



FINAL DECISION

SA Power Networks
Distribution Determination
2020 to 2025

Attachment 7
Corporate income tax

June 2020

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to SA Power Networks for the 2020–25 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

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 – Classification of services

Attachment 13 – Control mechanisms

Attachment 14 – Pass through events

Attachment 15 – Alternative control services

Attachment 17 – Connection policy

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

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7 Corporate income tax

Our distribution determination includes the estimated cost of corporate income tax for SA Power Networks' 2020–25 regulatory control period. Under the post-tax framework, corporate income tax allowance is calculated as part of the building block assessment using our post-tax revenue model (PTRM). This attachment sets out our final decision on SA Power Networks' revised proposed corporate income tax allowance for the 2020–25 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 SA Power Networks' estimated cost of corporate income tax is \$22.7 million over the 2020–25 regulatory control period. This represents an increase of \$12.3 million (or 116.8 per cent) from SA Power Networks' revised proposed cost of corporate income tax of \$10.5 million (\$ nominal). The key reasons for this change are:

- Our final decision to reduce the immediately expensed capital expenditure (capex) for tax purposes from \$751.7 million to \$680.4 million (\$2019–20).¹
- Our final decision to increase the regulatory depreciation (attachment 4).²
- Our final decision to apply an updated rate of return on equity (attachment 3).³

We accept the revised proposed opening tax asset base (TAB) value as at 1 July 2020 of \$3459.1 million. We note that SA Power Networks' revised proposal did not include its earlier claim for this opening value to be adjusted for past immediate expensing of capex.⁴ We also accept SA Power Networks' revised proposal on the standard tax asset lives for all of its asset classes and to continue using the year-by-year tracking approach for tax depreciation of its existing assets. The continued use of the year-by-year tracking approach reflects our 2015–20 distribution determination for SA Power Networks, where the capex for each year in that regulatory control period was depreciated individually for tax purposes.

Table 7.1 sets out our final decision on the estimated cost of corporate income tax for SA Power Networks over the 2020–25 regulatory control period.

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

⁴ SA Power Networks, *Revised proposal, Attachment 7*, 10 December 2019, p. 7.

Table 7.1 AER's final decision on SA Power Networks' cost of corporate income tax for the 2020–25 regulatory control period (\$million, nominal)

	2020–21	2021–22	2022–23	2024–24	2024–25	Total
Tax payable	8.0	8.5	11.6	13.6	13.1	54.8
Less: value of imputation credits	4.7	5.0	6.8	8.0	7.7	32.1
Net corporate income tax allowance	3.3	3.5	4.8	5.7	5.4	22.7

Source: AER analysis.

In the draft decision, we made the following changes to SA Power Networks' modelling of its cost of corporate income tax:

- We used the latest version of the PTRM (version 4) released in April 2019, which implemented the findings in our final report on the review of the regulatory tax approach.⁵ Specifically, we applied the diminishing value method for tax depreciation to all new depreciable assets except for forecast capex associated with the 'Buildings - capital works' and 'In-house software' asset classes.⁶
- We revised the opening TAB as at 1 July 2020 to correct for some minor input errors in the roll forward model (RFM) relating to movements in capitalised provisions over the 2015–20 regulatory control period. We did not accept SA Power Networks' proposal to adjust the TAB as at 1 July 2020 to reflect the immediately expensed capex incurred in the 2015–20 regulatory control period.
- We accepted SA Power Networks' proposed standard tax asset lives. We also determined standard tax asset lives of 40 years and 4 years respectively for the two new asset classes of 'Buildings - capital works'⁷ and 'In-house software'⁸ that are subject to the straight-line method of tax depreciation.⁹

SA Power Networks' revised proposal adopted the changes required by the draft decision in full.¹⁰

The South Australian Council of Social Service's submission and joint submission of SA Financial Counsellors Association, Uniting Communities and The Energy Project

⁵ AER, *Final report, Review of regulatory tax approach*, 17 December 2018.

AER, *Post-tax revenue models (transmission and distribution) - April 2019 amendment*, 24 April 2019.

⁶ All assets acquired prior to 30 June 2020 will continue to be depreciated using the straight-line depreciation method for regulatory tax purposes, until these assets are fully depreciated.

⁷ This is consistent with the number of years required to completely depreciate a capital works asset such as buildings under the ITAA, ss. 43.15, 43.140 and 43.210.

⁸ This is consistent with the ITAA, s. 40.95(7).

⁹ AER, *SA Power Networks 2020–25 Distribution Determination – Draft Decision – Attachment 7 – Corporate income tax*, October 2019, pp. 5–6.

¹⁰ SA Power Networks, *Revised proposal, Attachment 7*, 10 December 2019, p. 7.

provided their general support for our draft decision approach on tax, including not adjusting the TAB for previous immediately expensed capex.¹¹

Opening tax asset base as at 1 July 2020

For this final decision, we accept SA Power Networks' revised proposed opening TAB value as at 1 July 2020 of \$3459.1 million (\$nominal). This is \$17.0 million (or 0.5 per cent) lower than the value of \$3476.1 million determined in our draft decision.

In our draft decision, we did not accept SA Power Networks' proposed opening TAB value as at 1 July 2020 due to our corrections for some minor input errors in the RFM. We also did not accept a late proposal by SA Power Networks to adjust down the opening TAB as at 1 July 2020 to reflect the immediate expensing of capex incurred in previous regulatory control periods. We noted that the opening TAB may be updated to reflect actual capex for 2018–19 and any revised 2019–20 capex estimates as part of the final decision.¹²

SA Power Networks' revised proposal adopted the amendments we made to the opening TAB value in the draft decision in full. It also updated the 2018–19 estimated capex with actuals and revised the 2019–20 estimate of capex with the latest figures.¹³

We have checked the 2018–19 actual capex in the revised proposal and are satisfied that it aligns with SA Power Networks' annual reporting regulatory information notice for that year. For the reasons discussed in attachment 2, we accept the updated 2019–20 capex estimate in the revised proposal. This capex estimate is lower than what we approved in our draft decision, reflecting more recent data. We will update this for actuals at the next (2025–30) revenue reset.

Table 7.2 sets out our final decision on the roll forward of SA Power Networks' TAB values over the 2015–20 regulatory control period.

Table 7.2 AER's final decision on SA Power Networks' TAB roll forward for the 2015–20 regulatory control period

	2015–16	2016–17	2017–18	2018–19	2019–20 ^a
Opening TAB	2466.3	2609.9	2757.6	2989.8	3219.5
Capital expenditure ^b	304.9	320.4	417.5	429.0	436.9
Less: tax depreciation	161.3	172.7	185.3	199.3	197.3

¹¹ South Australian Council of Social Service, *Submission to the AER on SA Power Networks' 2025–25 revised regulatory proposal*, 16 January 2020, p. 50; SA Financial Counsellors Association, Uniting Communities and The Energy Project, *Submission to SA Power Networks 2020–2025 revenue determination – revised proposal*, 20 January 2020, pp.47–48.

¹² AER, *SA Power Networks 2020–25 Distribution Determination – Draft Decision – Attachment 7 – Corporate income tax*, 8 October 2019, pp. 19–20.

¹³ SA Power Networks, *Revised roll forward model*, 10 December 2019.

	2015–16	2016–17	2017–18	2018–19	2019–20 ^a
Closing TAB	2609.9	2757.6	2989.8	3219.5	3459.1

Source: AER analysis.
(a) Based on estimated capex.
(b) Net of disposals.

Standard tax asset lives

For this final decision, we accept SA Power Networks' 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 2019/5 and the Income Tax Assessment Act 1997.

Table 7.3 sets out our final decision on the standard tax asset lives for SA Power Networks for the 2020–25 regulatory control period. We are satisfied that the standard tax asset lives are appropriate for application over the 2020–25 regulatory control period. We are also satisfied that the standard 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.¹⁴

Table 7.3 AER's final decision on SA Power Networks' standard tax asset lives (years)

Asset class	Standard tax asset life
Sub-transmission lines	47.5
Distribution lines	47.5
Substations	40.0
Distribution transformers	40.0
LVS	47.5
Communications	10.0
Contributions	n/a
Land	n/a
Substation land	n/a
Easements	n/a
Buildings	40.0
Heavy vehicles - 15 year	15.0

¹⁴ NER, cl. 6.5.3.

Asset class	Standard tax asset life
Heavy vehicles - 10 year	15.0
Light vehicles	6.7
IT assets	4.0
Plant & tools/office furniture	10.0
Sub-transmission and distribution lines - short life	25.0
Substations and transformers - short life	20.0
Electronic network assets	15.0
Buildings - capital works ^a	40.0
In-house software ^a	4.0
Equity raising costs ^a	5.0

Source: AER analysis.

(a) These are the only asset classes used for the straight-line method of tax depreciation. All other asset classes used the diminishing value method of tax depreciation.

n/a not applicable. We have not assigned a standard tax asset life to the 'Contributions', 'Land', 'Substation land' and 'Easements' asset classes because the assets allocated to these asset classes are non-depreciating assets.

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.¹⁵

¹⁵ AER, *SA Power Networks 2020–25 Distribution Determination – Draft Decision – Attachment 7 – Corporate income tax*, 8 October 2019, pp. 9–14.

Shortened forms

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