FINAL DECISION

Ergon Energy
Distribution Determination
2020 to 2025

Attachment 7
Corporate income tax

June 2020

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585 165
Email: EnergyQueensland2020@aer.gov.au

AER reference: 62729

Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Ergon Energy 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

Attachment 13 – Control mechanisms

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 17 – Connection policy

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

Contents

7 Corporate income tax

Our revenue determination includes the estimated cost of corporate income tax for Ergon Energy'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 Ergon Energy'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 Ergon Energy's estimated cost of corporate income tax is $0.8 million over the 2020–25 regulatory control period. This is $0.8 million higher than Ergon Energy's revised proposal of zero corporate income tax. This is based on:

- our final decision to apply an updated rate of return on equity (attachment 3)[1]
- our final decision to increase the regulatory depreciation (attachment 4)[2]
- our final decision to reduce the immediately expensed capex for tax purposes from $622.0 million to $556.5 million ($2019–20)[3]
- our final decision to increase the revised proposed opening tax asset base (TAB) value as at 1 July 2020 by $4.0 million to $7774.0 million.[4]

The combination of the above decisions resulted in a positive forecast taxable income for Ergon Energy in 2020–21, but forecast tax losses for the remaining four years of the 2020–25 regulatory control period.[5] For this reason, our final decision is to set the 2020–21 cost of corporate income tax based on the forecast taxable income for that year, but set the cost of corporate income tax at zero for 2021–25 for Ergon Energy. We have determined that $22.5 million in tax losses as at 30 June 2025 will be carried forward to the 2025–30 regulatory control period.

We accept Ergon Energy's revised proposal on the standard tax asset lives for all of its asset classes, consistent with our draft decision. We have updated Ergon Energy's

---

1 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.

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 higher amount of capex that are immediately expensed for tax purposes will increase the tax expense and lower the cost of corporate income tax.

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

5 A forecast tax loss occurs when the forecast taxable income is lower than the forecast tax expense. Any residual amount of tax loss will be carry forward over the regulatory control periods to offset future taxable incomes until the full amount is exhausted No tax is payable until all tax losses are used.

remaining tax asset lives as at 1 July 2020 to reflect our amendment to the opening TAB value.

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

Table 7.1 AER's final decision on Ergon Energy'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	1.9	0.0	0.0	0.0	0.0	1.9
Less: value of imputation credits	1.1	0.0	0.0	0.0	0.0	1.1
Net corporate income tax allowance	**0.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.8**

Source: AER analysis.

In the draft decision, we made the following changes to Ergon Energy's modelling of its cost of corporate income tax:[6]

- 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.[7] 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.[8]
- 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 corrections for:[9]
    - movements in capitalised provisions over the 2015–20 regulatory control period
    - the actual capex for 2015–16, 2016–17 and 2017–18 so that they are consistent with the figures reported in the annual RINs.
- We accepted Ergon Energy'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 5 years respectively for the

---

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

7 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.

8 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.

9 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 Ergon Energy going forward.

two new asset classes of 'Buildings - capital works' and 'In-house software' that are subject to the straight-line method of tax depreciation.

Ergon Energy'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.[10] This is discussed further below.

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 $7774.0 million ($ nominal) for Ergon Energy. This amount is $4.0 million (or 0.1 per cent) higher than Ergon Energy's revised proposed opening TAB of $7770.0 million ($ nominal) as at 1 July 2020, reflecting the updated value of the legacy ICT assets to be rolled into the opening TAB and our correction for errors in the reported actual capex for 2015–16 to 2018–19.

In our draft decision, we accepted Ergon Energy'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 capex inputs and 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.[11]

Ergon Energy's revised proposal adopted our draft decision changes.[12] 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 identified an error in the allocation of under and over recoveries of corporate overheads between capital and operating expenditures. This also affected the capex for 2015–16 to 2017–18. Our correction for this error resulted in a reduction to the 2015–16 to 2018–19 actual capex by $4.5 million ($ nominal).[13]

---

10 Ergon Energy, *Revised proposal,* 10 December, p. 15.

Ergon Energy, *Revised Post tax revenue model*, 10 December 2019.

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

12 Ergon Energy, *Revised proposal, attachment 7,* 10 December, p. 7.

13 Our assessment found that there were under and over recoveries of corporate overheads in relation to Ergon Energy's 2015–20 Cost Allocation Method (CAM). We consider that instead of allocating these balances to opex, they should be allocated across the relevant services on the basis of proportional direct costs percentages, consistent with the method under Ergon Energy's CAM. This led to revision of actual capex reported for the years 2015–19. Ergon Energy's restated annual reporting RIN for its actual gross capex is now $4.5 million lower

For the reasons discussed in attachment 2, we accept the updated 2019–20 capex estimate in the revised proposal. This capex estimate is higher than what we approved in our draft decision, reflecting more recent data. We will update this for actuals at the next revenue reset.

Consistent with our approach in attachment 2, we asked Ergon Energy to provide an update to the draft decision value for the legacy ICT assets as at 1 July 2020.[14] In its response, Ergon Energy updated the estimated value of these assets to $130.1 million based on the actual capex for 2018–19 and a revised estimate of the capex for 2019–20.[15] For this final decision, we accept the actual 2018–19 and revised estimate of 2019–20 legacy ICT capex provided in Ergon Energy's response.[16] We note that any difference between the estimate and actual capex for 2019–20 will be corrected for at the next reset through the RFM. Our final decision is to include $130.2 million ($ nominal) of legacy ICT assets in the opening TAB as at 1 July 2020. This is $9.0 million higher than the draft decision.

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

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

	2015–16	2016–17	2017–18	2018–19	2019–20[a]
Opening TAB	6239.0	6607.3	6834.2	7062.6	7372.5
Capital expenditure[b]	630.6	508.8	528.6	609.4	584.1
Less: tax depreciation	262.3	281.9	300.2	299.6	312.8
Closing TAB	6607.3	6834.2	7062.6	7372.5	7643.8
Roll-in of legacy ICT assets					130.2
Opening TAB as at 1 July 2020					**7774.0**

Source: AER analysis.
(a) Based on estimated capex.
(b) Net of disposals.

compared to its revised proposed gross capex over these four years. Further details of our assessment is set out in section 6.4.1, attachment 6 of this final decision.

14 AER, *Information request IR#080*, 14 January 2020.

15 Ergon Energy, *Response to AER information request #IR080*, 21 January 2020.

16 We have substituted the estimated 2019–20 inflation rate used by Ergon Energy 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 in the value of the legacy ICT assets by $0.1 million as at 1 July 2020.

Standard and remaining tax asset lives as at 1 July 2020

For this final decision, we accept Ergon Energy's revised proposed standard 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 ATO ruling 2019/5 and the ITAA.

Consistent with the draft decision, we accept Ergon Energy's weighted average method to calculate its remaining tax asset lives as at 1 July 2020. In accepting the weighted average method, we have updated Ergon Energy's remaining tax asset lives as at 1 July 2020 to reflect our amendment to the opening TAB value.

Table 7.3 sets out our final decision on the standard and remaining tax asset lives as at 1 July 2020 for Ergon Energy. 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.[17]

Table 7.3 AER's final decision on Ergon Energy'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[b]
Overhead sub-transmission lines	45.0	22.7
Underground sub-transmission cables	50.0	33.5
Overhead distribution lines	45.0	34.1
Underground distribution cables	50.0	35.8
Distribution equipment	45.0	39.4
Substation bays	40.0	32.6
Substation establishment	40.0	30.2
Distribution substation switchgear	40.0	32.8
Zone transformers	40.0	22.8
Distribution transformers	40.0	26.6
Low voltage services	40.0	27.0
Communications - pilot wires	10.0	5.7
Generation assets	15.0	11.5

[17] NER, cl. 6.5.3.

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2020[b]
Other equipment	40.0	32.6
Control centre - SCADA	10.0	5.1
Land & easements (system) - combined	n/a	n/a
IT Systems	4.0	2.5
Office equipment & furniture	10.0	4.2
Motor vehicles	13.5	9.0
Plant & Equipment	5.0	3.2
Buildings	40.0	30.3
Land & easements - combined	n/a	n/a
Land improvements	40.0	33.2
Metering	25.0	18.0
Communications	10.0	2.9
ICT legacy assets	n/a[c]	4.0
Buildings - capital works	40.0[a]	n/a
In-house software	4.0[a]	n/a
Equity raising costs	5.0[a]	n/a[d]

Source: AER analysis.

(a) 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.

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

(c) There is no forecast capex allocated to the 'Legacy ICT' asset class, therefore no standard tax asset life is assigned to this asset class.

(d) 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 Land & easements (system) - combined ' and Land & easements - combined ' 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.[18]

[18] AER, *Ergon Energy 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
ATO	Australian Taxation Office
capex	capital expenditure
ITAA	Income Tax Assessment Act 1997
NER	National Electricity Rules
PTRM	post-tax revenue model
RIN	regulatory information notice
RFM	roll forward model
TAB	tax asset base