

ATTA 2019 Paper

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This paper is based on a PhD I am currently studying at Curtin University. The following are extracts from my research and from submissions made to the Australian Energy Regulator (AER) so far.

The National Tax Equivalent Regime (NTER) is an administrative intergovernmental arrangement under which, for competitive neutrality purposes, the Federal income tax laws are notionally applied to selected government business entities owned by the States and Territories. This regime seeks to notionally apply the tax laws to those entities as though they were subject to income tax. The resulting NTER tax is a liability owed and paid by these entities to their Owner State and Territory Governments – it does not form part of the actual Federal income tax base as it does for privately owned companies. Apart from some modifications, NTER entities have the same tax obligations as their federal counterparts.

This paper will explore some of the issues examined in the thesis.

Can the tax allowance set by the price regulator replace the NTER?

A proposition studied in my paper was whether the NTER could be abolished and instead replaced by the tax allowance set by price regulators in regulated monopoly industries. The theory is that the price regulator sets the tax allowance based on what it considers an efficient, well-managed privately-owned company would pay. Would it not then follow that this amount of tax allowance could instead be paid to the Owner State or Territory Treasury, thereby eliminating the need for a tax function in state-owned corporations?

In order to answer this question, this section will begin by briefly considering the regulatory framework in which price regulators operate, and then look at work done to date in this field by the Essential Services Commission (ESC) and Australian Energy Regulator (AER). Finally, the section will look at the reasons the tax allowance cannot replace the current tax neutrality regime.

Price regulation and the building block approach

Price regulation is of use in industries and markets which are subject to natural monopolies. Price regulation is used where there is no competition, and therefore there exists the potential for inefficient use of resources and higher pricing resulting from a lack of competition in the market.

Price regulators in Australia set the prices for regulated entities using the “building block approach”. Under the building block approach, the price regulator determines the most efficient costs of running the business, i.e., the costs the regulated entity would incur if it were an efficient, well managed, privately owned organisation. Prices are then set allowing for “indexation of the regulatory asset base, return on capital, depreciation, estimate cost of corporate income tax, revenue requirements, and forecast operating expenditure.”¹

¹ Australian Energy Market Commission, *Perspectives on the building block approach: Review into the use of total factor productivity for the determination of prices and revenues* (2009) 3.
<https://www.aemc.gov.au/sites/default/files/content/87162aab-a7cc-4189-bb0f-8e5b7b1ab768/Preliminary-findings-December-2009.PDF>

Calculating the annual revenue requirement (ARR) is the first step in determining prices. The ARR is made up of the following components:

- The return on assets;
- The return of assets (depreciation);
- Operating expenses; and
- A tax allowance.

As part of the price setting process, a regulated asset base (RAB) is determined. The RAB is the total asset value for the regulated assets of the business. Not all activities undertaken by a regulated entity are regulated activities. Some activities are non-regulated. Non-regulated activities are activities whereby there is sufficient competition in the market to enable a fair and efficient price to be set through a competitive market rather than needing a price regulator to determine a competitive price. For example, the retail arm of the electricity and gas industries is not regulated as there is sufficient competition to enable a fair and efficient price to be determined by the market. As a result, the price regulator will not determine the prices for those activities and will not allow for assets relating to those activities to form part of the RAB. The prices set by the price regulator do not allow for the recovery of costs relating to non-regulated activities. Most regulated entities are engaged in non-regulated activities.

Once the efficient costs related to running a regulated business have been determined by the price regulator, prices are then indexed for inflation. Also, for prices determinations involving multiple years (the most common price path is for four or five years), the cash flows are discounted back to today's dollars.

The price regulator can choose to use a pre-tax weighted average cost of capital (WACC) or a post-tax WACC to set its prices. Where a price regulator chooses to set its prices using a post-tax WACC, there are many decisions a price regulator needs to make about the parameters it will use to set that tax allowance. The methodology for setting the tax allowance can differ from price regulator to price regulator.

Essential Services Commission for the water sector

The Essential Services Commission of Victoria (ESC) regulates prices in the water industry in that state. In a study undertaken by CME Australia for the Essential Services Commission of Victoria, it was noted that there are intended differences between the tax paid and tax allowed by the price regulator.² These differences will be discussed in the following section which compares the tax allowed to the tax paid. That research paper also notes that, regardless of ownership (whether public or private), all regulated entities are motivated to maximise the tax allowance provided by the price regulator as it increases their overall revenue.³ This is because an increase in the tax allowance results in an increase in prices allowed by the price regulator and therefore, an increase in revenue received by the regulated entity resulting from higher bills to the consumer.

The paper goes on to state that privately owned organisations are then driven to reduce their tax, thereby maximising post-tax profits to be distributed to shareholders. However, it continues, this is

² CME, *Regulatory arrangements for the cost of capital and tax in the regulation of Victorian water companies: issues and ideas. A paper for the Essential Services Commission* (2015) 6.

³ CME, *Regulatory arrangements for the cost of capital and tax in the regulation of Victorian water companies: issues and ideas. A paper for the Essential Services Commission* (2015) 26.

not the case for government-owned entities, because the government-owned entity's owner State or Territory Treasury receives both the tax and the dividend.⁴

Furthermore, the paper finds that the differences between actual tax paid and the tax allowance set by the price regulator are mainly due to actual debt being much lower than the benchmark rate set by the regulator (resulting in a difference in interest deducted in the tax return and interest deductions allowed for in the calculation of the tax allowance component of the price determination), differences in the valuation of assets (including differences in tax depreciation claimed as a deduction and depreciation allowed as part of setting prices), assumptions regarding dividend imputation, and deferred tax liabilities.⁵

The AER review of the regulatory tax approach in the energy sector

The Australian Energy Regulator (AER) has recently announced a review into the difference between the tax allowed by the AER and the actual tax paid by companies the AER regulates in the distribution and transmission segments of the electricity and gas sectors.

The ATO alerted the AER about differences between the tax allowances allowed by the AER and the actual tax paid by energy companies in its letter dated 10 April 2018.⁶ In that letter, the ATO noted 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.”⁷

The ATO noted in its letter that the material differences between the tax allowance provided by the AER and the tax paid by those regulated entities were the entity structure (for example, stapled structures, companies and partnerships); the amount of interest claimed as a tax deduction compared to the interest allowed for in the AER pricing models; carried forward tax losses; and tax depreciation deductions claimed compared to tax depreciation allowed by the AER in its calculation of the tax allowance.⁸

⁴ CME, *Regulatory arrangements for the cost of capital and tax in the regulation of Victorian water companies: issues and ideas. A paper for the Essential Services Commission* (2015) 27.

⁵ CME, *Regulatory arrangements for the cost of capital and tax in the regulation of Victorian water companies: issues and ideas. A paper for the Essential Services Commission* (2015) 27-28.

⁶ Australian Taxation Office, ‘ATO Note’, *Indicative comparative analysis of the AER electricity distribution tax allowance and tax payable* (10 April 2018).

<https://www.aer.gov.au/system/files/ATO%20note%20to%20AER%20-%20Comparison%20of%20regulatory%20tax%20allowances%20and%20tax%20paid%20-%2010%20April%202018.PDF>

⁷ Australian Taxation Office, ‘ATO Note’, *Indicative comparative analysis of the AER electricity distribution tax allowance and tax payable* (10 April 2018) 1.

<https://www.aer.gov.au/system/files/ATO%20note%20to%20AER%20-%20Comparison%20of%20regulatory%20tax%20allowances%20and%20tax%20paid%20-%2010%20April%202018.PDF>

⁸ Australian Taxation Office, ‘ATO Note’, *Indicative comparative analysis of the AER electricity distribution tax allowance and tax payable* (10 April 2018).

<https://www.aer.gov.au/system/files/ATO%20note%20to%20AER%20-%20Comparison%20of%20regulatory%20tax%20allowances%20and%20tax%20paid%20-%2010%20April%202018.PDF>

The ATO also noted that it had to make some assumptions and had to apportion figures where the regulated entity operated within a consolidated group.⁹

The review came about after recent reports in the media of a \$400m power “price gouging” by electricity companies.¹⁰ This article exposed that customers of electricity networks and gas pipelines were being overcharged \$400m a year to cover corporate tax bills which were not actually incurred. The article argued that the price regulator (the AER) had allowed for tax allowances totalling \$600m in the energy and gas sectors when data extracted from the ATO has indicated that tax paid was in the vicinity of \$200m. The Federal Government then requested an AER review of what led to such considerable differences between the tax allowances provided by the AER and the actual tax collected by the tax office.

In a letter to the Chair of the AER, the Minister for the Environment and Energy, Hon Josh Frydenberg, has requested that the AER investigate whether the setting of the tax allowance has resulted in overcompensation of tax liabilities incurred in the energy sector. He has also requested a review of how the tax allowance is determined, including whether there is a need for more information gathering and whether the methodology for calculating the tax allowance needs to be updated or revised.¹¹

The following day, 15 May 2018, the AER released an issues paper “Review of Regulatory Tax Approach”.¹² This Issues Paper outlines the differences the AER found in their review into the tax allowance and tax payments of companies in the energy sector, as well as possible reasons for those differences, including difficulties encountered in gathering data and extracting relevant information. The Issues Paper seeks submissions from interested parties by 31 May 2018 and aims to complete the review by December 2018.

In its Issues Paper, the AER sought to investigate and explain the differences between the way it calculates its tax allowance and the way the ATO arrives at its tax payable. Figure 2.1 of the Issues Paper outlines how the AER determines its tax allowance in comparison to how the ATO arrives at the taxable income and tax payable. This table is reproduced below.

⁹ Australian Taxation Office, ‘ATO Note’, *Indicative comparative analysis of the AER electricity distribution tax allowance and tax payable* (10 April 2018).

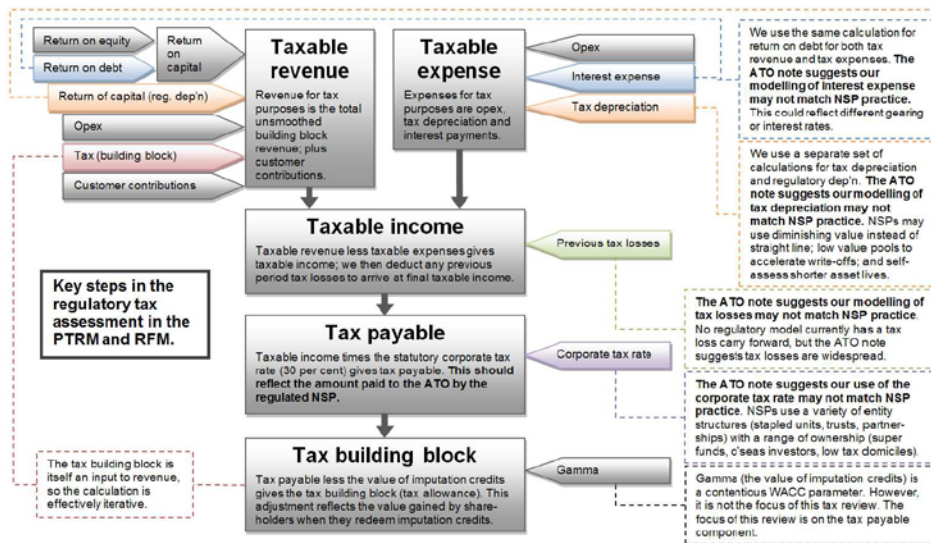
<https://www.aer.gov.au/system/files/ATO%20note%20to%20AER%20-%20Comparison%20of%20regulatory%20tax%20allowances%20and%20tax%20paid%20-%2010%20April%202018.PDF>

¹⁰ Nicole Hasham, ‘\$400m power price ‘gouging’’, *The Sydney Morning Herald* (Sydney), 15 May 2018 1.

¹¹ Australian Taxation Office, ‘ATO Note’, *Indicative comparative analysis of the AER electricity distribution tax allowance and tax payable* (10 April 2018). <https://www.aer.gov.au/system/files/180503%20-%20LTR%20-%20Chair%20of%20AER%20-%20Network%20tax%20allowance.pdf>

¹² Australian Taxation Office, ‘ATO Note’, *Indicative comparative analysis of the AER electricity distribution tax allowance and tax payable* (10 April 2018). <https://www.aer.gov.au/system/files/AER%20-%20Regulatory%20tax%20review%202018%20-%20Issues%20Paper%20-%20May%202018.pdf>.

Figure 2.1 Diagram showing the key steps in the AER's regulatory tax approach



The AER sought to explain the reasons for the differences between the tax allowance and tax payable. Similar to the CME review of the water industry above, gearing featured heavily as one of the main differences between the tax allowance and tax paid.¹³ The AER notes that net service providers are often more highly geared than the benchmark gearing of 60% it allows when setting prices. This results in a higher actual interest expense than is used in the calculation of the tax allowance, and therefore a lower taxable income and tax payable. Further, and also similar to the CME review of ESC (above), another factor resulting in a large difference between the tax allowance and tax paid is the calculation of depreciation and other asset-related adjustments. The AER uses straight-line depreciation and ATO effective lives for the determination of tax depreciation for use in the calculation of the tax allowance. However, the tax law allows entities a choice of either diminishing value or straight-line depreciation, allows entities to group low value assets into low value pools and also allows entities the option of forgoing the ATO effective lives in favour of self-assessed effective lives if the entity chooses. Also, the AER assumes a company tax rate of 30% without considering the ownership structure, thereby not accurately capturing structures such as stapled structures and partnerships. In addition, although the AER is aware of prior tax losses, it does not appear to take these carried forward losses into consideration when determining the tax allowance.¹⁴

Also, the AER outlines further possible differences between the tax allowance and tax payable in its Issues Paper.¹⁵ Research and development is not taken into account in the AER models, and the benchmark regulated cost of debt is used in its calculations (where the regulated entity might have higher or lower interest rates and cost of debt depending on its debt and credit ratings). Further, the AER does not take into account the effect that sale or corporate restructuring has on the tax asset base; and does not take into account that certain refurbishments can be written off for tax purposes rather than depreciated.¹⁶

As part of the AER review into the regulatory tax allowance, the AER engaged PwC to analyse data received as part of the voluntary information requests and provide an expert opinion and advice

¹³ Australian Energy Regulator, *Issues paper: Review of regulatory tax approach* (2018) Table 5.1; 16.

¹⁴ Australian Energy Regulator, *Issues paper: Review of regulatory tax approach* (2018) Table 5.1; 16.

¹⁵ Australian Energy Regulator, *Issues paper: Review of regulatory tax approach* (2018) Table 5.2; 17.

¹⁶ Australian Energy Regulator, *Issues paper: Review of regulatory tax approach* (2018) Table 5.2; 17.

around the difference between tax paid and the tax allowance. The report was released on 26 October 2018 and did not include analysis for all electricity network companies, but rather only those who had voluntarily provided data as part of the AER's information request.

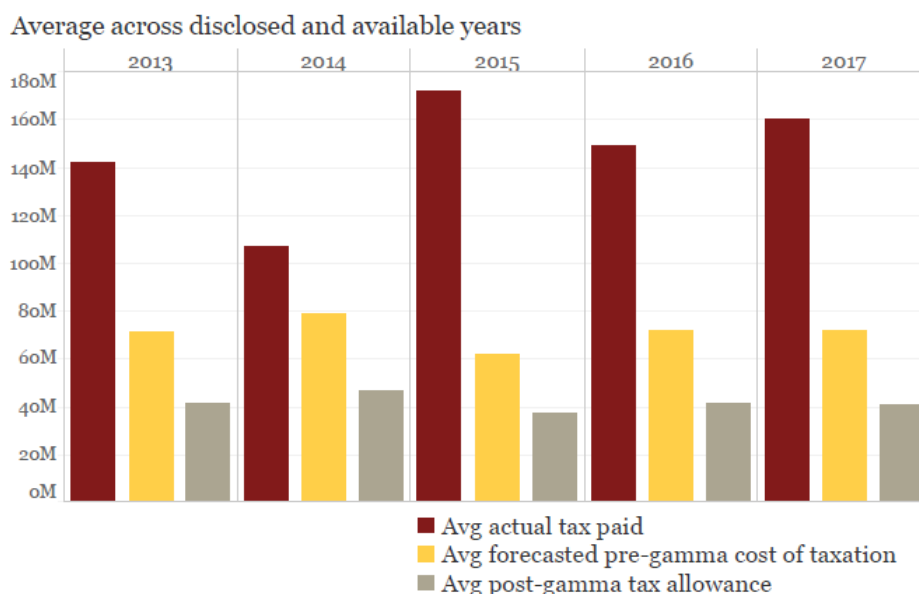
There were a number of limitations in PwC's report, the main one being that regulated and unregulated activities were not separated. Regulated activities are those activities for which the AER (or any price regulator) sets prices and provides a tax allowance. Unregulated activities are those activities for which there is a competitive market and, as such, there is no need for the price regulator to provide a price as the competitive market for those services is able to determine the most efficient price to be charged. PwC's report compared the tax allowance provided for regulated activities, with the total tax paid from the entities' tax returns for all activities – regulated and unregulated. In this way, the PwC analysis is not comparing like for like.

However, for the purposes of this exercise, this serves the case study well. If the proposition being made in this thesis is to abolish the NTER, thereby removing the tax paid according to what is calculated in the tax return, and replacing it instead with a tax payment based on the tax allowance, that would involve the removal of tax paid on all activities – both regulated and unregulated, and instead replacing that with a tax allowance based on only regulated activities.

NTER entities

The tax paid compared to the tax allowance for NTER entities which participated in the AER voluntary request for tax information was as follows:

Figure 4: NTER entities – actual tax paid v regulatory tax allowance



Notes relevant to interpretation of information:

- The above graph compares the average tax payable by NTER entities (as reported in the NTER returns provided on a voluntary basis) to the average forecast cost of tax and relating tax allowance for those same entities for regulatory purposes, on an annual basis.
- To the extent regulatory tax information is not available, the equivalent NTER return tax payable information has also been omitted. This explains why the tax payable averages in the above graph differ to Figure 2 above.
- The number of NTER NSPs that have provided income tax returns and have available tax allowance information, and are therefore reported above are as follows:
 - 2013: 3
 - 2014: 3
 - 2015: 4
 - 2016: 4
 - 2017: 4

FIG 4, PG 30 OF THE PWC REPORT

This table indicates that NTER entities paid far more tax than the tax allowance provided by the AER allowed. NTER entities paid well over double the tax allowance in actual tax payments. This table alone indicates that if the NTER were to be abolished and instead replaced with tax payments based on the tax allowance, State and Territory Treasuries would receive significantly less in tax equivalent payments than they are currently receiving.

If the tax allowance is based on the theoretical efficient, well-managed, privately-owned organisation, and the NTER tax payments returned a result that was so materially higher than the tax allowance, it could theoretically be argued that this is because the NTER entities are not efficient in the management of their tax affairs.

Privately-owned entities

Following on from the above section, it could be expected then, that an actual privately-owned, well-managed organisation would return a result which showed tax payable to be similar to the tax allowance.

The tax paid compared to the tax allowance for privately-owned entities which participated in the AER voluntary request for tax information was as follows:

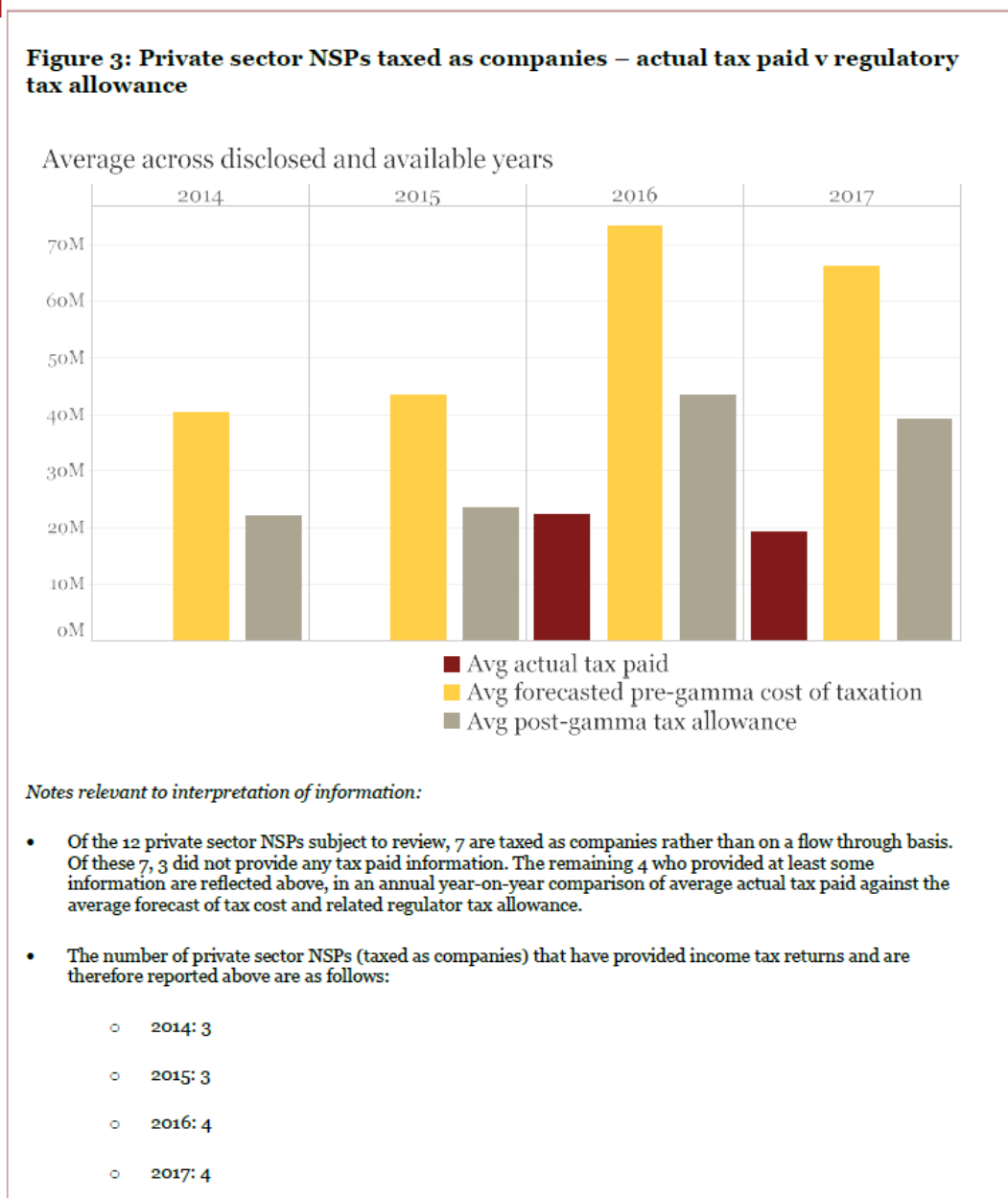


FIG 3 ON PG 29 OF PWC REPORT

The above table indicated the exact opposite of the NTER – that average tax paid by the electricity network companies in the private sector was less than half for two of the years surveyed, and for the other two years surveyed, the privately-owned network companies paid no tax at all. The reasons for this are discussed below.

For the purposes of this study, the above clearly illustrates that the tax allowance provided by the price regulator is not an accurate indicator of taxes paid in neither the privately-owned nor the publicly-owned sectors, and therefore should not be used a replacement for a tax function in the state-owned sector. Further, it was not even a near-accurate measure of tax payments made by either sector.

Comparison of tax paid in the AER Review of Regulatory Tax Approach 2018

As part of the AER Review of Regulatory Tax Approach 2018, the AER collected data from electricity network companies on a voluntary basis and performed some high-level comparisons of tax paid between privately owned and publicly owned network companies. It found that NTER electricity network companies paid significantly more tax than their privately-owned counterparts, as follows:

Figure 2: Tax payable per tax returns for corporate entities (including NTER)

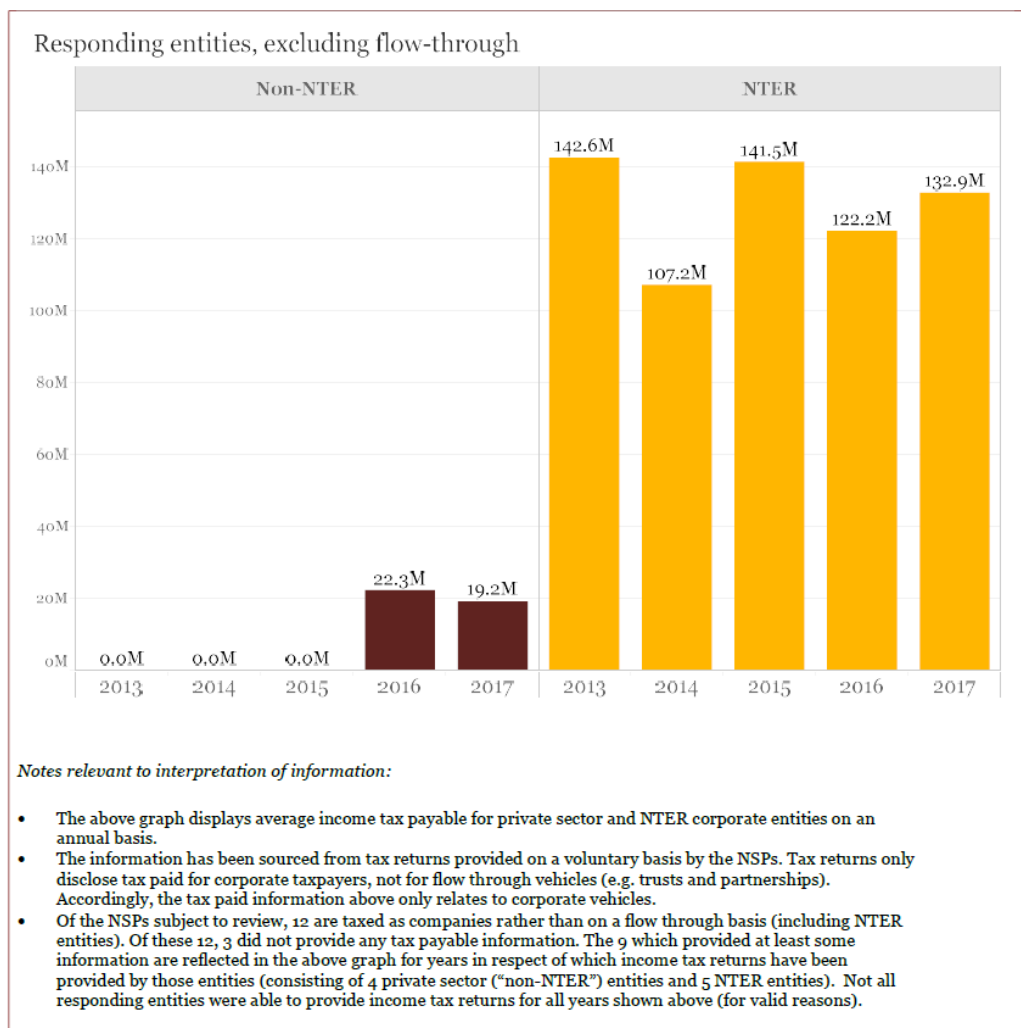


FIGURE 2: TAX PAYABLE FOR CORPORATE ENTITIES, PG 28 FROM THE PWC REPORT

Keeping in mind that the above table is based on only those electricity network companies who chose to voluntarily provide their tax data to the AER as part of this review, it can be seen that the NTER entities pay vastly more tax than their privately-owned counterparts.

The PwC report then goes on to analyse why this would be the case.

Briefly, the drivers for the high amount of tax the NTER entities paid were found to be:

- The revenue reported in the NTER entities' tax returns was much higher than the income allowed for by the regulator. This could be due to a high amount of unregulated income.
- The tax fixed asset registers overall were less than the regulatory tax asset book, resulting in less depreciation claimed as a deduction in the tax returns.
- Actual financing costs claimed as a deduction were likely lower than the financing costs allowed by the price regulator.¹⁷

The drivers for the low amount of tax the private sector paid were found to be as follows:

- The holding structures utilised by some of the electricity network companies meant that tax was payable by other entities. As such, the network companies themselves showed no tax as payable, whereas tax would be paid further up the line by other entities in the holding structure.
- The availability of carry forward tax losses and costs associated with mergers and acquisitions has driven down the amount of tax paid by privately owned entities.
- The tax treatment employed by privately owned entities in relation to capex and financing (for example, write-off of refurbishment costs).¹⁸

Depreciation method

For most assets, a company can choose whether it wants to depreciate assets using the prime cost (s 40-75 ITAA97) or diminishing value (s 40-72 ITAA97) method. The prime cost method spaces depreciation evenly over the asset's useful life. The diminishing value is a more aggressive method which allows for greater depreciation deductions in the early years of an asset's ownership and then peters out in the later years.

Of the data collected by the AER as part of their voluntary data collection, entities provided details of their tax fixed asset registers and the depreciation methods utilised. PwC collated this data in their expert advice. It was found that the private sector had a higher rate of adoption of the diminishing value method, whereas the NTER had a very low rate of adoption of diminishing value depreciation.

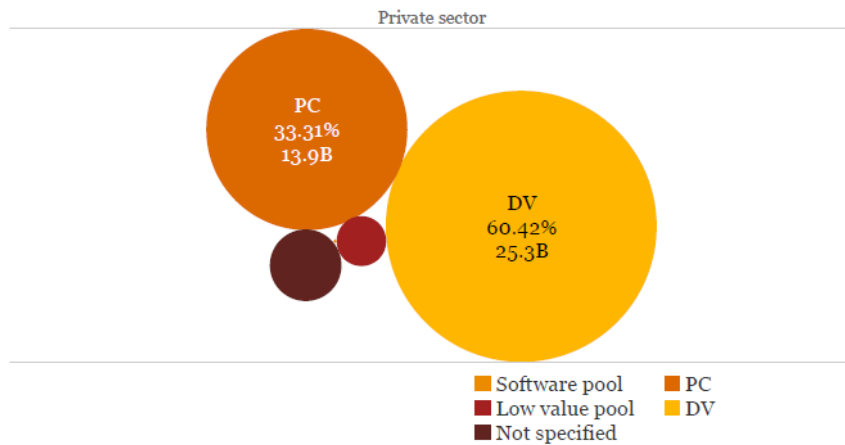
The tables from the PwC report have been reproduced below.

In the privately-owned electricity network companies, the depreciation method adopted is as follows:

¹⁷ PwC Presentation at the AER forum, 7 November 2018, pg 6.

¹⁸ PwC Presentation at the AER forum, 7 November 2018, pg 7.

Figure 23: Depreciation method adopted by private sector entities



Overall (Electrical & Gas assets)

	TFAR CWDV (nearest available date as provided)	% of total CWDV
PC	13.94B	33.31%
DV	25.29B	60.42%
Not specified	1.76B	4.22%
Low value pool	0.85B	2.04%
Software pool	0.00B	0.01%
Grand Total	41.85B	100.00%

Notes relevant to interpretation of information:

- The percentages displayed above relate to the TFAR balances at the latest reporting period, as provided by the NSPs on a voluntary basis.
- Non-depreciating assets (such as land) have been excluded from the TFARs provided by the NSPs.

FIG 23 FROM PG 76 OF THE PWC REPORT

The above table indicates that, of the total tax asset registers carried by the privately-owned electricity network businesses who voluntarily provided their information, 60.42% of assets were depreciated using the diminishing value method, and 33.31% of the assets were depreciated using the prime cost method.

The NTER electricity network companies presented their depreciation methods as follows:

Figure 24: Depreciation method adopted by NTER entities

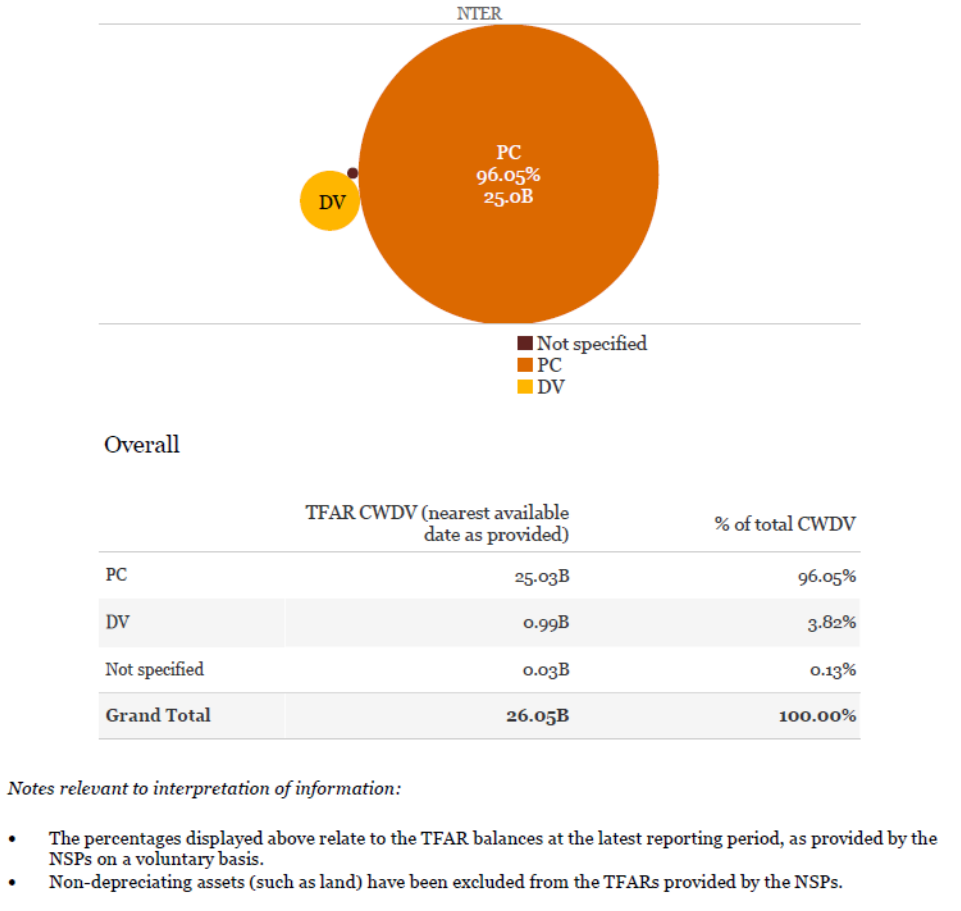


FIG 24 FROM PG 77 OF THE PWC REPORT

The above table indicates that, of the total tax asset registers carried by the NTER entity network businesses who voluntarily provided their information, 96.05% of assets were depreciated using the prime cost method, and the diminishing value method was utilised for only 3.82% of total assets.

The difference in depreciation method adopted by NTER and privately-owned electricity network entities is materially different. It could be a potential indicator that NTER entities are indeed less efficient than their privately-owned counterparts, especially in this instance, where tax laws allow for the selection of either method, and one method (diminishing value) is clearly more favourable as it allows more tax deductions to be claimed upfront. This is especially beneficial to an organisation because tax depreciation is not adjusted for the time value of money. However, it might also be an indicator that perhaps the State and Territory Treasuries dictated the method used by NTER entities, in which case there would have been a preference for the prime cost method because it maximised the tax returned to those State and Territory Treasuries.

Helen, I'm aware of instances where this is the case – where the Treasury dictated the depreciation method used on entry to the STER/NTER but I've got no formal way of backing this up.

Privatisation and M&A costs

There has been a lot of privatisation and merger and acquisition (M&A) activity in recent years. As a result of these activities, newly privatised electricity network companies have been able to deduct

expenses like stamp duty involved in the transaction, costs of the transaction (legal expenses, accounting fees, and so on). These additional expenses have, in part, driven the lower amount of tax paid by the private sector.

Carry forward tax losses

A number of privately-owned electricity network businesses has tax losses carried forward, which minimised the amount of tax those companies paid. The availability of tax losses over the years studied are as follows:

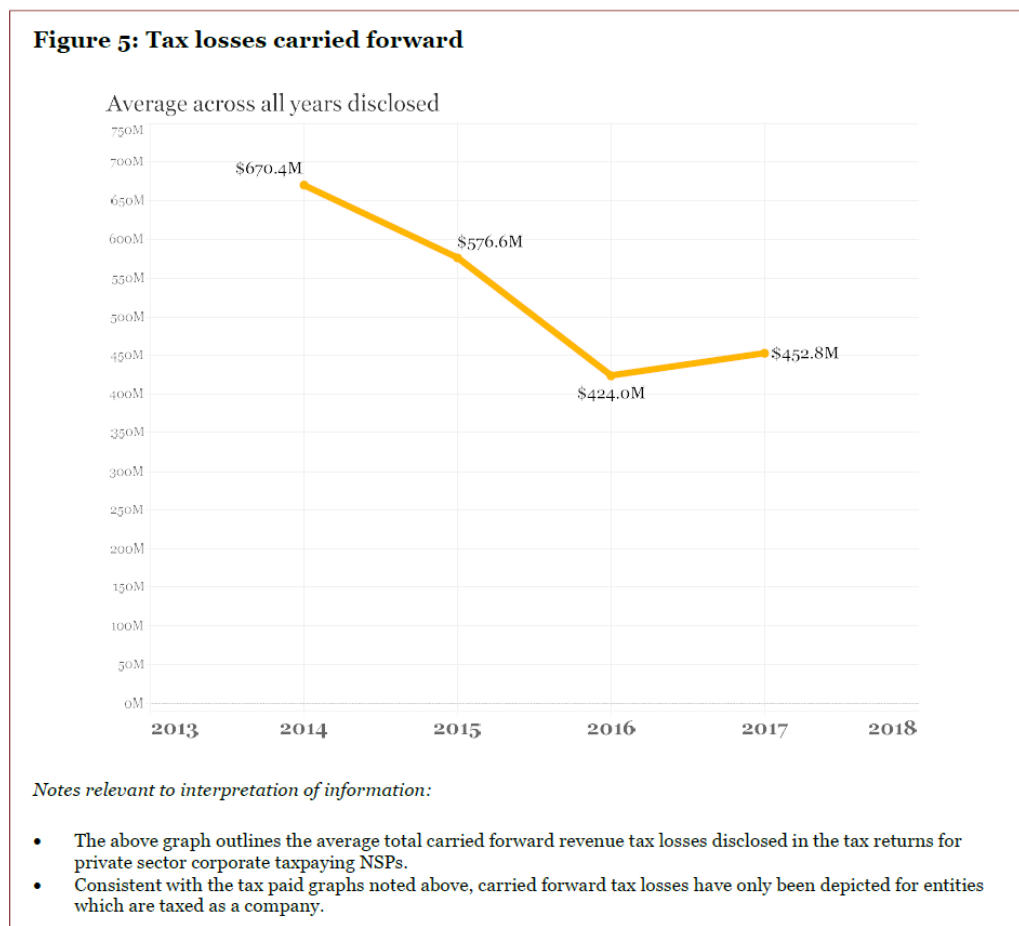


FIG 5 FROM PG 31 PWC REPORT

The above indicates a very high level of tax losses available to the private sector. The cause of these losses was not specified in the report, but it could be due to the high costs of privatisation and M&A activities.

Conclusion

Therefore, when considering the proposition that the NTER is not needed if the pricing regulator already calculates a tax allowance based on what would be payable if an organisation were efficient, it can be seen that this would not be a suitable replacement for the NTER. In addition to the reasons outlined above, the price regulator calculates the tax allowance on a forecast basis and does not often allow a true-up for tax in the previous price path. Also, the price regulator fails to adequately account for the complexities of the tax system and makes assumptions around gearing and interest rates which often vary from the actual. As outlined above, the tax allowance was not an accurate

reflection of tax paid by the private sector. As such, it is not an adequate replacement for a system of tax neutrality.

Can the NTER be abolished and instead be replaced with a larger single payment to the Owner State or Territory Treasury?

State and Territory Treasuries receive two streams of income from their State Owned Enterprises. They receive a dividend payment and the tax equivalents made by the SOCs. In addition, the Treasuries also receive the government guarantee fee from their SOEs, but as this is outside the scope of this research, this will not be discussed in great detail.

The question could be asked whether it is necessary for the State to receive both the tax and dividend, and whether this is an inefficient use of resources to determine both streams of payment separately.

One could propose the removal of tax equivalent payments (and the tax equivalent regimes) and have SOCs pay a larger dividend to the State or Territory Government. Alternatively, both payment types, tax equivalents and dividend payments, can be made redundant and replaced with a single payment to the State or Territory Government.

It will be argued here that both streams are indeed necessary and are not the cause of inefficiency in Government operations (although it does place an administrative cost on the entity to have to calculate both).

In order to consider this, one needs to consider the difference between tax and dividends.

Tax, whether actual tax or a tax equivalent, is an expense. It forms part of other business expenses, is reported in the profit and loss statement, and reduces net profit after tax.

On the other hand, a dividend is a return on the Government's equity investment. A dividend is not an expense. Rather, it is a distribution of part of a company's net profit or reserves which are reported in the Statement of Changes in Equity section of the Financial Statements.

Therefore, if a State Owned Enterprise were not to pay separate tax equivalents and instead return a larger dividend, this would present a distortion and a false inflation of the Government's return on equity. As a result, the dividend received by the Government would not be a true reflection on their investment, as the tax would be rolled up as part of the dividend paid. This could result in inefficiencies being hidden by showing a larger return on equity than would be available from a privately-owned organisation and would result in the competitive neutrality issues that were trying to be avoided by introducing tax equivalent regimes in the first place.

Removing any tax equivalent payments that are currently required by Government businesses would effectively under-value the entity's expenses, and over-inflate the return on equity, thereby returning the market to an uneven playing field.

Furthermore, in considering the removal of a tax equivalent regime and the dividend policies, and replacing them with a single payment by SOCs to their owner State or Territory Treasury, problems would arise with the correct classification of such a payment. Would it be an equity payment? A return on equity? Or an expense? The ability to correctly separate and classify such a payment into equity or expense would be vital to maintaining any semblance of competitive neutrality. This would also lead to the financial statements of a publicly owned entity to be incomparable to those of a privately owned entity.

Burton supports this view by stating that the introduction of tax equivalent payments saw what was previously a single payment to Treasury divided into a dividend component, a tax equivalent component, and a government guarantee fee.¹⁹ Burton further argues that part of the intention of introducing commercialisation comes with the view of privatisation, and the requirements of separating payments made to Treasury into tax equivalent, dividend and government guarantee fee would enable comparison of the real rate of return as would be expected by the shareholders of a privately owned corporation.²⁰

Although National Tax Equivalent Regime payments may not be made with the future long-term view of privatisation, they still provide a transparent, easy means of comparison of the financial results of a state-owned with a privately owned organisation. This comparison will be made in the case studies.

This section examined why entities were required to make two separate payments to their State or Territory Government. It considered the result of removing tax neutrality and the resultant tax paid, tax expense and any tax balances in the balance sheet, and instead allowing for a greater dividend. As discussed in the opening, tax is an expense whereas a dividend is a return on equity, so the overall classification of the payments being made to the State or Territory Governments needs to be kept separate. The case study provided the figures to support this. In addition to just the reclassification of the payments being made to the government, a change to equity balances was witnessed, sometimes in the billions. Except for TasWater and Synergy (whose overall tax position, including tax expense, was an asset rather than a liability), this change in equity was favourable. Energy Queensland saw its equity double. Melbourne Water has an increase to equity of 25.34%. SA Water had the greatest dollar increase in equity of \$1.677bn or 30.94%.

The return on assets, net profit margin and earnings per share ratios increased on average 32.65% for those companies studied, with the majority increasing in the vicinity of 40 - 43%. If compared to a privately owned entity, this advantage would be material. In addition, the debt to equity ratios, which compared total liabilities to equity, and separately to total assets, decreased by an average of 18.78% and 7.45% respectively. This decrease is favourable as it represents a decrease to total liabilities when compared to both equity and total assets.

Although there are differences in removing the effect of tax in the current year results, the true effect of removing tax is seen over the long-term – in the deferred tax assets and liabilities that are reported in the balance sheet. This is especially true of businesses in the infrastructure industries, where asset bases are very large and even a small difference between tax and accounting treatments of assets results in very large deferred tax assets and liabilities which are often not recognised in the short-term.

This case study illustrates the competitive advantage that would be given to state-owned businesses if they were not subject to tax. It examined the result of keeping the payments to the government the same from a cashflow perspective, but reclassifying them to be a dividend instead. The case study returned some large differences that would result in a material competitive advantage if such a policy were to be introduced. It also illustrated the need for a system of tax neutrality, as to exclude tax from the financial statements would leave any competitor at a disadvantage. These advantages would result in a better credit rating, which in turn means that the state-owned corporation could obtain cheaper borrowing as a result (although under current laws, most state-

¹⁹ Mark Burton, 'The imposition of income taxation upon State Authorities by State Governments: A Clayton's tax or the real thing?' (1992) 11(2) *University of Tasmania Law Review* 107, 109.

²⁰ *Ibid.*

owned corporations are not permitted to borrow from any private institutions – they are required to borrowing from their own State to Territory Treasury Corporation). In addition, an entity which does not have to pay tax is able to charge lower prices than one which is liable to tax.

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