

FINAL DECISION

Jemena Gas Networks (NSW) Ltd

Access Arrangement 2015-20

Attachment 8 − Corporate income tax

June 2015

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1. Note

This attachment forms part of the AER's final decision on Jemena Gas Networks' 2015–20 access arrangement. It should be read with other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – services covered by the access arrangement

Attachment 2 – capital 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 carryover mechanism

Attachment 10 – reference tariff setting

Attachment 11 – reference tariff variation mechanism

Attachment 12 – non-tariff components

Attachment 13 – demand

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1. Shortened forms

| 1. Shortened form
 | 1. Extended form
 |
| --- | --- |
| 1. AER
 | 1. Australian Energy Regulator
 |
| 1. capex
 | 1. capital expenditure
 |
| 1. CAPM
 | 1. capital asset pricing model
 |
| 1. CCP
 | 1. Consumer Challenge Panel
 |
| 1. Code
 | 1. National Third Party Access Code for Natural Gas Pipeline Systems
 |
| 1. CPI
 | 1. consumer price index
 |
| 1. DRP
 | 1. debt risk premium
 |
| 1. ERP
 | 1. equity risk premium
 |
| 1. JGN
 | 1. Jemena Gas Networks (NSW) Ltd (ACN 003 004 322)
 |
| 1. MRP
 | 1. market risk premium
 |
| 1. NGL
 | 1. national gas law
 |
| 1. NGO
 | 1. national gas objective
 |
| 1. NGR
 | 1. national gas rules
 |
| 1. opex
 | 1. operating expenditure
 |
| 1. PPI
 | 1. partial performance indicators
 |
| 1. PTRM
 | 1. post-tax revenue model
 |
| 1. RAB
 | 1. regulatory asset base
 |
| 1. RBA
 | 1. Reserve Bank of Australia
 |
| 1. RFM
 | 1. roll forward model
 |
| 1. RIN
 | 1. regulatory information notice
 |
| 1. RPP
 | 1. revenue and pricing principles
 |
| 1. SLCAPM
 | 1. Sharpe-Lintner capital asset pricing model
 |
| 1. WACC
 | 1. weighted average cost of capital
 |

# Corporate income tax

1. When determining the total revenue for JGN, we must estimate JGN’s cost of corporate income tax.[[1]](#footnote-1) JGN has adopted the post-tax framework to derive its revenue requirement for the 2015–20 access arrangement period.[[2]](#footnote-2) Under the post-tax framework, a separate corporate income tax allowance is calculated as part of the building blocks assessment.

## Final decision

1. We do not approve JGN’s revised proposed corporate income tax allowance of $105.9 million ($nominal) for the 2015–20 access arrangement period.[[3]](#footnote-3) This is mainly a consequence of our adjustments to JGN's proposed value of imputation credits—gamma—(attachment 4) and other building block costs that affect revenues, such as the rate of return on capital (attachment 3), forecast capex (attachment 6) and opex (attachment 7).[[4]](#footnote-4)

Our adjustments result in an estimated corporate income tax allowance of $42.4 million ($nominal) for JGN as shown in Table 8‑1. We have made all amendments necessary to give effect to this final decision in the *Approved Access Arrangement, JGN’s NSW gas distribution networks 1 July 2015 – 30 June 2020* (June 2015).[[5]](#footnote-5)

Table 8‑1 AER's final decision on corporate income tax allowance for JGN ($million, nominal)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | 2015–16 | 2016–17 | 2017–18 | 2018–19 | 2019–20 | Total |
| Tax payable | 9.7 | 11.6 | 15.2 | 19.0 | 15.2 | 70.6 |
| Less: value of imputation credits | –3.9 | –4.6 | –6.1 | –7.6 | –6.1 | –28.2 |
| **Net corporate income tax allowance** | **5.8** | **6.9** | **9.1** | **11.4** | **9.1** | **42.4** |

Source: AER analysis.

## JGN's revised proposal

JGN's revised proposal forecast a cost of corporate income tax of $105.9 million ($nominal).[[6]](#footnote-6) JGN's methodology for determining its corporate income tax is unchanged from its initial proposal.

JGN adopted the methodology accepted in our draft decision to determine the revised proposed tax asset base (TAB) at 1 July 2015. The TAB at 1 July 2015 was updated for 2013–14 actual conforming capex and 2014–15 revised estimate of capex.[[7]](#footnote-7)

JGN's revised proposed TAB roll forward over the 2010–15 access arrangement period is set out in Table 8‑2.[[8]](#footnote-8)

Table 8‑2 JGN's revised proposed tax asset base roll forward over the 2010–15 access arrangement period ($million, nominal)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | 2010–11 | 2011–12 | 2012–13 | 2013–14 | 2014–15 |
| Opening tax asset base | 600.1 | 679.3 | 753.5 | 786.7 | 840.1 |
| Capex | 159.9 | 169.3 | 132.2 | 153.6 | 256.3 |
| Tax depreciation | –80.6 | –95.1 | –99.1 | –100.2 | –114.1 |
| **Closing tax asset base** | **679.3** | **753.5** | **786.7** | **840.1** | **982.3** |

Source: JGN, Revised access arrangement proposal, Appendix 10.1, Revenue model - updated, February 2015. JGN, Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model, 27 March 2015.

Using the same approach accepted in the draft decision, JGN's revised proposal calculated the corporate income tax over the 2015–20 access arrangement period using the following inputs:[[9]](#footnote-9)

* revised TAB at 1 July 2015 of $982.3 million reflecting updates for 2013–14 actual conforming capex and 2014–15 estimated capex
* diminishing value rates for tax depreciation accepted in the draft decision
* revised forecast capex
* revised forecast opex
* a value for gamma of 0.25, consistent with its initial proposal.
1. For the 2015–20 access arrangement period, JGN's revised proposal forecast a total corporate income tax allowance of $105.9 million ($nominal) as set out in Table 8‑3.[[10]](#footnote-10)

Table 8‑3 JGN's revised proposal corporate income tax allowance for the 2015–20 access arrangement period ($million, nominal)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|   | 2015–16 | 2016–17 | 2017–18 | 2018–19 | 2019–20 | Total |
| Tax payable | 23.2 | 25.5 | 29.5 | 33.5 | 29.5 | 141.2 |
| Less: value of imputation credits | 5.8 | 6.4 | 7.4 | 8.4 | 7.4 | 35.3 |
| **Net cost of corporate tax** | **17.4** | **19.2** | **22.1** | **25.1** | **22.1** | **105.9** |

Source: JGN, Revised access arrangement proposal, Appendix 10.1, Revenue model - updated, February 2015. JGN, Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model, 27 March 2015.

## AER’s assessment approach

We have not changed our assessment approach for the corporate income tax from our draft decision. Section 8.3 of our draft decision details that approach.[[11]](#footnote-11)

## Reasons for final decision

Our final decision on JGN’s corporate income tax allowance is $42.4 million ($nominal), which is a reduction of $63.5 million ($nominal) or 60 per cent of JGN's revised proposal.

1. Consistent with our draft decision, we accept the method used by JGN to calculate the revised proposed corporate income tax allowance, including the updated opening TAB as at 1 July 2015. However, we adjusted several inputs proposed by JGN for calculating the corporate income tax allowance for the 2015–20 access arrangement period. These relate to:
* changing the value of gamma to 0.4 from 0.25 (attachment 4)
* changes to other building block components including the rate of return on capital (attachment 3), forecast capex (attachment 6) and opex (attachment 7) that impact total revenues, and therefore also impact the forecast corporate income tax allowance.[[12]](#footnote-12)

### Opening tax asset base as at 1 July 2015

We accept JGN's revised proposed opening TAB value of $982.3 million ($nominal) as at 1 July 2015.

In the draft decision, we accepted JGN's proposed inputs such as capex, disposals and tax depreciation rates over the 2010–15 access arrangement used by JGN to calculate its opening TAB at 1 July 2015. We noted the capex inputs for 2013–14 and 2014–15 would be updated in the revised proposal using latest actual/available data.

JGN's revised proposal updated the values for these inputs.[[13]](#footnote-13)

1. We assessed the updated inputs including actual conforming capex for 2013–14 and the resulting tax depreciation for that year, and the revised forecast data for 2014–15. We are satisfied the updated capex over the 2010–15 access arrangement period reflects the requirements of rule 79 of the NGR. Our detailed assessment of this conforming capex is set out in attachment 6.
2. Table 8‑4 sets out our final decision on the roll forward of JGN's TAB values for the 2010–15 access arrangement period.

Table ‑ AER's final decision on JGN's tax asset base roll forward for the 2010–15 access arrangement period ($million, nominal)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Details | 2010–11 | 2011–12 | 2012–13 | 2013–14 | 2014–15 |
| Opening tax asset base | 600.1 | 679.3 | 753.5 | 786.7 | 840.1 |
| Capex | 159.9 | 169.3 | 132.2 | 153.6 | 256.3 |
| Tax depreciation | –80.6 | –95.1 | –99.1 | –100.2 | –114.1 |
| **Closing tax asset base** | **679.3** | **753.5** | **786.7** | **840.1** | **982.3** |

Source: AER analysis; JGN, Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model, 27 March 2015.

### Tax depreciation method

1. Consistent with our draft decision, we accept JGN's revised proposal to use the diminishing value method for estimating tax depreciation for the 2015–20 access arrangement period. JGN's revised proposal adopted the diminishing value rates––used to calculate the forecast tax depreciation for each asset class––approved in our draft decision. We therefore maintain our draft decision position on this issue for this final decision.
2. Table 8‑5 sets out our final decision on JGN's diminishing value rates for tax depreciation over the 2015–20 access arrangement period.

Table ‑ AER's final decision on JGN's diminishing value rates for tax depreciation calculation (per cent)

|  |  |
| --- | --- |
| Asset class | Diminishing value rate for tax depreciation |
| Trunk Wilton-Sydney | 10 per cent |
| Trunk Sydney-Newcastle | 10 per cent |
| Trunk Wilton-Wollongong | 10 per cent |
| Contract meters | 10 per cent |
| Fixed Plant - distribution | 10 per cent |
| HP mains | 10 per cent |
| HP services | 10 per cent |
| MP mains | 10 per cent |
| MP services | 10 per cent |
| Meter reading devices | 10 per cent |
| Country POTS  | 10 per cent |
| Tariff meters | 10 per cent |
| Building  | 3 per cent |
| Computers | 40 per cent |
| Software | 50 per cent |
| Fixed plant | 20 per cent |
| Furniture | 20 per cent |
| Land |  n/a  |
| Leasehold improvements | 3 per cent |
| Low value assets | 60 per cent |
| Mobile plant | 20 per cent |
| Vehicles | 25 per cent |
| Equity raising costs | 11 per cent |

Source: AER analysis; JGN, Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model, 27 March 2015.

1. NGR, r. 76(c). [↑](#footnote-ref-1)
2. JGN, Revised access arrangement proposal, Appendix 10.1 Revenue model - updated, February 2015. [↑](#footnote-ref-2)
3. JGN updated its proposed corporate income tax after the submission of its revised proposal. JGN, Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model, 27 March 2015. [↑](#footnote-ref-3)
4. Changes to other building block costs affect revenues, which also impact the tax calculation. [↑](#footnote-ref-4)
5. NGR, rr. 64(1) & (4). [↑](#footnote-ref-5)
6. JGN updated its proposed corporate income tax after the submission of its revised proposal. JGN, Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model, 27 March 2015. [↑](#footnote-ref-6)
7. JGN, Revised access arrangement proposal, Appendix 10.1 Revenue model - updated, February 2015. [↑](#footnote-ref-7)
8. JGN, Revised access arrangement proposal, Appendix 10.1 Revenue model - updated, February 2015.

 JGN updated the proposed projection of tax asset base after the revised proposal. JGN, Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model, 27 March 2015. [↑](#footnote-ref-8)
9. JGN, Revised access arrangement proposal, Appendix 10.1 Revenue model - updated, February 2015. [↑](#footnote-ref-9)
10. JGN, Revised access arrangement proposal, Appendix 10.1 Revenue model - updated, February 2015. [↑](#footnote-ref-10)
11. AER, Draft decision, attachment 2, November 2014, pp. 13–14. [↑](#footnote-ref-11)
12. NGR, r. 87A. [↑](#footnote-ref-12)
13. JGN, Revised access arrangement proposal, Appendix 10.1 Revenue model - updated, February 2015. These were updated in JGN, Submissions on draft decision, Attachment N - updated appendix 10.1 - JGN revenue forecast model, 27 March 2015. [↑](#footnote-ref-13)