



**FINAL DECISION**  
**Essential Energy distribution**  
**determination**  
**2015–16 to 2018–19**

**Attachment 8 – Corporate**  
**income tax**

April 2015

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## Note

This attachment forms part of the AER's final decision on Essential Energy's revenue proposal 2015–19. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 - Annual revenue requirement

Attachment 2 - Regulatory asset base

Attachment 3 - Rate of return

Attachment 4 - Value of imputation credits

Attachment 5 - Regulatory depreciation

Attachment 6 - Capital expenditure

Attachment 7 - Operating expenditure

Attachment 8 - Corporate income tax

Attachment 9 - Efficiency benefit sharing scheme

Attachment 10 - Capital expenditure sharing scheme

Attachment 11 - Service target performance incentive scheme

Attachment 12 - Demand management incentive scheme

Attachment 13 - Classification of services

Attachment 14 - Control mechanism

Attachment 15 - Pass through events

Attachment 16 - Alternative control services

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## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	expenditure forecast assessment Guideline for electricity distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure
RFM	roll forward model

RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

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## 8 Corporate income tax

We are required to make a decision on the estimated cost of corporate income tax for Essential Energy in the 2014–19 period.<sup>1</sup> Under the post-tax framework, a corporate income tax allowance is calculated as part of the building block assessment using our post-tax revenue model (PTRM). This amount enables Essential Energy to recover the costs associated with the estimated corporate income tax payable during the 2014–19 period.

This attachment presents our final decision on Essential Energy's revised proposed corporate income tax allowance for the 2014–19 period. It also presents our final decision on its revised proposed opening tax asset base (TAB), the standard and remaining tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses, and the tax treatment of incentive scheme revenues.

### 8.1 Final decision

We do not accept Essential Energy's revised proposed cost of corporate income tax allowance of \$366.7 million (\$ nominal). Our final decision on the estimated cost of corporate income tax is \$196.9 million (\$ nominal) for Essential Energy over the 2014–19 period. This represents a reduction of \$169.8 million (or 46.3 per cent) from its revised proposal.

This reduction reflects our final decision on the inputs for forecasting the cost of corporate income tax such as the opening tax asset base (section 8.4.1), and the standard and remaining tax asset lives (sections 8.4.2 and 8.4.3 respectively). It also reflects our final decision on the value of imputation credits—gamma—(attachment 4) and changes to the building block costs affecting revenues, which also impact the tax calculation. The changes affecting revenues are discussed in attachment 1.

Table 8.1 sets out our final decision on the estimated cost of corporate income tax allowance for Essential Energy.

**Table 8.1 AER's final decision on Essential Energy's cost of corporate income tax allowance for the 2014–19 period (\$ million, nominal)**

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
Tax payable	59.2	62.8	71.1	64.3	70.8	328.2
Less: value of imputation credits	23.7	25.1	28.5	25.7	28.3	131.3
<b>Corporate income tax allowance</b>	<b>35.5</b>	<b>37.7</b>	<b>42.7</b>	<b>38.6</b>	<b>42.5</b>	<b>196.9</b>

Source: AER analysis.

<sup>1</sup> NER, cl. 6.4.3(a)(4).

## 8.2 Essential Energy's revised proposal

Essential Energy's revised proposal forecasts a cost of corporate income tax allowance of \$366.7 million (\$ nominal). Essential Energy's methodology for determining its corporate income tax is unchanged from its initial proposal except for the treatment of revenue adjustments arising from efficiency benefit sharing scheme (EBSS) and demand management innovation allowance (DMIA) carryovers, and the DMIA forecast payments. Essential Energy amended the revised proposed PTRM so that these adjustments were not included as expenses for tax purposes.<sup>2</sup> Essential Energy calculated the cost of corporate income tax allowance using this amended PTRM and the following inputs:<sup>3</sup>

- a revised opening TAB at 1 July 2014 of \$5353.7 million (\$ nominal), reflecting updates for 2013–14 actual capex
- revised forecast capex
- revised forecast opex.

Essential Energy also used the remaining tax asset lives approved in the draft decision but updated to reflect 2013–14 actual capex, and a value for gamma of 0.25 consistent with its initial proposal. It also used the standard tax asset lives consistent with those approved in the draft decision, but did not adopt the draft decision adjustment for the standard tax asset life of the 'Equity raising costs' asset class.

Table 8.2 sets out Essential Energy's revised proposed cost of corporate income tax allowance over the 2014–19 period.

**Table 8.2 Essential Energy's revised proposed cost of corporate income tax allowance for the 2014–19 period (\$ million, nominal)**

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
Tax payable	87.5	77.6	90.7	119.6	113.6	489.0
Less: value of imputation credits	21.9	19.4	22.7	29.9	28.4	122.2
<b>Corporate income tax allowance</b>	<b>65.6</b>	<b>58.2</b>	<b>68.0</b>	<b>89.7</b>	<b>85.2</b>	<b>366.7</b>

Source: Essential Energy, *Revised regulatory proposal*, January 2015, Attachment 5.5.

## 8.3 AER's assessment approach

We did not change our assessment approach for the cost of corporate income tax from our draft decision. Section 8.3 of our draft decision details that approach.<sup>4</sup>

<sup>2</sup> Essential Energy, *Revised regulatory proposal*, January 2015, Attachment 5.5.

<sup>3</sup> Essential Energy, *Revised regulatory proposal*, January 2015, Attachment 5.5.

<sup>4</sup> AER, *Draft decision - Essential Energy distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 8–10.



## 8.4 Reasons for final decision

We do not accept Essential Energy's revised proposed cost of corporate income tax allowance. We instead determine a cost of corporate income tax allowance of \$196.9 million (\$ nominal) for the 2014–19 period. This represents a reduction of \$169.8 million (or 46.3 per cent) from Essential Energy's revised proposal.

We have adjusted the following proposed inputs to the PTRM which affect the calculation of the taxable income, and therefore the estimated corporate income tax allowance. These include:

- the opening TAB value at the commencement of the 2014–19 period (section 8.4.1)
- the standard tax asset life for the 'Equity raising cost' asset class (section 8.4.2)
- the remaining tax asset lives at 1 July 2014 (section 8.4.3)
- the treatment of revenue arising from incentive schemes (such as DMIA) for tax purposes (section 8.4.4)
- the value of gamma (attachment 4)
- other building block components including forecast opex (attachment 7) and forecast capex (attachment 6) that affect revenues, and therefore also impact the forecast corporate income tax allowance.

### 8.4.1 Opening tax asset base

We accept Essential Energy's revised proposed method to establish the opening TAB at 1 July 2014 as it is based on the approach set out in our RFM. However, we do not accept Essential Energy's revised proposed opening TAB value at 1 July 2014 of \$5353.7 million (\$ nominal). Instead we determine an opening TAB value at 1 July 2014 of \$5344.2 million (\$ nominal) and is consistent with our draft decision opening TAB updated for actual 2013–14 capex. This represents a reduction of \$9.6 million (\$ nominal) or 0.2 per cent from Essential Energy's revised proposal. This reduction is due to the adjustments made to the capex values for capitalised provisions in Essential Energy's RFM as discussed in attachment 2.

In the draft decision, we amended Essential Energy's opening TAB for adjustments made to the capex values in respect of movements in capitalised provisions. We also noted the roll forward of Essential Energy's TAB included estimated capex values for 2013–14.<sup>5</sup> Essential Energy's revised proposal updated the opening TAB for actual 2013–14 capex. However, Essential Energy's revised proposal did not adopt our draft decision adjustment to the capex values used in the TAB roll forward. For the reasons discussed in attachment 2, we maintain our approach in the draft decision to adjusting the capex values for this final decision. We have also taken account of the actual

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<sup>5</sup> AER, *Draft decision - Essential Energy distribution determination attachment 8 - Corporate income tax*, November 2014, p. 8.

2013–14 capex update in determining the opening TAB at 1 July 2014 for this final decision.

Table 8.3 sets out our final decision on the roll forward of Essential Energy's TAB over the 2009–14 regulatory control period.

**Table 8.3 AER's final decision on Essential Energy's TAB roll forward for the 2009–14 regulatory control period (\$ million, nominal)**

	2009–10	2010–11	2011–12	2012–13	2013–14
Opening TAB	2728.3	3319.9	3909.3	4525.8	5010.5
Capital expenditure <sup>a</sup>	728.5	754.6	809.5	702.8	646.4
Less: tax depreciation	136.9	165.2	193.0	218.1	224.4
Closing TAB	3319.9	3909.3	4525.8	5010.5	5432.5
Meters moved to alternative control services					88.3
<b>Opening TAB as at 1 July 2014</b>					<b>5344.2</b>

Source: AER analysis.

(a) Net of disposals.

## 8.4.2 Standard tax asset lives

Consistent with our draft decision, we accept Essential Energy's revised proposed standard tax asset lives because they are:

- broadly consistent with the values prescribed by the Commissioner for taxation in tax ruling 2014/4<sup>6</sup>
- the same as those approved standard tax asset lives for the 2009–14 regulatory control period.

In the draft decision, we made one amendment to the proposed standard tax asset life. We changed the standard tax asset life for the 'Equity raising costs' asset class to 5 years from Essential Energy's proposed 44.7 years for tax depreciation purposes. This was because the Australian Taxation Office (ATO) requires equity raising costs to be amortised over a five-year period on a straight-line basis.<sup>7</sup> Essential Energy's revised proposal did not adopt our draft decision on the standard tax asset life of 5

<sup>6</sup> ATO, *Taxation Ruling Income tax: effective life of depreciating assets (applicable from 1 July 2014)*, August 2014, <http://law.ato.gov.au/atolaw/view.htm?docid=%22TXR%2FTR20144%2FNAT%2FATO%2F00001%22>, accessed on 24 February 2015.

<sup>7</sup> AER, *Draft decision - ActewAGL distribution determination attachment 8 - Corporate income tax*, November 2014, pp. 13-14.

years.<sup>8</sup> It did not provide reasons for not adopting our draft decision standard tax asset life for this asset class.

Our final decision is to apply a standard tax asset life of 5 years for the 'Equity raising costs' asset class for tax depreciation purposes. Consistent with the draft decision, we consider this standard tax asset life better reflects the ATO ruling on equity raising costs and therefore likely to provide an appropriate estimate for tax depreciation purposes.

Table 8.4 sets out our final decision on the standard tax asset lives for Essential Energy. We are satisfied these standard tax asset lives are likely to provide an appropriate estimate of the tax depreciation amount for a benchmark efficient service provider as required by the NER.<sup>9</sup>

### 8.4.3 Remaining tax asset lives

We accept Essential Energy's weighted average method to calculating the remaining tax asset lives as at 1 July 2014 in its revised proposal. This method is consistent with our preferred approach.

In the draft decision, we accepted Essential Energy's proposed weighted average method for calculating the remaining tax asset lives at 1 July 2014. The proposed method is consistent with our preferred approach. We adjusted the remaining tax asset lives to reflect our adjustments to the capex values in the TAB roll forward. We noted that the remaining tax asset lives would be updated for the final decision because Essential Energy's revised proposal would include revisions for 2013–14 actual capex. This was because capex is an input for calculating the remaining tax asset lives.<sup>10</sup>

Essential Energy's revised proposal updated the remaining tax asset lives calculation for actual 2013–14 capex, however, it did not adopt our draft decision adjustment to the capex values for the movement in capitalised provisions (attachment 2).<sup>11</sup>

As discussed in attachment 2 and section 8.4.1, we have adjusted the capex values and therefore we have updated the remaining tax asset lives at 1 July 2014 for this final decision.

Table 8.4 sets out our final decision on the remaining tax asset lives as at 1 July 2014 for Essential Energy.

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<sup>8</sup> Essential Energy, *Revised regulatory proposal*, January 2015, Attachment 5.1.

<sup>9</sup> NER, cl. 6.5.3.

<sup>10</sup> AER, *Draft decision - Essential Energy distribution determination attachment 5 - Regulatory depreciation*, November 2014, p. 12.

<sup>11</sup> Essential Energy, *Revised regulatory proposal*, January 2015, Attachment 5.1.

**Table 8.4 AER's final decision on Essential Energy's standard and remaining tax asset lives at 1 July 2014 (years)**

Asset class	Standard tax asset life	Remaining tax asset life at 1 July 2014
Sub-transmission lines and cables	47.5	37.7
Distribution lines and cables	45.0	32.4
Substations	40.0	29.7
Transformers	40.0	32.3
Low voltage lines and cables	45.0	35.3
Customer metering and load control	25.0	14.1
Communications	10.0	7.2
Land	n/a	n/a
Easements	n/a	n/a
IT systems	4.0	1.2
Furniture, fittings, plant and equipment	6.7	4.0
Motor vehicles	15.0	9.7
Buildings	100.0	87.2
Land (non-system)	n/a	n/a
Other non-system assets	43.8	37.7
Equity raising costs	5.0	40.7

Source: AER analysis.

n/a: not applicable.

#### 8.4.4 Tax treatment of incentive scheme revenues

We do not accept Essential Energy's revised proposed approach of treating the amounts associated with various incentive schemes as non-deductions for tax purposes.

Essential Energy's revised proposal altered the tax treatment of proposed revenue adjustments arising from EBSS and DMIA carryovers, and the DMIA forecast payments. It proposed to remove these adjustments from its taxable expenses when calculating its cost of corporate income tax.<sup>12</sup>

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<sup>12</sup> Essential Energy did not propose such a change in its initial (May 2014) regulatory proposal, and instead applied the AER's standard approach. Accordingly, our draft decision accepted Essential Energy's proposal and treated the EBSS revenue adjustment as both taxable income and a tax expense. See: Essential Energy, *Regulatory*

In its revised proposal Essential Energy removed the DMIA forecast payments (as distinct from the DMIA carryover) from its taxable expenses. In its recent submission to the amendments of the AER's distribution PTRM, the NSW service providers proposed not to remove amounts that specifically incur opex—such as the DMIA—when estimating tax deductible expenses.<sup>13</sup> We agree with this approach and confirm that the DMIA amounts should be included as a tax deduction. We consider that because the DMIA is an allowance that specifically incurs opex, it should be treated as an expense for tax purposes. We also note that the other NSW service providers' revised proposal did not alter the tax treatment of the DMIA as accepted in the draft decision.<sup>14</sup>

As discussed in attachment 9 we will not be applying the negative EBSS carryover penalties for Essential Energy. We also consider that DMIA carryover amounts will be dealt with via the annual pricing mechanism (attachment 16). The removal of these revenue amounts from the PTRM means that we do not need to make an assessment in this final decision about Essential Energy's revised proposal to alter the tax treatment for these matters.<sup>15</sup>

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*proposal*, 30 May 2014, attachment 4.1; AER, *Draft decision, Essential Energy distribution determination 2015-16 to 2018-19*, 27 November 2014, PTRM and Attachment 8: Corporate income tax.

<sup>13</sup> Networks NSW, *Submission on proposed amendments to post-tax revenue model*, 17 November 2014, Attachment 1.

<sup>14</sup> Endeavour Energy did not alter the tax treatment of incentive scheme revenues while Ausgrid removed EBSS and DMIA carryover amounts from tax expenses, but not DMIA forecast payments. See: Endeavour Energy, *Revised regulatory proposal*, January 2015, Attachment 4.01a; and Ausgrid, *Revised regulatory proposal*, January 2015, Attachments 4.08 and 4.09 (PTRMs for distribution and transmission).

<sup>15</sup> Ausgrid also proposed to alter the tax treatment of incentive carryovers. This is discussed further in AER, *Final decision, Ausgrid distribution determination attachment 8 – Corporate income tax*, April 2015, section 8.4.5.