FINAL DECISION

United Energy
Distribution Determination
2021 to 2026

Attachment 7
Corporate income tax

April 2021

AUSTRALIAN
ENERGY
REGULATOR

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Note

This attachment forms part of the Australian Energy Regulator (AER)'s final decision on the distribution determination that will apply to United Energy for the 2021–26 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

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 – Customer Service Incentive Scheme

Attachment 13 – Classification of services

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Attachment A – Negotiating framework

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7 Corporate income tax

Our distribution determination includes the estimated cost of corporate income tax for United Energy's 2021–26 regulatory control period. Under the post-tax framework, the cost of corporate income tax is calculated as part of the building block assessment using our post-tax revenue model (PTRM).

This attachment sets out our final decision on United Energy's revised proposed cost of corporate income tax for the 2021–26 regulatory control period. It presents our assessment of the inputs required in the PTRM for the calculation of the cost of corporate income tax.

7.1 Final decision

Our final decision on United Energy's estimated cost of corporate income tax is $23.7 million over the 2021–26 regulatory control period. This represents an increase of $13.3 million (or 127.6 per cent) from United Energy's revised proposed cost of corporate income tax of $10.4 million ($ nominal).The key reasons for this change are:

- Our final decision to reduce the immediately expensed capital expenditure (capex) for tax purposes from $328.7 million to $295.4 million ($2020–21).[1]
- Our final decision to increase the regulatory depreciation (attachment 4).[2]
- Our final decision to increase the rate of return on equity (attachment 3).[3]
- Our final decision to reduce the revised proposed opening tax asset base (TAB) value as at 1 July 2021 by $16.2 million to $1998.5 million.[4]

We accept United Energy's revised proposal on the standard tax asset lives for all of its asset classes, consistent with our draft decision. We have updated United Energy's remaining tax asset lives as at 1 July 2021 to reflect our amendments to the opening TAB value.

We also accept United Energy's revised proposal for changing the tax treatment of gifted assets. The change in approach is consistent with a recent ruling by the Full Federal Court of Australia made after the draft decision.[5]

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1 All else equal, a lower immediately expensed capex amount will increase the cost of corporate income tax because it reduces the tax expense.

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 rate of return on equity will increase the cost of corporate income tax because it increases the return on equity, a component of the taxable income.

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 Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169*, 21 October 2020.

Table 7.1 sets out our final decision on the estimated cost of corporate income tax for United Energy over the 2021–26 regulatory control period.

Table 7.1 AER's final decision on United Energy's cost of corporate income tax for the 2021–26 regulatory control period ($ million, nominal)

	2021–22	2022–23	2024–24	2024–25	2025–26	Total
Tax payable	8.9	8.2	7.9	15.1	17.0	57.1
Less: value of imputation credits	5.2	4.8	4.6	8.8	10.0	33.4
Net cost of corporate income tax	**3.7**	**3.4**	**3.3**	**6.3**	**7.1**	**23.7**

Source: AER analysis.

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

- We revised the opening TAB as at 1 July 2021 to correct for some minor input errors in the roll forward model (RFM) for 2015–17 historical capex. We updated the 2019 estimated capex with actuals and amended the estimated capex for the six month period of 1 January to 30 June 2021. We also reallocated the opening TAB value to the new asset class of 'Accelerated depreciation assets' from the existing asset class of 'Distribution system assets' in relation to accelerated depreciation of assets which are expected to be redundant by end of the 2021−26 regulatory control period.[7]
- We revised United Energy's forecast immediate expensing of capex by applying an approach that is informed by United Energy's current immediate expensing rate.[8]
- We accepted United Energy's proposed standard tax asset lives. We also determined a standard tax asset life of 5 years for the new asset class of 'In-house software'[9] that is subject to the straight-line method of tax depreciation.[10]
- While we accepted United Energy's proposed approach to calculating its remaining tax asset lives as at 1 July 2021, we updated these lives to reflect our adjustments to the opening TAB value. We also determined a remaining tax asset life of 5 years for the new asset class of 'Accelerated depreciation assets'.[11]

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6 AER, *Draft decision: United Energy distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 4–5.

7 AER, *Draft decision: United Energy distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 17–18.

8 AER, *Draft decision: United Energy distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, p. 15–16.

9 This is consistent with the Income Tax Assessment Act 1997, s. 40.95(7).

10 AER, *Draft decision: United Energy distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, p. 19.

11 AER, *Draft decision: United Energy distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, p. 18–19.

United Energy's revised proposal adopted the changes required by the draft decision in full.[12]

Opening tax asset base as at 1 July 2021

Our final decision is to determine an opening TAB value as at 1 July 2021 of $1998.5 million ($ nominal) for United Energy. This amount is $16.2 million (or 0.8 per cent) lower than United Energy's revised proposed opening TAB of $2014.7 million ($ nominal) as at 1 July 2021.

In our draft decision, we accepted United Energy's proposed method to establish the opening TAB as at 1 July 2021. However, we amended some of the proposed inputs used for the TAB roll forward—specifically, we made adjustments for actual and estimated capex and a reallocation for accelerated tax depreciation. We noted that the opening TAB may be updated as part of the final decision to reflect:

- any revised 2020 capex estimate.
- any revised capex estimates for the six month period between 1 January to 30 June 2021.

United Energy's revised proposal adopted our draft decision changes.[13] It provided a revised estimate for 2020 capex in its response to our information request.[14] United Energy submitted that the capex estimate for the six month period of 1 January to 30 June 2021 remains appropriate.

For the reasons discussed in attachment 2, we accept the updated 2020 capex estimate for this final decision. This capex estimate is lower than what we approved in our draft decision, reflecting more recent data. We will update the 2020 and the six month period estimated capex for actuals at the next revenue reset (2026–31).

Table 7.2 sets out our final decision on the roll forward of United Energy's TAB values over the 2016–21 period.

Table 7.2 AER's final decision on United Energy's TAB roll forward for the 2016–21 period ($ million, nominal)

	2016	2017	2018	2019	2020[a]	2021[b]
Opening TAB	1364.6	1517.4	1636.2	1722.7	1821.8	1936.0
Capital expenditure[c]	212.7	190.4	166.3	176.6	200.0	108.3
Less: tax depreciation	59.9	71.5	79.8	77.5	85.8	45.8
Closing TAB	**1517.4**	**1636.2**	**1722.7**	**1821.8**	**1936.0**	**1998.5**

12 United Energy, *Revised regulatory proposal 2021–26,* December 2020, pp. 48, 54.

13 United Energy, *Revised regulatory proposal 2021–26,* December 2020, pp. 48, 54.

14 United Energy, *Response to AER Information Request #076*, 05 February 2021.

Source: AER analysis.

(a) Based on estimated capex.

(b) The half year period of 1 January to 30 June 2021. Based on estimated capex.

(c) Net of disposals.

Forecast immediate expensing of capex

For this final decision, we determine that forecast capex of $295.4 million ($2020–21) is to be immediately expensed for tax purposes in the 2021–26 regulatory control period.

In our draft decision, we amended United Energy's approach to forecast its immediately expensed capex. United Energy's proposed forecast immediate expensing of capex over the 2021–26 regulatory control period was based on a simple average of the actual immediately expensed capex claimed over 2016–2018. The proposed approach provided an immediate expensing amount that was disproportionate to overall forecast capex, as it resulted in a fixed amount irrespective of total forecast capex. We did not agree with this approach and instead considered that the forecast immediate expensing amount should be based on the rate of immediate expensing of capex relative to actual capex. We expected that the same proportion of capex would also be deducted immediately by United Energy for its annual tax returns during the 2021–26 regulatory control period.

United Energy's revised proposal adopted our draft decision approach to calculate its immediate expensing of forecast capex for tax purposes in the 2021–26 regulatory control period.[15] However, United Energy updated its forecast immediate expensing amount to $328.7 million ($2020–21, or 29.3 per cent of total capex),[16] which reflected its revised proposal overall forecast capex.[17]

As discussed in attachment 5, we have reduced United Energy's proposed forecast capex by 4 per cent.[18] Consistent with the approach adopted in the draft decision and revised proposal, we need to adjust the amount of immediate expensing of capex to reflect the overall substitute estimate of forecast capex. Our final decision therefore reduces the immediately expensed capex for tax purposes to $295.4 million ($2020–21).

We will collect actual data relating to the immediately expensing of capex in our annual reporting regulatory information notice to further inform our decision for this type of expenditure in the next regulatory determination for United Energy.

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15 United Energy, *Revised regulatory proposal 2021–26,* December 2020, p. 54.

16 Compared with the proposed gross capex of $1120.8 million ($2020–21).

17 United Energy, *Revised regulatory proposal 2021–26 – MOD 10.02 – PTRM 2021–26,* updated 24 March 2021.

18 AER, *Final decision: United Energy distribution determination 2021 to 2026, attachment 5 – Capital Expenditure*, April 2021, p. 6.

Treatment of gifted assets

We accept United Energy's revised proposal for changing the tax treatment of gifted assets. We have therefore excluded the value of gifted assets from the cash flow modelling in the PTRM for the purposes of calculating the corporate income tax building block.

In our draft decision, we applied the usual treatment as adopted by the Australian Taxation Office where gifted assets (along with cash customer contributions) were included as assessable income in the cash flow modelling in the PTRM.

On 21 October 2020, the Full Federal Court of Australia published its determination on the tax treatment of customer contributions.[19] The determination:

- Confirmed an earlier Court ruling that cash contributions were ordinary income and should be treated as assessable income for tax purposes.
- Overturned an earlier Court ruling and determined that while a gifted asset was a 'non-cash business benefit' there was effectively nil income for tax purposes.

United Energy's revised proposal noted this determination—in particular, on the changed tax treatment of gifted assets.[20] As a result, United Energy suggested that the cost of construction of gifted assets be excluded from gross capex and customer contributions.[21] While this results in no change to net capex, this tax treatment change results in a decrease to the cost of corporate income tax building block. The impact of this change in approach for gifted assets will reduce United Energy's cost of corporate income tax, all else being equal.

We have assessed United Energy's revised proposal and are satisfied that it reflects the Court's ruling on the tax treatment of gifted assets.

Standard and remaining tax asset lives

For this final decision, we accept United 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 the Australian Tax Office ruling 2020/3 and the Income Tax Assessment Act 1997.

We also accept United Energy's revised proposed approach to calculate the remaining tax asset lives as at 1 July 2021 for tax depreciation purposes of its existing assets,

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[19] Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169*, 21 October 2020.

[20] United Energy, *Revised regulatory proposal 2021–26,* December 2020, pp. 85–87.

[21] Any associated rebates would remain being included in net capex and therefore treated as a tax depreciating asset.

which were calculated using the weighted average method.[22] This is consistent with the approach accepted in our draft decision. However, we have updated the remaining tax asset lives as at 1 July 2021 to reflect the amendments we made to the opening TAB values as at 1 July 2021.[23]

Table 7.3 sets out our final decision on the standard and remaining tax asset lives as at 1 July 2021 for United Energy. We are satisfied that the standard and remaining tax asset lives are appropriate for application over the 2021–26 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.[24]

Table 7.3 AER's final decision on United Energy's standard and remaining tax asset lives (years)

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2021[b]
Subtransmission	45.0	24.2
Distribution system assets	46.0	35.4
SCADA (10-year asset)	10.0	7.5
Non-network general assets - IT	4.0	3.0
Non-network general assets - Other	12.0	8.4
Land	n/a	n/a
SCADA (5-year asset)	5.0	5.0
Accelerated depreciation assets	n/a	5.0
In-house software	5.0[a]	n/a
Equity raising costs	5.0[a]	3.2

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.

n/a not applicable. We have not assigned a standard tax asset life and remaining tax asset life to the 'Land' asset class because the assets allocated to it are non-depreciating assets. We have not assigned a standard tax asset life to the asset class of 'Accelerated depreciation assets' because there is no forecast

22 The proposed method is a continuation of the approved approach used in the 2016–20 regulatory control period and applies the approach as set out in our RFM.

23 The estimates of 2020 and 2021 capex are used to calculate the weighted average remaining tax asset lives in the RFM. Therefore, for this final decision we have recalculated United Energy's remaining tax asset lives as at 1 July 2021 reflecting the updates for the estimates of 2020 and 2021 capex, using the method approved in the draft decision.

24 NER, cl. 6.5.3.

capex allocated to it. We also have not assigned a remaining tax asset life to the 'In-house software' asset class prescribed for SL tax depreciation because it has no opening TAB values as at 1 July 2021.

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.[25]

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25 AER, *Draft decision: United Energy distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 7–14.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
ITAA	Income Tax Assessment Act 1997
PTRM	post-tax revenue model
RFM	roll forward model
TAB	tax asset base