote-ref-10)
10. NER, clauses. 6.6.1 and 6.16. [↑](#footnote-ref-11)
11. NER clause 6.6.1(f). [↑](#footnote-ref-12)
12. NER clause 6.6.1(g1) [↑](#footnote-ref-13)
13. NER, chapter 10 (definition of 'materially'). [↑](#footnote-ref-14)
14. NER, chapter 10 (definition of 'positive change event'). [↑](#footnote-ref-15)
15. NER clause 6.6.1(j)(4)-(8). [↑](#footnote-ref-16)