



**THE HON JOSH FRYDENBERG MP
MINISTER FOR THE ENVIRONMENT AND ENERGY**

MS18-000442

Ms Paula Conboy
Chair
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Dear Ms ^{Paula} Conboy

As you are aware, recent analysis by the Australian Taxation Office (ATO) has identified a discrepancy between the tax allowances the Australian Energy Regulator (AER) has previously set for network businesses and the amount of tax they actually pay.

The AER's network revenue determinations estimated total tax payable by electricity network businesses and regulated gas pipelines at around \$4.6 billion (nominal) for the five financial years from 2013-14 to 2017-18.

The ATO reviewed the tax paid by electricity distribution businesses between 2013 and 2016 against its tax allowance. It found that the tax allowance provided to non-state owned electricity distribution networks consistently overstated the actual tax payable by these entities.

The Australian Government wants to ensure that consumers are paying a fair price for their energy. I am concerned network businesses may be collecting more than is needed to cover their tax liabilities, at the consumers' expense.

Under the national energy laws, the AER has information gathering powers to compel network businesses to share information relevant to setting their revenue determinations. I ask that the AER investigate whether network businesses are being overcompensated for their corporate tax liabilities, including using its information gathering powers if necessary. This should include a review of how the AER models tax costs. As part of this investigation, I also ask that you consider whether the method for estimating the cost of corporate income tax as set out in the rules remains appropriate.

I ask that you release an initial public report in June 2018 and a final report to COAG Energy Council on the results of your investigation and provide recommendations on any changes required by December 2018.

I have copied this letter to the Treasurer, the Hon Scott Morrison MP.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Josh Frydenberg', written over a horizontal line.

JOSH FRYDENBERG



ATO NOTE

10 April 2018

To: Warwick Anderson, Australian Energy Regulator

Subject: Indicative comparative analysis of the AER electricity distribution tax allowance and tax payable

Key Points

We reviewed the tax allowance data published by the Australian Energy Regulator ('AER') and the income tax return data lodged by electricity distribution businesses that the AER regulates over a four year period from 2013 to 2016.

The electricity distribution businesses we reviewed were either state owned National Tax Equivalent Regime ('NTER entities') entities or private and public owned entities ('taxpaying entities').

In general, our analysis indicates that:

- the aggregate AER tax allowance provided to taxpaying entities consistently overstated the actual tax payable by those entities; and
- the aggregate AER tax allowance provided to NTER entities consistently understated the 'notional' tax payable by those entities.

Over the four year review period the AER provided the taxpaying entities with a substantial tax allowance. However, the aggregate tax paid by these entities per their tax returns was significantly less than the tax allowance they received under the notional AER tax allowance rules.¹

Our analysis indicates that there are several key drivers for this difference. The material drivers are as follows:

- > the entity structure adopted meaning that tax may be payable at an investor level not the entity level (and potentially subject to concessional treatment at the investor level);
- > deductions for interest expenses;
- > available tax losses; and
- > deductions for depreciation.

It should be noted that we made some assumptions and exclusions in undertaking this comparative analysis due to limitations in the data available. Where entities conduct a mixed business, or operate within a consolidated group, we have either apportioned the data on a reasonable basis where possible to attempt to isolate the electricity distribution business or excluded the entity from the aggregated amounts if the electricity distribution business could not be apportioned.

In relation to NTER entities, we suspect the reason their notional tax payable under the NTER regime is higher than their AER tax allowance is because these entities typically have more conservative tax positions. For example, they are less likely to claim accelerated R&D deductions, or have related party international dealings (as they are only permitted to borrow from State Treasury Corporations).

¹ Noting the potential for tax positions to be adjusted, i.e. the potential for amended tax assessments.

- > We surmise that taxpaying entities are also using the 'low-value pool' mechanism to write-off a large amount of component assets – this method enables the capital cost of those assets to be written off over several years rather than the effective lives associated with the larger composite asset.

Other factors

There are a number of other tax technical factors that we consider are likely to be driving a difference between the AER tax allowance and actual tax paid, however these factors appear to be not material in terms of their quantum.

Relevant Background

We are only able to provide limited information to you as information that is 'protected', that is, disclosed or obtained under or for the purposes of a taxation law, that relates to the affairs of an entity and that identifies, or is reasonably capable of identifying the entity cannot be divulged by the ATO to the AER.

We trust that this preliminary analysis provides a high-level comparison that helps inform the matters under review by the AER