FINAL DECISION

Energex
Distribution Determination
2020 to 2025

Attachment 7
Corporate income tax

June 2020

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Energex for the 2020–25 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

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7 Corporate income tax

Our revenue determination includes the estimated cost of corporate income tax for Energex's 2020–25 regulatory control period. Under the post-tax framework, corporate income tax allowance is calculated as part of the building block assessment using our post-tax revenue model (PTRM). This attachment sets out our final decision on Energex's revised proposed corporate income tax allowance for the 2020–25 regulatory control period. It presents our assessment of the inputs required in the PTRM for the calculation of the cost of income tax.

7.1 Final decision

Our final decision on Energex's estimated cost of corporate income tax is $22.5 million over the 2020–25 regulatory control period. This represents an increase of $22.5 million from Energex's revised proposed cost of corporate income tax of zero. The key reasons for this change are:

- our final decision to reduce the immediately expensed capex for tax purposes from $748.3 million to $502.5 million[1]
- our final decision to increase the regulatory depreciation (attachment 4)[2]
- our final decision to apply an updated rate of return on equity (attachment 3)[3]
- our final decision to reduce the revised proposed opening tax asset base (TAB) value as at 1 July 2020 by $3.9 million to $8285.2 million[4]

We accept Energex's revised proposal on the standard and remaining tax asset lives for all of its asset classes, consistent with our draft decision.

Table 7.1 sets out our final decision on the estimated cost of corporate income tax allowance for Energex over the 2020–25 regulatory control period.

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1 Other than the outcomes of our forecast capex assessment, this reduction also reflects our decision to accept a correction by Energex for errors in its calculation of the revised proposed forecast immediately expensed capex and the forecast asset disposals. The corrections reduced the revised proposed forecast immediately expensed capex from $748 million to $502.5 million. All else equal, a lower amount of capex that are immediately expensed for tax purposes will reduce the tax expense and increase the cost of corporate income tax.

Energex, *Response to AER information request #IR079*, 10 March 2020.

2 All else equal, a higher regulatory depreciation amount will increase the cost of corporate income tax because it increases the taxable income.

3 All else equal, a lower rate of return on equity will lower the cost of corporate income tax because it reduces the return on equity, a component of the taxable income.

4 All else equal, a lower opening TAB value will reduce the tax depreciation, a component of the tax expense, and increase the cost of corporate income tax.

Table 7.1 AER's final decision on Energex's cost of corporate income tax for the 2020–25 regulatory control period ($ million, nominal)

	2020–21	2021–22	2022–23	2024–24	2024–25	Total
Tax payable	14.1	4.0	5.0	9.6	21.4	54.1
Less: value of imputation credits	8.3	2.4	2.9	5.6	12.5	31.7
Net corporate income tax allowance	**5.9**	**1.7**	**2.1**	**4.0**	**8.9**	**22.5**

Source: AER analysis.

In the draft decision, we made the following changes to Energex's modelling of its cost of corporate income tax:[5]

- We used the latest version of the PTRM (version 4) released in April 2019, which implemented the findings in our final report on the review of the regulatory tax approach.[6] Specifically, we applied the diminishing value method for tax depreciation to all new depreciable assets except for forecast capex associated with the 'Buildings - capital works' and 'In-house software' asset classes.[7]
- We reduced the opening TAB as at 1 July 2020 to reflect our decision on including a lower value of the legacy ICT assets and the correction for movements in capitalised provisions over the 2015–20 period.[8]
- We accepted Energex's proposed standard and remaining tax asset lives for all of its asset classes (with the exception of 'Legacy ICT' asset class). We also determined standard tax asset lives of 40 years and 3.8 years respectively for the two new asset classes of 'Buildings - capital works' and 'In-house software' that are subject to the straight-line method of tax depreciation.
- We removed the 'Communications', 'Research and development' and 'Easements' asset classes since they have an immaterial opening tax asset value and no new capex allocated to them for the 2015–20 and 2020–25 regulatory control periods.

Energex’s revised proposal adopted all of the changes required by the draft decision. However, it did not update the value of the legacy ICT assets to be included in the opening TAB at 1 July 2020.[9] This is discussed further below.

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5 AER, *Energex 2020–25 Distribution Determination – Draft Decision – Attachment 7 – Corporate income tax*, October 2019, p. 5, pp. 15–16.

6 AER, *Final report, Review of regulatory tax approach*, 17 December 2018.

AER, *Post-tax revenue models (transmission and distribution) - April 2019 amendment*, 24 April 2019.

7 All assets acquired prior to 30 June 2020 will continue to be depreciated using the straight-line depreciation method for regulatory tax purposes, until these assets are fully depreciated.

8 The legacy ICT assets were previously owned by a third party entity SPARQ (which was part of Energy Queensland) but used to provide ICT services for Energex and Ergon Energy in the 2015–20 regulatory control period. With the merger of the two entities to Energy Queensland in 2017, these functions will be performed by Energex going forward.

9 Energex, *Revised proposal,* 10 December, p. 17. Energex, *Revised Post tax revenue model*, 10 December 2019.

Opening tax asset base as at 1 July 2020

Our final decision is to determine an opening TAB value as at 1 July 2020 of $8285.2 million ($ nominal) for Energex. This amount is $3.9 million (or 0.05 per cent) lower than Energex's revised proposed opening TAB of $8289.0 million ($ nominal) as at 1 July 2020, reflecting the updated value of the legacy ICT assets to be rolled into the opening TAB.

In our draft decision, we accepted Energex's proposed method to establish the opening TAB as at 1 July 2020. However, we amended some of the proposed inputs used for the TAB roll forward—specifically, we made adjustments for movements in capitalised provisions and the value of legacy ICT assets. We noted that the opening TAB may be updated as part of the final decision to reflect:

- actual capex for 2018–19
- any revised 2019–20 capex estimates
- revisions to the value of legacy ICT asset as a result of capex spending updates for the final two year of the 2015–20 regulatory control period.[10]

Energex's revised proposal adopted our draft decision changes.[11] It also updated the 2018–19 estimated capex with actuals and revised the 2019–20 estimate of capex with the latest figures. However, it did not update its value of legacy ICT assets.

We have checked the 2018–19 actual capex in the revised proposal and are satisfied it aligns with Energex’s annual reporting regulatory information notice for that year. For the reasons discussed in attachment 2, we accept the updated 2019–20 capex estimate in the revised proposal. This capex estimate is lower than what we approved in our draft decision, reflecting more recent data. We will update this for actuals at the next revenue reset (2025–30).

Consistent with our approach in attachment 2, we asked Energex to provide an update to the draft decision value for the legacy ICT assets as at 1 July 2020.[12] In its response, Energex updated the estimated value of these assets to $120.9 million based on the actual capex for 2018–19 and a revised estimate of the capex for 2019–20.[13] For this final decision, we accept the actual 2018–19 and revised estimate of 2019–20 legacy ICT capex provided in Energex's response.[14] We note that any difference between this estimate and actual capex will be corrected for at the next

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10 AER, Energex 2020–25 *Distribution Determination – Draft Decision – Attachment 7 – Corporate income tax*, 8 October 2019, p. 19.

11 Energex, *Revised proposal, attachment 7,* 10 December, p. 7.

12 AER, *Information request IR#073*, 14 January 2020.

13 Energex, *Response to AER information request #IR073*, 21 January 2020.

14 We have substituted the estimated 2019–20 inflation rate used by Energex to convert the 2018–19 capex into 2019–20 real dollar terms by the actual 2019–20 (December to December) CPI, as it is now available for the final decision. This resulted in a minor increase to the value of the legacy ICT assets by $82,000 as at 1 July 2020.

reset through the roll forward model (2025–30). Our final decision is to include $120.9 million ($ nominal) of legacy ICT assets in the opening TAB as at 1 July 2020. This is $3.9 million lower than the draft decision.

Table 7.2 sets out our final decision on the roll forward of Energex's TAB values over the 2015–20 regulatory control period.

Table 7.2 AER's final decision on Energex's TAB roll forward for the 2015–20 regulatory control period

	2015–16	2016–17	2017–18	2018–19	2019–20[a]
Opening TAB	6672.9	7050.6	7388.2	7677.1	7927.2
Capital expenditure[b]	597.0	569.8	537.0	512.5	510.8
Less: tax depreciation	219.3	232.2	248.1	262.4	273.8
Closing TAB	7050.6	7388.2	7677.1	7927.2	8164.2
Roll-in of legacy ICT assets					120.9
Opening TAB as at 1 July 2020					**8285.2**

Source: AER analysis.

(a) Based on estimated capex.

(b) Net of disposals.

Standard and remaining tax asset lives as at 1 July 2020

For this final decision, we accept Energex's revised proposed standard and remaining tax asset lives for all of its asset classes. They are consistent with our draft decision and we confirm our position that the standard asset lives are broadly consistent with the values prescribed by the Commissioner for taxation in Australian Tax Office ruling 2019/5 and the Income Tax Assessment Act 1997.

Table 7.3 sets out our final decision on the standard and remaining tax asset lives as at 1 July 2020 for Energex. We are satisfied that the standard and remaining tax asset lives are appropriate for application over the 2020–25 regulatory control period. We are also satisfied that the standard and remaining tax asset lives provide an estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.[15]

[15] NER, cl. 6.5.3.

Table 7.3 AER's final decision on Energex's standard and remaining tax asset lives as at 1 July 2020 (years)

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2020[c]
OH sub-transmission lines	45.0	32.4
UG sub-transmission cables	50.0	34.9
OH distribution lines	45.0	36.0
UG distribution cables	50.0	34.9
Distribution equipment	45.0	36.6
Substation bays	40.0	29.6
Substation establishment	40.0	32.6
Distribution substation switchgear	40.0	30.9
Zone transformers	40.0	28.6
Distribution transformers	45.0	33.9
Low voltage services	40.0	30.0
Load control & network metering devices[a]	25.0	21.4
Communications - pilot wires	10.0	7.7
Street lighting (residual rate 2 assets)	n/a[d]	1.3
Systems buildings	40.0	33.4
Systems easements	n/a	n/a
System land	n/a	n/a
Control centre - SCADA	10.0	10.0
IT systems	3.8	3.1
Office equipment & furniture	13.1	5.7
Motor vehicles	12.9	8.2
Plant & equipment	5.2	3.4
Buildings	40.0	30.5
Land	n/a	n/a
Legacy ICT	n/a[d]	3.8
Buildings - capital works	40.0[b]	n/a
In-house software	3.8[b]	n/a
Equity raising costs	5.0[b]	n/a[e]

Source: AER analysis.

(a) This asset class was renamed 'Load control & network metering devices' in the 2015–20 distribution determination to better reflect the assets that make up this asset class. Energex referred to it as 'Metering' asset class in its proposal.

(b) These are the only asset classes used for the straight-line method of tax depreciation for new assets. All new assets for other asset classes used the diminishing value method of tax depreciation.

(c) Used for straight-line method of tax depreciation.

(d) There is no forecast capex allocated to the 'Legacy ICT' and the Street lighting (residual rate 2 assets) asset classes, therefore no standard tax asset life is assigned to these two asset classes.

(e) There is no opening tax value for the 'Equity raising costs' asset class, therefore no remaining tax asset life is assigned to this asset class.

n/a not applicable. We have not assigned a standard tax asset life and remaining tax asset life to the 'System land', 'System easements' and 'Land' asset classes because the assets allocated to these asset classes are non-depreciating assets. We also have not assigned a remaining tax asset life to the 'Buildings - capital works' and 'In-house software' asset classes prescribed for straight-line tax depreciation because they have no opening TAB values as at 1 July 2020.

7.2 Assessment approach

We did not change our assessment approach for the cost of corporate income tax from our draft decision. Attachment 7 (section 7.3) of our draft decision details that approach.[16]

[16] AER, *Energex 2020–25 Distribution Determination – Draft Decision – Attachment 7 – Corporate income tax*, 8 October 2019, pp. 8–14.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
NER	National Electricity Rules
PTRM	post-tax revenue model
TAB	tax asset base