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Review of regulatory tax approach 2018

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments Energy Council in 2015, our objective is to promote the long-term interests of energy consumers with respect to price, quality, reliability, safety and security of supply.

We appreciate the opportunity to comment on the Australian Energy Regulator's *Review of regulatory tax approach 2018, Initial Report (the Report),* which is an important to ensuring that consumers pay no more than necessary for the energy transported by the energy network businesses.

As the Minister for the Environment and Energy, the Hon Josh Frydenberg has stated in his letter to the Chair of the Australian Energy Regulator (AER),

> *"The Australian Government wants to ensure that consumers are paying a fair price for their energy. I am concerned that network businesses may be collecting more than is needed to cover their tax liabilities, at consumers expense."*[1]

Introduction

The promotion of the long-term interests of consumers is the objective of the three national energy laws. The AER is directed by these laws to make decisions that contribute, or are likely to contribute, to the achievement of these objectives.

The long-term interest of consumers occurs when current and future consumers pay no more than they need to for the quality of service the community has come to expect.

Over the last decade the experience of energy consumers has been of ongoing real price increases for energy services.

In our most recent Energy Consumer Sentiment survey, only 20% of consumers say they are confident that the market is working in their interests and fewer households say they receive value for money for electricity than any other like service including banking and insurance

The ATO has provided advice to the AER that all taxpaying energy networks (listed or privately held) paid less tax provided for in their tax allowance.

[1] Letter to the Chair of the AER

In the face of this advice, a review of tax allowances is necessary to assess whether the outcomes of regulatory decisions in fact meet the test for consumer confidence in the framework. This assessment will require the collection of information and co-operation from the energy network businesses. Consumers expect nothing less.

The regulatory approach

The current framework for the regulation of energy network businesses is a hybrid model. The energy network businesses are provided with a revenue allowance determined on the basis of the AER's estimate of efficient costs, but the energy network businesses are provided with incentives to outperform the efficient costs.

Under the current framework, as the AER states in its Initial Report:

> *Unlike capex or opex, actual tax payments are not readily observed on a disaggregated basis. There is no CESS or EBSS equivalent sharing scheme in place for tax. If revealed tax efficiencies are not considered when setting the regulatory forecast of tax costs at a revenue determination then tax costs will not align with the benchmark incentive framework. This would mean NSPs are able to keep the savings from reducing their tax costs below the benchmark indefinitely, and consumers will not benefit from lower costs.*[2]

The AER's challenge is how to ensure that energy network businesses are not over-compensated for their tax liabilities without reducing the incentives for efficient cost management. The AER has identified a range of possible responses:

1. make changes to the treatment of tax depreciation in the regulatory model;
2. make changes to other aspects of the tax approach that would require a change in the rules;
3. adjust tax allowances to reflect actual tax payments by energy network businesses.

1. Calculating tax depreciation

Energy network businesses have a choice between using the straight-line or diminishing value approach to depreciation. In the long run, this only affects the timing of tax liabilities overall not the overall tax liability.

As the Initial Report demonstrates the network providers have an incentive to adopt diminishing value depreciation. For the AER to not use the same deprecation method as the energy network businesses results in current consumers paying more than they need to.

In our view there does not appear to be any other structural flaws in the AER methodology; the allowance will in general be sufficient to compensate energy network businesses.

2. Other changes not related to depreciation

According to the AER such changes could include changing the statutory tax rate to account for tax minimisation structures, using different debt gearing for tax purposes than is used in the rate of return etc.[3]

[2] AER, Initial Report, page 44
[3] AER Initial Report, page 40

Energy Consumers Australia's view is that any decision about whether these changes could be beneficial will depend on the detailed information proposed to be gathered from the AER under its information gathering powers. Further, we understand from the Report that it is uncertain how such changes might be incorporated into the rules.

3. Determining the actual tax paid

The AER is not currently provided with tax details by the energy network businesses providing regulated services. Energy Consumers Australia supports the proposal by the AER to collect the relevant actual tax payment information from the network businesses.

The ATO has reported that the government owned businesses under the National Tax Equivalent Regime were paying more that the tax allowance determined by the AER. We note that none of these businesses have historically mounted claims for a higher tax allowance. Consequently, we see no need to be concerned about the notional under-provisioning of tax allowances.

Energy Consumers Australia notes that there is a general principle of confidentiality in relation to tax affairs. However, energy network businesses have a guaranteed and largely protected market, they are provided with significant powers to construct their infrastructure and they are given a legislative guarantee of the ability to recover at least their efficient costs.

In the interests of consumer confidence in the price outcomes of revenue determination decisions, relevant tax records of the entities that provide regulated services should be available to the AER. Where there is a concern that this would cover too many unregulated revenue streams then the provider has a first option to restructure their business in a way to place the assets providing regulated energy services into a separate entity.

Comments on AER key issues

In the Initial Report the AER stated that it was particularly interested in stakeholders' views on six issues. Our responses to these issues are provided here for clarity.

The type of detailed tax information we should seek from energy networks

The AER should obtain the full taxation details for the entities that provide the regulated services. Consumer confidence in the regulatory process and price outcomes must be strong.

The list of potential drivers, including the interaction with timing effects arising from different depreciation profiles

We find no deficiency with the list of potential drivers. However, we are cautious about whether the solution to the overprovision of taxation allowances is more complex rules for calculating the allowance. Further information is needed before final conclusions can be reached.

The relevance and materiality of potential drivers

We consider that the most likely cause other than depreciation timing effects will be capital structure of the unlisted businesses allowing a higher deduction for interest expense. Further information is needed before final conclusions can be reached.

The list of potential changes

We consider that consistent with the rest of the regime it is important that the providers have an incentive to manage tax costs efficiently and that consumers should benefit from these efficiencies. Further work is needed to refine the concept of the 'benchmark efficient entity' in regard to the calculation of tax allowance and to determine the appropriate level of incentive sharing with consumers.

The advantages and disadvantages of a move to a tax pass-through approach

Our concern is that a tax pass through approach may remove incentives for further efficiencies. Further analysis is needed before we can be clear on which approach best meets the long-term interests of consumers.

The implementation of this review to the April 2019 determinations

We encourage the AER to move swiftly to introduce the information requests and rule changes required to allow consumers to share the benefits of the network providers existing tax minimisation strategies and to apply any changes to the April 2019 revenue determination decisions.

If you have any questions regarding our submission, please contact David Havyatt, Senior Economist of Energy Consumers Australia on [redacted] or david.havyatt@energyconsumersaustralia.com.au.

Yours sincerely,

Rosemary Sinclair AM

Chief Executive Officer