SA Power Networks

Attachment 7
Corporate income tax

2020-25 Revised Regulatory Proposal

10 December 2019

This section outlines:

› how we have estimated our cost of corporate income tax for the 2020-25 Regulatory Control Period.

Company information

SA Power Networks is the registered Distribution Network Service Provider for South Australia.
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Note

This attachment forms part of our Proposal for the 2020-25 Regulatory Control Period. It should be read in conjunction with the other parts of the Proposal.

Our Proposal comprises the overview and attachments listed below, and the supporting documents that are listed in Attachment 18:

Document	Description
	Regulatory Proposal overview
Attachment 1	Annual revenue requirement and control mechanism
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 11	Demand management incentives and allowance
Attachment 12	Classification of services
Attachment 13	Pass through events
Attachment 14	Alternative Control Services
Attachment 15	Negotiated services framework and criteria
Attachment 16	Connection Policy
Attachment 17	Tariff Structure Statement Part A
Attachment 17	Tariff Structure Statement Part B - Explanatory Statement
Attachment 18	List of Proposal documentation

Contents

List of tables

7. Corporate Income Tax

7.1 Overview

Table 7-1 below sets out and compares SA Power Networks' Regulatory Proposal (**Original Proposal**) for the 2020-25 regulatory control period (**RCP**), the Australian Energy Regulator's (**AER**) position in its draft decision on our Original Proposal (**Draft Decision**) and SA Power Networks' response (**Revised Proposal**) in relation to corporate income tax.

Table 7-1: Summary of corporate income tax in Original Proposal, AER Draft Decision and Revised Proposal

Original Proposal	AER Draft Decision	Revised Proposal
$1 Placeholder allowance proposed as updated PTRM not released	$37.6m Updated PTRM used to determine allowance	$10.5m Recalculated for Revised Proposal

Under the post-tax revenue framework, a corporate income tax allowance is calculated for each Distribution Network Service Provider (**DNSP**) using the AER's post-tax revenue model (**PTRM**). The DNSP's estimate of the cost of corporate income tax for each regulatory year of the RCP forms part of the DNSP's building block proposal for that RCP.

The building block for the estimated cost of corporate income tax takes into account the DNSP's estimated taxable revenue and tax expenses (such as depreciation, interest and operating expenditure), the statutory corporate income tax rate and the value of imputation credits.

7.2 Original Proposal

In December 2018, the AER completed its review of the regulatory tax approach (**Tax Review**). The purpose of the Tax Review was to investigate the nature of any identified difference between the regulatory forecast of tax costs under the post-tax revenue framework and actual tax payments[1]. The AER made a number of recommendations based on its findings, some of which have since been implemented through changes to the PTRM.

At the time of the submission of our Original Proposal in January 2019, the AER had not finalised the PTRM amendments to implement the Tax Review recommendations. The amended PTRM was not released until April 2019. Therefore, SA Power Networks provided a placeholder estimate of $1 for the corporate income tax allowance for the 2020–25 RCP.

Following the publication of the amended PTRM (version 4), SA Power Networks consulted with the AER on the changes and inputs required to populate the amended PTRM. We proposed an approach to forecast the immediate expensing of capital expenditure (**capex**) for the 2020-25 RCP. The proposed capex to be immediately expensed reflected the proportion of immediately expensed capex historically claimed by SA Power Networks.

Subsequent to our Original Proposal, SA Power Networks also proposed that the value of the opening tax asset base (**TAB**) in its proposed Roll Forward Model (**RFM**) should be adjusted down to reflect the immediate expensing of capex incurred in previous RCPs. We have set out our reasoning for proposing such an adjustment in section 7.5.2 below. SA Power Networks estimated that this adjustment would add around $15 million ($ nominal) to the cost of corporate income tax for the 2020–25 RCP.

[1] *AER, Final report – Review of regulatory tax approach, 17 December 2018, page 2.*

7.3 AER's Draft Decision

In its Draft Decision, the AER implemented the Tax Review changes and applied the latest version of the PTRM (version 4) released in April 2019. This resulted in a corporate income tax allowance of $37.6 million ($ nominal) for SA Power Networks in the 2020–25 RCP.[2]

The AER recognised immediate expensing of some forecast capex for the calculation of tax depreciation. The accepted forecast for immediately expensed capex for the 2020-2025 RCP of $578 million ($real, 2019/20) was consistent with the approach proposed by SA Power Networks.

The AER also applied the diminishing value (**DV**) method for tax depreciation to all new depreciable assets except for forecast capex associated with buildings (capital works) and in-house software. SA Power Networks provided additional information to reallocate the Original Proposal capex to these new categories.

The opening TAB at 1 July 2020 was revised for movements in capitalised provisions over the 2015-20 RCP, consistent with the RAB set out in Attachment 2 – Regulatory asset base of our Revised Proposal.

The AER in its Draft Decision accepted the continued use of the year-by-year tracking approach for calculating tax depreciation of existing assets.

The AER did not accept in its Draft Decision SA Power Networks' proposal to adjust the TAB as at 1 July 2020 to reflect the immediate expensing of capex incurred prior to 1 July 2020.

7.4 SA Power Networks' response to AER's Draft Decision

SA Power Networks accepts the AER's decisions to:[3]

- accept the continued use of the year-by-year tracking approach for calculating tax depreciation of existing assets;
- apply the DV method for tax depreciation to all new depreciable assets except for forecast capex associated with buildings (capital works) and in-house software;
- recognise the immediate expensing of some forecast capex when calculating tax depreciation, consistent with the approach proposed by SA Power Networks; and
- determine the opening TAB at 30 June 2020 in the manner set out in the Draft Decision, except for updating the actual and forecast capex for the 2018/19 and 2019/20 regulatory years respectively.

7.5 Revised Proposal

7.5.1 Allowance for Corporate Income Tax

We have calculated a different value for the allowance for corporate income tax for the purposes of our Revised Proposal, due to the changes contained in other parts of this Revised Proposal in relation to:

- forecast capex, as discussed in Attachment 5 – Capital expenditure;
- forecast of immediately deductible capex, discussed below; and
- determination of the opening TAB, discussed below.

[2] *AER, Draft Decision for SA Power Networks Distribution Determination 2020-2025, Attachment 7: Corporate income tax, pages 5 and 6.*
[3] *Ibid.*

Table 7-2 below sets out our proposed allowance for corporate income tax for the 2020-25 RCP.

Table 7-2: Allowance for corporate income tax (nominal, $ million)

	2020/21	2021/22	2022/23	2023/24	2024/25
Tax Payable	2.6	2.0	4.8	7.9	8.0
Less value of imputation credits	(1.5)	(1.2)	(2.8)	(4.6)	(4.7)
Net corporate income tax	1.1	0.8	2.0	3.3	3.3

7.5.2 Opening TAB

SA Power Networks has accepted the AER's decision to determine the opening TAB at 30 June 2020 in the manner set out in the AER's Draft Decision, except for updating the actual and forecast capex for the 2018/19 and 2019/20 regulatory years.

Since our Original Proposal, the 2018/19 regulatory year has ended and we have used the actual 2018/19 regulatory year capex data in the RFM when determining the opening TAB at 30 June 2020 set out in our Revised Proposal.

The actual data for the 2019/20 regulatory year will not be available before the AER's final decision for the 2020-25 RCP. However, we have updated the forecast capex data for the 2019/20 regulatory year based on the current forecast data. This revised forecast has been inputted into the RFM. The difference between this forecast amount and the actual amount will be reflected in the roll forward of the TAB to 1 July 2025.

In doing this, SA Power Networks has determined the roll forward of the TAB value from 1 July 2015 to 30 June 2020 to be $3,459.1 (nominal, $ million) for standard control services (**SCS**).

Further details concerning the roll forward of SA Power Networks' TAB over the 2015-20 RCP are set out in Table 7-3 below.

Table 7-3: SCS TAB roll forward to 30 June 2020 (nominal, $ million)

	2015/16	2016/17	2017/18	2018/19	2019/20
Opening TAB	2,466.3	2,609.9	2,757.6	2,989.8	3,219.5
Plus capex, net of disposals	304.9	320.4	417.5	429.0	436.9
Less straight line depreciation	(161.3)	(172.7)	(185.3)	(199.3)	(197.3)
Closing TAB	2,609.9	2,757.6	2,989.8	3,219.5	3,459.1

When calculating the estimated cost of corporate income tax for the 2020-25 RCP using the AER's amended PTRM (version 4), SA Power Networks identified an issue with the new approach.

Under the AER's new approach, SA Power Networks' estimated cost of corporate income tax set out in the Draft Decision is lower than the allowance which would have been determined under the previous regulatory approach because the AER now assumes that a benchmark efficient entity (**BEE**) will immediately expense certain types of capex as and when they are incurred during the 2020-25 RCP.[4]

However, the AER's approach to estimating the taxable income that would be earned by a BEE during each regulatory year of the 2020-25 RCP also assumes that the BEE will be claiming depreciation in relation to its entire TAB even though a portion of the TAB will not be depreciated during the 2020-25 RCP because it was immediately expensed during a previous period. It follows that the estimate of the taxable income that would be earned by a BEE during the 2020-25 RCP is lower than the actual taxable income because the AER's estimate assumes that the BEE will be claiming deprecation in relation to its entire TAB even though this will not be the case.

Setting the BEE’s forward looking tax allowance on the basis that it will simultaneously receive (a) the benefit of immediate expensing of certain forecast capex, and (b) depreciation deductions from the capitalisation of the same type of expenditure incurred under the previous regulatory approach that has been fully expensed, results in an underestimate of the BEE’s tax allowance. As a consequence, we believe that we will receive less than our efficient tax costs for the 2020-25 RCP.

We raised this issue with the AER prior to the publication of its Draft Decision, noting that the partial write-down of our TAB would correct this mismatch. However, this was rejected by the AER. We also discussed this issue with stakeholders but those stakeholders did not support our proposed approach.

In our view:

- clause 6.5.3 of the National Electricity Rules (**NER**) requires the AER to estimate the taxable income that will be earned by a BEE during each regulatory year of the 2020-25 RCP (ie without reference to past periods);
- the NER does not permit the AER to take into account under recoveries or over recoveries of the tax allowance that may have occurred during previous periods when setting this forwarding looking estimate;
- neither the National Electricity Law (**NEL**) or the NER permit the deliberate under estimation of a BEE's estimated taxable income in order to adjust for a past over recovery that was permitted under the approach to estimating taxable income at the time.

Whilst we remain of this view, we have nevertheless accepted the AER's methodology for computing the tax allowance for the 2020-25 RCP and this is reflected in the calculations underpinning our Revised Proposal.

7.5.3 Roll forward of the TAB for the 2020-25 RCP

SA Power Networks has not incorporated the AER’s Draft Decision concerning the forecast closing TAB at 30 June 2025 because we do not accept the AER’s Draft Decision in relation to forecast capex for 2020-25 RCP (see Attachment 5 – Capital expenditure).

Applying the revised forecast of capex set out in this Revised Proposal, SA Power Networks has determined the roll forward TAB value from 1 July 2020 to 30 June 2025 to be $3,702.3 (nominal, $ million) for SCS.

Further details concerning the roll forward of SA Power Networks’ TAB over the 2015-20 RCP are set out in Table 7-4.

[4] *AER, Attachment 7, page 10.*

Table 7-4: SCS TAB roll forward to 30 June 2025 (nominal, $ million)

	2020/21	2021/22	2022/23	2023/24	2024/25
Opening TAB	3,459.1	3,520.2	3,580.0	3,619.5	3,661.5
Plus capex, net of disposals	427.0	446.9	442.7	445.2	442.3
Less straight line depreciation	(365.8)	(387.1)	(403.2)	(403.2)	(401.5)
Closing TAB	3,520.2	3,580.0	3,619.5	3,661.5	3,702.3

7.5.4 Forecast of immediately deductible capex for the 2020-25 RCP

SA Power Networks has updated its calculation of the forecast for immediately deductible capex for the 2020-25 RCP. This calculation is based on the same methodology we provided to the AER during consultation following the submission of our Original Proposal.

The calculation has been updated to:

- reflect the revised capex forecast set out in our Revised Proposal (Attachment 5 – Capital expenditure); and
- incorporate actual results from the 2018/19 regulatory year.

The calculations are contained in the Supporting Document 5.1 - Revised Regulatory Proposal Capex model.

Shortened Forms

AER	*Australian Energy Regulator*
BEE	*Benchmark efficient entity*
capex	*capital expenditure*
DNSP	*Distribution Network Service Provider*
Draft Decision	*AER, Draft Decision—SA Power Networks Distribution Determination 2020 to 2025*
DV	*diminishing value*
NEL	*National Electricity Law*
NER	*National Electricity Rules*
Original Proposal	*Regulatory Proposal for the 2020-25 RCP*
PTRM	*Post-tax revenue model*
RCP	*Regulatory Control Period*
Revised Proposal	*Revised Regulatory Proposal for the 2020-25 RCP*
RFM	*Roll Forward Model*
SCS	*Standard control services*
TAB	*Tax asset base*
Tax Review	*AER review of regulatory tax approach*