



# SP AusNet

## 2006/07 Application for Pass-through due to Change in Taxes Event

6 February 2006

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## 1. INTRODUCTION

In 2004 the Victorian Government extended land tax to electricity transmission easements owned by electricity transmission companies in Victoria. The new tax arrangement is designed to counter a shortfall in Government revenue as a result of the Government's abolition of the Smelter Reduction Amount levy.

This very significant new impost is not currently provided for in the current regulated revenue cap, therefore, SP AusNet is applying annually for a pass-through of the financial effect associated with this new tax under the Pass Through Rules under section 5.7.5 of the ACCC *Decision on Victorian Transmission Network Revenue Caps 2003-2008* ("**ACCC Decision**").

This Application for pass-through relates only to the current regulatory year from 1 April 2006 to 31 March 2007. SP AusNet envisages making a similar annual pass-through application for the remaining regulatory years of the current revenue cap as the exact amounts of land tax to be levied in future years becomes known (most likely in February of each year). Therefore, annual estimates only for the remaining years of the revenue cap are provided to allow the AER and customers to forecast future revenue effects as accurately as possible.

The Application is divided into the following sections:

- Details of the pass-through event including the date of the relevant pass-through event;
- The financial effect of the pass-through event and the relevant interested parties;
- The finalised SP AusNet pass-through amount; and
- Appendices containing relevant supporting documents

It should be noted that all amounts expressed in this Application are GST exclusive (that is, GST is **not** included).

## 2. DETAILS OF PASS-THROUGH EVENT

In April 2004, the Victorian Parliament passed the **Land Tax (Amendment) Act 2004** (submitted previously with 2004 application). The Act extends the essential parts of the **Land Tax Act 1958** to electricity transmission easements owned by electricity transmission companies in Victoria. Specifically (and most likely exclusively), this refers to electricity easements owned by SP AusNet.

SP AusNet considers the extended land tax constitutes a “Relevant Tax” for the purposes of the Pass Through Rules under section 5.7.5 of the **ACCC Decision** (see clause 1.2 of SP AusNet Pass-through Rules (submitted previously with 2004 application)). The definition of a “Relevant Tax” is provided below:

“Relevant Tax means any tax, rate, duty, charge, levy or other like or analogous impost that is:

- (a) paid, to be paid, or taken to be paid by SP AusNet in connection with the provision of transmission services, or
- (b) included in the operating expenses or other cost inputs of SP AusNet’s revenue cap;

but excludes:

- (c) income tax (or State tax equivalent) and capital gains tax;
- (d) penalties and interest for late payment relating to any tax, rate, duty, charge, levy or other like or analogous impost;
- (e) fees and charges paid or payable in respect of a Service Standards Event;
- (f) stamp duty, financial institutions duty, bank accounts debits tax or similar taxes or duties; and
- (g) any tax, rate, duty, charge, levy or other like or analogous impost which replaces the taxes and charges referred to in (c) to (f).”  
(clause 3.1, SP AusNet Pass-through Rules)

The land tax is paid in connection with the provision of transmission services and does not fall within any of the exclusions in paragraphs (c) to (g) of the definition.

The Commission makes it clear on page 83 of the **ACCC Decision** that it regards taxes such as land tax as legitimate taxes that would be incurred by a prudent service provider acting efficiently and that these costs should be incorporated into the revenue cap.

SP AusNet also considers the amendments to the **Land Tax Act 1958** outlined above to be a “Change in Taxes Event” for the purpose of the Pass Through Rules under section 5.7.5 of the **ACCC Decision** (see clause 1.2 of SP AusNet Pass-through Rules). The definition of a “Change in Taxes Event” is provided below:

“Change in Taxes Event means:

- (a) a change in the way or rate at which a Relevant Tax is calculated (including a change in the application or official interpretation of Relevant Tax);
- (b) the removal or imposition of a new Relevant Tax,  
to the extent that the change, removal or imposition:
- (c) occurs after the date of the Determination; and
- (d) results in a change in the amount SP AusNet is required to pay or is taken to pay (whether directly, under any contract or as part of the operating expenses or other cost inputs of SP AusNet’s revenue cap) by way of Relevant Taxes.” (clause 3.1, SP AusNet Pass-through Rules)

## **2.1 Date of Relevant Pass-through Event**

The extension of land tax to electricity transmission easements has applied from 1 July 2004. The 2006 Assessment was issued on 13 January 2006. The Land Tax Assessment Notice is attached as Appendix A.

## **2.2 Proposed Assessment of the Land Tax Liability**

### ***2.2.1 Amount of tax from 1 January 2006 to 31 December 2007***

The amount of tax to be levied for the period 1 January to 31 December 2006 is based on a high-level valuation of the easements established by the Valuer-General of Victoria pursuant to the **Valuation of Land Act 1960**. The Valuer-General has established the 2004 level valuation of the easements at **\$1.580 billion**. A letter from the State Revenue Office (SRO) outlining this valuation is attached as appendix B.

This valuation is for the purposes of assessing land tax only and will not impact on asset valuations established by the AER for regulatory revenue setting purposes.

In accordance with the new Part II of the **Land Tax Act 1958**, the liability for land tax in respect of transmission easements for the period 1 January 2006 to 31 December 2007 will be **\$78,919,880**.

### **2.2.2 Amount of tax from 2007 onwards**

For the 2007 easement assessment, the 2004 valuation will be indexed, using the relevant Indexation Factors that will be calculated in late 2006 for each of the municipalities through which the easements run.

The completed detailed 2006 level valuation will be used for the calculation of Land Tax in 2008.

In effect, from 2006, the above methodology will be consistent with the valuation and escalation regime used for the calculation of land tax liabilities on freehold land outlined in the current **Land Tax Act 1958**.

### 3. ESTIMATED FINANCIAL EFFECTS OF PASS-THROUGH EVENT

Although the tax liability is assessed for a calendar year, SP AusNet has agreed with the SRO a payment schedule that aligns with SP AusNet's regulatory year from 1 April to 31 March. This allows the required pass-through amount sought from the AER to be calculated exactly and avoids under/over recovery adjustments going forward. The schedule of payments is included as part of the Tax Assessment Notice attached as appendix A

Annual pass-through amounts for the April to March regulatory years from 2006/07 to the end of the current regulatory period will equal the tax assessments for the concurrent calendar years. Therefore, monthly payments to the SRO of the land tax assessed for the calendar year 2006 will begin upon receipt of VENCORP's Network Charges for the month of April. Payment is required within 11 business days from the end of April.

Therefore, for the regulatory period 1 April 2006 to 31 March 2007, the pass-through amount will equal the tax assessment for calendar year 2006 – **\$78,919,880**. This will be collected in twelve (12) monthly instalments in the months May through to April of the 2006/07 financial year.

Table 1 shows the actual and estimated easement land tax amounts for the remainder of the current regulatory period.

**Table 1: Actual and estimated easement land tax for period to 31 March 2008**

Regulatory year (April to March)	Pass-through Amount	Actual/Estimated
2006/07	\$78,919,880	Actual
2007/08	\$83,813,000	Estimated*

\* Amount of tax based on \$1.58 billion easement value escalated by 6.2%. Percentage based on average annual increase in Melbourne house prices over the last 14 years (*ABS Publication 6416.0 House Prices Indexes: Eight Capital Cities*).

#### 3.1 Incremental operating expenditure

Under clause 2.4 of the Pass Through Rules under section 5.7.5 of the **ACCC Decision**, the AER must seek to ensure that the financial effect on SP AusNet associated with the pass-through event is economically neutral.

SP AusNet expected a detailed easement-by-easement valuation by Valuer-General's for the 2004 assessment and consequently anticipated that it would be required to rigorously review the valuation in order that the Company prudently minimise its tax costs on behalf of its customers. However, as the Valuer-General has issued only a high-level valuation for 2004 and will now only issue a detailed valuation for 2006. Therefore, any costs associated with a review are likely to be incurred after the 2006/07 financial year.

### 3.2 Changes in other taxes

There has been a reduction in (non-easement) land tax payable by SP AusNet that should offset a minor amount of the relevant "Change in Taxes" for the purposes of clause 2.4(a)(iv) of the SP AusNet Pass-through Rules.

After SP AusNet's *2004 Pass-through Application*, the Victorian Government announced (18 May) and implemented a phased cut in land tax from 5% to 3% by 2009.

In 2005, the Victorian Government announced further changes to the land tax regime (enacted in June) that increased the value thresholds to which various the rates applied and accelerated the phased cut announced and implemented the previous year by one year (3% reached by 2008).

The dates of the rate reductions and resultant percentage cuts to SP AusNet's tax allowance are as shown in Table 2 below.

**Table 2: Implementation dates and percentage size of land tax cuts**

Year Commencing	Rate	Resultant cut to SP AusNet Tax Benchmark*
Original Rate	5%	
1 January 2006	3.5%	30.11%
1 January 2007	3.25%	34.97%
1 January 2008	3%	39.82%

\* note a 20% cut in the rate does not exactly equate with a 20% cut in tax as the top rate is phased over the first \$2.7 million of the Company's land value. This principle also applies to the subsequent cuts.

The Table 3 outlines the actual and forecast dollar cuts to SP AusNet's tax allowance as a result of the (non-easement) land tax cuts.



**Table 3: Actual and forecast cuts to SP AusNet’s existing tax allowance**

SP AusNet Financial Year	Old Land Tax Benchmark	Cut in Tax	New Land Tax Benchmark
	000’s	000’s	000’s
2006/07	\$4,174	1,311	2,875
2007/08*	\$4,278	1,553	2,738

\* forecast only.

The offsetting amount for 2006 will equal **\$1,311,404**.

### **3.3 The AER Performance Incentive Scheme**

SP AusNet will continue to exclude the revenue increase approved by the AER for pass-through of this “Change in Taxes Event” for the purposes of calculating penalties and bonuses under the AER Performance Incentive Scheme applied to the Company’s service standards. This ensures that the company’s and customers’ potential liabilities under the scheme remain unchanged from the introduction of the easement land tax.

### **3.4 Allocation of Pass-through Amount to Customer Charges**

Once the maximum revenue is calculated according to formulae set out by the **ACCC Decision**, SP AusNet allocates the revenue to the following four pools as per the definitions included under Clause 6.3.1 and Schedule 6.2 of the NEC:

- (1) Entry services;
- (2) Exit services;
- (3) Transmission Network Services; and
- (4) Common services.

Costs allocated with easements currently fall into common service pool.

As the new tax is directly associated with the value of the easement portfolio, SP AusNet intends to allocate the cost of the new tax to VENCORP via the common service pool. VENCORP has agreed to this allocation via the common service pool. This allocation is also preferred because it quarantines entry connection parties, who cannot easily pass-through the costs themselves, from changes to transmission

connection charges resulting from this pass-through event (VENCorp's letter of agreement submitted previously with 2004 application). The estimated affect on VENCorp's charges for 2006/07 are attached in appendix C

The pass-through amount will be identified as a discrete item on VENCorp's bill.

The offsetting cut to (non easement) land taxes will be made from general revenue and distributed amongst customers using the annual price setting methodology.

### **3.5 Interested parties**

Given the agreed allocation outlined above, SP AusNet believes the interested parties to this pass-through Application to be:

- VENCorp – as it will be directly charged by SP AusNet; and
- the five Victorian Distribution Companies – as they will also have to seek a pass-through from the Essential Services Commission of Victoria.

Nonetheless, SP AusNet recognises the AER will consult more widely.

#### **4. SP AUSNET PROPOSAL**

Therefore, SP AusNet is seeking a pass-through of **\$77,608,476** for the regulatory year 1 April 2006 to 31 March 2007. This amount will be charged to VENCorp in twelve (12) monthly instalments starting with the bill issued for the month of April 2006.

**Appendix A: Easement Land Tax Assessment**

**Appendix B: SRO Letter on Easement Valuation**

**Appendix C: Effect on Charges**