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Submission to AER Discussion Paper: Review of regulatory tax approach

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Comparison of tax payable per corporate tax returns to regulatory tax allowance

The comparison of the tax payable per the corporate tax returns to regulatory tax allowance was not a comparison of like-for-like. While I understand that there were time and data constraints that limited the scope of PWC's expert advice, when time and data permits, the AER might want to consider performing the comparison as follows:

1. Split the tax payable per corporate tax return into regulated and unregulated activities.
2. Compare the forecast income and expenses that comprised the tax allowance to actual income and expenses in the tax return.

The difference between the tax payable per corporate tax return to regulatory tax allowance has two components:

1. Difference between actual and forecast regulated activities. This could be something as simple as demand forecasts being different to actual demand, the actual gearing could vary to the benchmark gearing, and so on.
2. Unregulated activities. The tax on these should not be taken into account in the difference between the tax allowance and tax paid.

Financing costs

My own opinion is to disagree with adjusting gearing for the tax allowance as it is inconsistent with other parts of the building block framework.

I understand that financing costs have not been covered in too much detail to date. A note for financing costs relating to NTER entities when you do get to that stage. NTER entities are subject to debt neutrality adjustments and/or government guarantee fees to ensure they are not advantaged over their private sector counterparts by virtue of their government ownership.[1] The AER might want to take these into account when considering the financing costs for NTER entities.

Benchmark efficient firm

For tax purposes, I think the AER should decide what tax structure it considers a benchmark efficient firm to have and apply that to all regulated entities, rather than applying multiple benchmarks. The consumer should not be disadvantaged based on which tax structure or benchmark the network business servicing their area has.

Capex and depreciation

Recognising immediate expensing of capex: The AER might want to consider using actual capex expenses in the following price-path. For example, find out what the business expensed for capex in the prior determination period, and apply that as an expense in the next.

Using the diminishing value approach: The AER could consider using actual depreciation for all new assets. This would reduce the gap between actual tax depreciation and the forecast the AER uses. Tax laws do not allow switching from straight line to diminishing value. If the AER were to choose to switch depreciation approach, this would disadvantage entities that used straight line as they are unable to mirror that change for their existing assets in order to minimise their tax in line with the

[1] http://www.oecd.org/corporate/50302961.pdf. Refer to pg 73-74 for more detail.

tax allowance. If the AER chooses to change depreciation method for existing assets, the AER might want to consider applying the diminishing value method to the closing values of its TAB to ensure no gains or losses would result depending on where the asset is in its life.

Reducing tax asset lives for gas: I agree with the AER approach of reducing the tax asset lives for gas pipeline assets, although for ease of implementation, the AER might want to consider applying this to new assets.

Privatisation, M&A, stamp duty

I agree that costs associated with privatisation, M&A activities, and stamp duty should not form part of the tax allowance as they are not costs incurred in the provision of regulated services. If the AER chooses to benchmark according to a private company, it should do so on the basis that this entity has already been privatised and not include any costs related to privatisation or M&A activities.

However, the AER should keep in mind that if it chooses to allow actual depreciation going forward, it might need to carefully examine any depreciation on step up costs from privatisations that occur after that point in time.