School of Business Law and Taxation

The Effectiveness of the National Tax Equivalent Regime (NTER) in Encouraging Competitive Neutrality

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Declaration

To the best of my knowledge and belief this thesis contains no material previously published by any other person except where due acknowledgment has been made.

This thesis contains no material which has been accepted for the award of any other degree or diploma in any university.

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Date: 25.02.19

Abstract

The Hilmer report (1993) sought to recommend a consistent national approach to encourage greater competition in the Australian economy. One of the ways it sought to do this was to remove any competitive advantages government-owned businesses might have by way of any tax advantages.[1] These competitive advantages needed to be removed in order to achieve competitive neutrality - a market whereby all firms compete on a level playing field and are subject to the same rules and regulations regardless of their ownership. This aim to achieve competitive neutrality between public and private businesses paved the way for the formation of the National Tax Equivalent Regime (NTER).

The National Tax Equivalent Regime (NTER) is an administrative inter-governmental arrangement under which, for competitive neutrality purposes, the Federal income tax laws are notionally applied to listed governmental business entities owned by the State and Territories as if they were subject to those laws. The resulting NTER tax is a liability owed and paid by these entities directly to their owner State and Territory Governments – it does not form part of the actual Federal income tax base as it would for privately owned companies. Apart from some specific modifications, NTER entities are treated in the same way as their federal counterparts. For example, an NTER entity is required to lodge income tax returns, make quarterly or monthly PAYG instalment payments, is subject to audit or other compliance assurance activities by the Australian Taxation Office (ATO), has the ability to seek private rulings, and is subject to interest and penalty charges in the same manner applicable to privately owned organisations.[2]

The follow up to the Hilmer Report, the Competition Policy Review Final Report ("The Harper Review"), was released on 31 March 2015. Competitive neutrality formed one of the critical competition topics covered in this report. The NTER was mentioned in several of the submissions but none called for a sizeable sweeping reform of the system currently in place, nor was it suggested in any of the recommendations of the Final Report. It does not appear that the findings or recommendations of the Competition Policy Review will have any impact on the

[1] Department of Treasury and Finance (Vic), *Guide to National Competition Policy*, (n.d.) 3.
[2] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* (2016) 6.

structure or administration of the NTER. The recommendations relating to competitive neutrality included:

- Recommendation 15: a review of competitive neutrality policies by the proposed Australian Council for Competition Policy;
- Recommendation 16: greater transparency and effectiveness surrounding the competitive neutrality complaints process; and
- A requirement for annual reports to include a statement on compliance with competitive neutrality principles.[3]

The objective of this research is to determine whether the National Tax Equivalent Regime achieved its goal of encouraging competitive neutrality.

Key findings

The key findings of the research were that, while the NTER did contribute to its goal of encouraging competitive neutrality, there were a number of areas, both within the tax law and within the regime, which resulted in both advantages and disadvantages when the private and public sector were compared. The NTER entities had a number of advantages and disadvantages over their privately-owned counterparts.

A comparison of tax paid between NTER entities and their privately-owned counterparts found that NTER entities typically paid more tax. In addition, compared to their privately-owned counterparts, the NTER entities studied had higher liabilities compared to total equity, paid a higher rate of interest (when interest paid was compared to total borrowings), paid more dividends, and had a lower ratio of expenses to each dollar earned.

A case study considered the effect of the removal of the NTER, and instead increasing the amount of dividend paid to Treasury. It was found that doing so would increase 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.

[3] Commonwealth of Australia, *Competition Policy Review Final Report*, (2015) 50-51.

Further, a comparison of the tax allowance provided by the price regulator to the tax paid was studied to determine whether the tax allowance would be a suitable and more efficient substitute for the NTER. It was found that the tax allowance would not be an adequate substitute for a tax equivalent regime.

The comparison of the tax allowance to the tax paid has been the subject of a review by the Australian Energy Regulator, which was concluded in December 2018.

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Acronyms

ACCC	Australian Competition and Consumer Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ATO	Australian Taxation Office
ATOID	ATO Interpretative Decision
CGT	Capital Gains Tax
COAG	Council of Australian Governments
CPA	Competition Principles Agreement
ESC	Essential Services Commission
IPART	Independent Pricing and Regulatory Tribunal
GOC	Government owned corporation
NCP	National Competition Policy
NEM	National Energy Market
NTER	National Tax Equivalent Regime
NTTC	Northern Territory Treasury Corporation
OECD	The Organisation for Economic Co-operation and Development
QTC	Queensland Treasury Corporation
RAB	Regulated Asset Base
SAFA	South Australian Government Financing Authority
SOC	State-owned corporation
SOE	State-owned enterprise
STER	State Tax Equivalent Regime
SWIS	The South West Interconnected System
TASCORP	The Tasmanian Public Finance Corporation
TCorp	New South Wales Treasury Corporation
TCV	Treasury Corporation of Victoria
TER	Tax Equivalent Regime
WACC	Weighted Average Cost of Capital
WATC	Western Australia Treasury Corporation

1 Introduction

1.1 Introduction

This chapter provides an overview of the thesis, including the central research questions and the six objectives addressed in order to answer the research questions. The chapter provides a brief background of the area studied and why this research is a significant contribution. It goes on further to provide an outline of research method, and a summary of the chapters in this thesis.

1.2 Objectives

The central objectives of this research are:

1. To evaluate how effective a tool the National Tax Equivalent Regime (NTER) is in achieving competitive neutrality, and
2. Whether other methods could be more effective.

In order to address the objectives, the thesis:

1. Provides an outline and history of the NTER and competitive neutrality;
2. Defines what is meant by "competitive neutrality" in this context;
3. Identifies alternative tools to achieve competitive neutrality and examines whether they were also subject to variation from State to State due to differences arising from the workings of each State's Treasury;
4. Examines a different existing regulatory structure and the impact it has on competitive neutrality;
5. Determines why tax was the policy used to achieve competitive neutrality in this circumstance; and
6. Examines whether or not another tool (instead of tax) could have been more effective or appropriate.

1.3 Background

1.3.1 The National Competition Policy and competitive neutrality

The economic concept of efficiency is a significant social goal as it aims to ensure maximum economic surplus.[4] Briefly, efficiency occurs when the allocation of resources achieves the maximum output possible. Competition policy plays a substantial role in encouraging efficiency.[5] However, there is evidence that a competitive market will not always encourage efficiency. This will be further examined in section 2.11.4.

The need for a national competition policy arose because government-owned entities can have both competitive and economic advantages over their privately-owned counterparts. These advantages include, for example: exemption from taxation and charges; government guarantee on debts; lower interest rates on loans; and no requirement to achieve a commercial rate of return on assets.[6] Further commercial advantages of government ownership can include cross-subsidisation, protection from bankruptcy, and favourable regulatory conditions.[7]

Where a government-owned entity has a net advantage over its privately owned counterparts, it can set its prices below private-sector rivals, even though it is not necessarily more efficient in its operations than those entities.[8] This means that public sector entities which have advantages over private sector entities might be able to undercut private sector entities because of a reduced cost of production resulting from these advantages, and possibly put up a barrier to entry for potential competitors.[9] In other words, the government-owned entity can use the advantages by virtue of its ownership to be able to price privately owned entities out of the market where those entities may, in effect, have been more efficient than the government-owned entity.

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[4] Ben S. Bernanke, Nilss Olekalns and Robert H. Frank, *Principles of Macroeconomics* (McGraw-Hill, 2nd ed, 2008) 29.
[5] Philip Clarke and Stephen Corones, *Competition Law and Policy: Cases & Materials* (Oxford University Press, 2nd ed, 2005) 14.
[6] National Competition Council, *National Competition Policy*, (1993) 296.
[7] Zahirul Hoque and Jodie Moll, 'Public sector reform: Implications for accounting, accountability and performance of state-owned entities – an Australian perspective' (2001) 14(4) *The International Journal of Public Sector Management* 304, 310.
[8] National Competition Council, above n 6, 297.
[9] The Treasury, *Australian Government National Competition Policy Report 2005-07*, (2007) 46.

However, there are also disadvantages associated with being a government-owned entity. These disadvantages include: greater accountability obligations; requirements to provide various community service obligations; and a greater superannuation expense.[10] Further disadvantages of government ownership can include government control over employee matters (including wages and industrial relations matters) and the management and running of the organisation.[11]

The Organisation for Economic Co-operation and Development (OECD) recommends that the best way to implement a competitive neutrality framework is by starting with an evaluation of current legislation and administration in which the state-owned entities operate, and then to make changes that will attempt to have those entities operating in the same legislative and administrative environment as privately-owned entities. This is important in order to be able to compare the costs of the public and private sectors.[12]

The principle of competitive neutrality, therefore, requires that "government owned businesses competing with private sector businesses should compete on the same footing: business activities of government owned bodies should not enjoy any net competitive advantage simply as a result of their public-sector ownership."[13] This includes making both government owned businesses and privately-owned entities subject to the same taxation and regulatory regimes.

In October 1992, the then Prime Minister, Paul Keating, formed a Committee of Inquiry whose task it was to formulate a national competition policy. Headed by Professor Frederick Hilmer, *National Competition Policy* ('The Hilmer Report') was released in 1993.[14] The policy sought to implement a consistent national approach to encourage greater competition in the Australian economy. One of the ways it sought to do this was to attempt to remove any competitive advantage government owned businesses might have by way of any tax advantages.[15]

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[10] National Competition Council, above n 6, 297. The Enterprise Agreements for public sector entities frequently require contributions in excess of the superannuation guarantee rate.
[11] Hoque and Moll, above n 7, 310.
[12] OECD, *State owned enterprises and the principle of competitive neutrality*, (2009) 326.
[13] Department of Treasury and Finance (Vic), *Guide to National Competition Policy*, above n 1, 19.
[14] National Competition Council, above n 6, v.
[15] Department of Treasury and Finance (Vic), *Guide to National Competition Policy*, above n 1, 3.

The Hilmer Report (1993) made recommendations regarding the implementation of a national competition policy in Australia. At the time, the intended result was that the removal of any net competitive advantages enjoyed by government owned businesses, and the levelling of the playing field would result in a fair market environment and improved efficiency and productivity.[16]

However, two important points need to be made here. Firstly, the introduction of competitive neutrality does not mean that all government owned entities need to be privatised, although that course of action is an option which will be examined further in this thesis. The push is not for privatisation of government owned entities, but rather only for corporatisation. Privatisation results from the government's relinquishment of its assets or businesses, usually through sale to the private sector. Corporatisation involves the structuring of government businesses into corporations, similar to those which are privately owned. It entails implementing a similar legal and management structure as the private sector[17] and requires the corporatised entity to operate as a commercial entity.[18] It seeks to imitate private sector conditions while retaining government ownership.[19] Corporatisation is one of the methods required under competitive neutrality as it can remove a state-owned business' net competitive advantage.[20] Corporatisation is discussed further in section 3.2.1. Secondly, outsourcing of government operations is not required in order for an entity to comply with the competitive neutrality guidelines. The only thing that is required is for government owned corporations to be managed and run as competitively as the private sector.[21] The difference between privatisation, corporatisation, and outsourcing is examined in section 3.2.

Hamilton and Denniss assert that one of the main aims of the National Competition Policy (NCP) is to produce goods and services at a lower cost, especially those goods

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[16] Department of Treasury and Finance (Vic), *Competitive Neutrality Policy Victoria*, (2000) 4.
[17] Stephen Bottomley, 'Government business enterprises and public accountability through Parliament' (Research Paper No18, Parliamentary Library, Parliament of Australia, 2000). y
[18] Queensland Treasury, *National Competition Policy Implementation in Queensland: Competitive neutrality and Queensland Government Business Activities* (1996) 9.
[19] Ibid.
[20] Government of Western Australia, *Policy Statement on Competitive Neutrality*, (Perth: WA Treasury, 1996) 12. http://www.finance.wa.gov.au/cms/uploadedFiles/Economic_Reform/policy-on-competitive-neutrality.pdf.
[21] The Treasury, *Australian Government National Competition Policy Report 2005-07*, above n 9, 49.

and services produced by government owned entities.[22] They argue that because public companies produce essential services that are then used by industry to produce other goods and services, then it will automatically follow that a reduction in costs and improvement in efficiency of these public sector entities will have a flow-on effect and be of more significant benefit to the economy.[23] Hamilton and Denniss believe that the outcome of this will result in an overall lower price for the final product, an increase in exports, and an increase in employment.[24] One needs to consider at this point whether the introduction of the NCP was the appropriate way to achieve this, or whether there might have been other more appropriate methods of achieving these outcomes.

1.3.2 Alternative tools available to achieve competitive neutrality

There are a number of different tools used to achieve the ultimate objective of competitive neutrality. These tools include taxation neutrality, debt neutrality, rate of return requirements, regulatory neutrality, and full cost pricing principles[25] explained in chapter 3, and aspects of which will be expanded in the case studies in chapters 5 and 6.

The focus of this study is taxation neutrality, in particular, the NTER. The NTER was selected for this study because it has not been the subject of any detailed study in the past and therefore this research seeks to make a substantial contribution to the literature in this area. It was also selected because of ease of access to the relevant information.[26]

This study will focus on two case studies: a monopoly (for example, water) and an industry with competition from the private sector (for example, electricity). Looking at a monopoly will allow the research to consider whether there is a need for a monopoly to be subject to the NTER, especially since NTER entities which are in a naturally monopolistic market are usually subject to price regulation. The role of pricing regulators is to set prices based on the most efficient use of resources.

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[22] Clive Hamilton and Richard Denniss, 'Generating emissions? The impact of microeconomic reform on the electricity industry' (2001) 20(3) *Journal of Applied Economics and Policy* 15, 24.
[23] Claire Thomas, 'Why national competition policy?'(1996) 55(2) *Australian Journal of Public Administration* 100, 100.
[24] Clive Hamilton and Richard Denniss, above n 22.
[25] The Treasury, *Commonwealth Competitive Neutrality Policy Statement*, (1996) 13-14.
[26] Note that the author has access to policy documents and manuals that may not be readily available to the broader community.

Looking at the electricity industry will enable a comparison between publicly and privately-owned entities. Also, since the electricity industry has its own pricing regulator, the Australian Energy Regulator (AER), this will eliminate any potential problems caused by differences arising as a result of differences between pricing regulators, as is the case in the water industry, where state-based pricing regulators regulate water utilities.

1.3.3 The National Tax Equivalent Regime (NTER)

As a result of the recommendations of The Hilmer Report, the Tax Equivalent Regime (TER) was introduced in the early to mid-1990s. The TER was introduced to ensure that government owned entities would be subject to paying tax equivalents. The TER was a Tax Equivalent Regime which was set and administered by each State, and which varied in its form and application from State to State – there was no one consistent method of application. Subsequently, in 2001, the National Tax Equivalent Regime (NTER) was introduced. Both regimes are still in operation and have the same objectives, being that they seek to tax government owned entities in the same or a similar manner that privately-owned entities are taxed, thereby removing any advantage that government owned entities had previously enjoyed by virtue of not having to pay any tax. Despite having the same objectives, they do have their differences. The NTER is administered nationally by the Australian Taxation Office and is based on the *Income Tax Assessment Act 1936* and *Income Tax Assessment Act 1997*. On the other hand, TERs use an Accounting Profit Model to derive the taxable income and subsequent tax payable and are administered by each State's Office of State Revenue.[27]

This section provides a brief background of how the National Tax Equivalent Regime (NTER) operates in practice.

The NTER is an administrative arrangement between the Federal and State governments under which the Federal income tax laws are notionally applied to selected government business entities owned by the State and Territories as if they were subject to those laws. This is done with the aim of achieving competitive neutrality. The resulting NTER tax is a liability owed and paid by these entities directly to the Owner State and Territory Governments – it does not form part of the

[27] New South Wales Treasury, *Tax Equivalent Regimes for Government Business*, (2003) 6.

actual Federal income tax base. Apart from some specific modification, NTER entities are treated in the same way as privately-owned corporations. For example, NTER entities are required to lodge income tax returns, make quarterly or monthly PAYG instalment payments, are subject to audit and/or other compliance assurance activities by the Australian Taxation Office, have the ability to seek private rulings and are subject to penalties and interest charges.[28] In order for an entity to be part of the NTER, the owner State or Territory must nominate the entity for inclusion into the NTER. Any government owned entities that are not subject to the NTER are automatically governed by their respective State's TER, unless an exemption from paying tax equivalent has been granted.

Any tax payments required to be made by the State-owned corporation as a result of tax obligations arising from the operation of the NTER are to be paid to the State Treasury of the State-owned corporation. The same State or Territory Treasury that benefits from the taxes paid by the NTER entity also owns that State-owned corporation. This means that the State-owned corporation pays both a tax and a dividend to its shareholder – the State or Territory Treasury. It could be argued that paying both tax and a dividend to the same entity is creating unnecessary administrative burdens.

1.3.4 The need for tax neutrality

Unfortunately, government owned corporations cannot be subject to an identical tax system as the private sector. For constitutional reasons[29], the only way to subject the government owned corporation to a tax system similar to the private sector is through the payment of tax equivalents instead of actual taxation. Tax equivalent payments should closely mirror the system under which the private sector pays taxes.[30] However, the tax system that governs tax equivalents will not exactly mirror that of the tax system that governs the payment of tax by the private sector. One might question whether the differences in the two systems have resulted in an advantage to either the private sector or the public sector. It has already been indicated that not all the advantages that come with government ownership can be removed through the

[28] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2.
[29] s. 114 of The Constitution. Note that examination of the Constitutional limitations is beyond the scope of this thesis.
[30] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12, 328.

introduction of a competition policy. This research will look at whether any advantages still exist, or whether there have been disadvantages to state-owned corporations through the operation of the NTER.

A concern relating to the implementation of competitive neutrality is that tax is not considered to play a significant enough role in competition policy and is mostly ignored or seen to be of lesser importance when compared to other tools which are used to achieve competitive neutrality. Freebairn believes that different taxation policy options are considered to be of secondary importance on competition.[31] Furthermore, when considering the taxation issue of public-private partnerships, Lehman and Tregoning believe that although tax is a large feature of regulation, it attracts very little consideration in most texts and studies on the matter.[32] Although tax is rarely the subject of any considered study, taxation can stand in the way of achieving social goals and infrastructure development.[33]

There is a benefit to having a tax neutrality regime in place. A study undertaken by Sadiq and Richardson compared tax-paying entities to charities. Charities are exempted from tax in Australia. It was found that some charities carry on commercial business activities that put them in direct competition with other taxpaying entities. Having a tax advantage enabled those charities to produce the same product as the taxpaying entities but at a lower cost, and not necessarily more efficiently. This compromised the consistency and integrity of the taxation regime.[34] In applying the results of this study to the tax neutrality of publicly owned corporations compared to privately owned corporations, one can conclude that the integrity of the taxation regime can also be considered compromised if public corporations are not taxed in at least a similar manner to privately owned corporations.

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[31] John Freebairn, 'Competition policy: Some neglected issues in the Hilmer report' (1996) 28(3) *The Australian Economic Review* 27, 36.
[32] Glen Lehman and Ian Tregoning, 'Public-private partnerships, taxation and a civil society' (2004) 15 *The Journal of Corporate Citizenship* 77, 79.
[33] Ibid.
[34] Kerrie Sadiq and Catherine Richardson, 'Tax concessions for charities: competitive neutrality, the tax base and "public goods" choice' (2011) *The University of Queensland* 127.

This research aims to examine whether the NTER has been effective[35], if and how it has altered the manner in which business is conducted within the NTER entities, and whether it has contributed to the goal of competitive neutrality. In addition to examining the NTER entities, comparison will also be made between NTER entities and private entities in the same industry. For example, comparing two electricity suppliers, one of which is in the NTER and the other which is privately owned; and comparing whether the NTER entity had to become more competitive and efficient as a result of the introduction of the NTER and the effect on the industry as a result of the introduction of the NTER.

1.3.5 Other considerations

1.3.5.1 Monopolies

It is believed that the mere threat of competition can result in improved efficiency.[36] This is the rationale for the inclusion of monopolies in competitive neutrality measures and the reason that monopolies are subject to tax equivalent regimes. There may be no room in the market for actual competition due to the nature of the industry; however, just having legislation that does not prevent any competition and leaves an opening for potential competitors to enter the market is enough to achieve competition goals.[37] Therefore, the threat of potential competition, no matter how unlikely, should lead to the monopoly becoming more efficient and, as such, result in lower prices.

1.3.5.2 Pricing regulators

State and industry differences can arise as a result of pricing regulators. Pricing regulators set the maximum price that a business can charge for its output. Price regulators usually operate in industries which are subject to a natural monopoly. The main reason for regulating prices in monopoly industries (for example, energy, water, railways) is to stop organisations in a monopoly market from abusing their

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[35] During the course of the research, the determination of what is "effective" or "not effective" will be undertaken by utilising the Productivity Commission's guidelines and a Cost versus Benefits analysis. The research will also consider efficiency according to any other methods discovered in additional reading for the literature review.

[36] Peter Collins, 'Public sector-private sector cooperation and competition as government prepares for the twenty-first century – The 1994 Spann oration' (1995) 54(1) *Australian Journal of Public Administration* 12, 16.

[37] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12, 327.

market power and thereby removing deadweight loss.[38] Deadweight loss, or allocative inefficiency, occurs when the marginal cost of each good does not equal the marginal benefit that consumers derive from that good. Throughout Australia, there is one national pricing regulator and several state pricing regulators. The process and method which is used to calculate the prices businesses can charge varies from regulator to regulator.[39] Therefore, when comparing an industry without its own price regulator, it can be expected that the price charged per unit of output can vary throughout the different States of Australia. This could advantage some entities over other equivalent entities in different States. This is further examined in chapter 6: Price regulation, the Tax Allowance and Actual Tax Payable.

1.3.5.3 State Treasuries and dividend policies

State Treasuries each set their own policies relating to the setting of dividends. The *Financial Distribution Policy* 'requires Government businesses to determine an appropriate distribution policy based on a 'modified' residual approach.'[40] Using this approach, a dividend "would be paid only if there were retained earnings left over after the firm has financed all investment projects capable of generating acceptable returns."[41] This policy enables Government businesses to agree on dividend targets and capital repayments.

This could impact the extent to which the NTER has achieved competitive neutrality given that, State-by-State, the approach to taxation might be different depending on how the dividend is calculated, or whether the entity can expect to receive any tax refunds due to it. For example, an entity might be more diligent in applying favourable tax positions if it paid a set dividend when compared to an entity that paid a dividend that was set as a percentage of post-tax profits. Also, if the State Treasury decided not to refund tax, an NTER entity might not be as driven to minimise tax beyond a certain point. This is discussed in further detail in section 4.3.1.

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[38] Darryl Biggar, 'The rationale for monopoly regulation: Why do we regulate monopolies?' (Paper presented at ACCC Annual Regulatory Conference, Surfers Paradise Marriott Resort, Gold Coast, Queensland, 24 July 2008) 4..
[39] Robert Breunig et al., 'Price regulation in Australia: How consistent has it been?' (2006) 82(256) *Economic Record* 67.
[40] New South Wales Treasury, *Financial Distribution Policy for Government Businesses (applies until 30 June 2010)*, (2007) 2.
[41] Ibid 9.

1.3.5.4 The Competition Policy Review

There have been many changes in the Australian economy and many technological and business advances since the Hilmer Report and the introduction of the National Competition Policy. The primary drivers of change in the Australian economy over the last twenty years have been:

- The growth of emerging economies, including Asia, which has provided new opportunities for Australian business to supply these growing markets;
- The aging population, which has seen a growth in health and aged care needs. Providing choice and a competitive health sector enables individuals to better meet their health care needs;
- Rapidly developing new technologies which existing competition policy does not adequately cover.[42]

At the time of the release of the Hilmer Report, global competition was new to Australia and technology was not as advanced. With the advances in technology and greater availability of information, competition policy and competition law needed to be reviewed and updated to reflect these changes.

On 4 December 2013, the Prime Minister and Minister for Small Business announced that there would be a review of the competition policy.[43] It had been twenty years since the Hilmer Report, and the Government decided that it was time to re-examine the role of competition in the economy and update the competition policy for all the changes that had occurred in the past twenty years. This review was referred to as a "Hilmer Mark II" review. The review was intended to be a "root and branch" review with the aim of examining current laws and the competition framework with the long-term view of increasing productivity and efficiency. It was hoped that the review would uncover means by which to improve the economy, create more jobs and encourage investment. It was hoped the result would be a rise in the living standards in Australia.

The review was led by Professor Ian Harper and supported by a Review Panel ("The Panel").

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[42] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 7.
[43] The Hon Bruce Billson MP, Minister for Small Business, 'Review of competition policy' (Media Release, 4 December 2013) http://bfb.ministers.treasury.gov.au/media-release/014-2013/

The Competition Policy Review Final Report was released on 31 March 2015. Elements of this report, which will be discussed in further detail in the following chapter, include:

- Competition policy
- The establishment of a new national competition body, the Australian Council for Competition Policy (ACCP)
- Competition payments
- Competitive neutrality
- Competitive neutrality complaints; and
- Infrastructure.

1.4 Significance

The research will add considered analysis to an area that has been in operation for over 15 years but has not, as yet, ever been the subject of any detailed analysis concerning its effectiveness. In the past, questions regarding the effectiveness of the NTER have been raised in Parliament, but no definite answer was able to be given. This research will be the first of its kind focusing on the NTER and will offer the Australian Taxation Office and State Treasury either reassurance that the system is working well, or it may highlight areas that need to be improved in order for the regime to achieve its goal of competitive neutrality.

Furthermore, this research adds considerable literature to the Australian Energy Regulator's (AER) review of the tax allowance and the tax paid. The AER commenced a review into why the regulated privatised electricity networks were paying less tax than the tax allowed by the AER in its pricing models, and why the state-owned electricity network businesses were paying more tax than allowed for by the AER in its tax allowance as part of its price determinations. Since this thesis examines whether the tax allowance could be a substitute to the tax equivalent regime, and closely examines the reasons for differences between tax paid and tax allowed by the price regulators, research conducted was used in submissions to the AER's Review of Regulatory Tax Approach. This is an area of current public policy debate at a time when electricity prices are at an all-time high. At the time of writing, this review is ongoing, and aspects of the comparison of tax paid to tax allowance will be an area for further research.

1.5 Research methods

Doctrinal research has been described as "research which provides a systematic exposition of the rules governing a particular legal category, analyses the relationship between the rules, explains areas of difficulty and, perhaps, predicts future developments."[44] McKerchar states that doctrinal research is most useful in determining the definition of a legal scenario in accordance with legal positivism.[45] Legal positivism involves identifying, analysing, organising and synthesising statutes, and decisions of the court as is required by "black letter of the law" research.[46]

This research was conducted using inductive legal reasoning based on doctrinal research. The research sought to examine data from primary sources which established the reasons for the decisions made around the implementation of the NTER, and then attempted to quantify the impact of these decisions.

The research used mixed methods and was both quantitative and qualitative, although doctrinal research is recognised as mainly comprising of qualitative research methods. The form of legal research undertaken in this thesis was based on inductive legal reasoning.[47] The research utilised both primary and secondary sources. Primary sources used comprise cases and legislation.[48] Secondary sources focused on scholarly works including textbooks, law journal articles, law reform publications, and legal encyclopaedias.[49] Government policies, procedures and working documents were also accessed and examined.

The qualitative research utilised submissions from the Competition Policy Review Issues Paper and Competition Policy Review Draft and Final reports, and the AER issues, submissions and draft papers. The use of these submissions aimed to obtain a better understanding of the differences in the behaviour of impacted entities and

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[44] Terry Hutchinson, *Researching and Writing in Law 3rd edn*, (Lawbook, 2010) 7.
[45] Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting*, (Thomson Reuters, 2010) 115.
[46] Pearce, et al. (1987) 309, Margaret McKerchar, *Design and Conduct of Research in Tax, Law and Accounting*, (Thomson Reuters, 2010) 73.
[47] McKerchar, above n 45.
[48] Bruce Bott and Ruth Talbot-Stokes, *Nemes and Coss' Effective Legal Research*, 4th Edn, (LexisNexis Butterworths, 2010) 113.
[49] Ibid 112.
Referencing used in the research will be as per the requirements of the AGLC Third Edition: http://mulr.law.unimelb.edu.au/go/aglc

differences in each entity's understanding about what competitive neutrality is, who should be subject to competitive neutrality measures and whether this has been achieved in practice.

The qualitative research involved an analysis of the NTER Manual. NTER Working Party meeting notes or circulars were accessed to provide additional data as to the administration and functionality of the regime. Traditional legal research methods were used to examine primary legal sources such as Parliamentary debates, legislation and decisions of Australian courts. Secondary sources including scholarly journal articles or scholarly books were also used.[50]

The quantitative component of the research utilised a number of case studies. These case studies dealt with comparisons between State Owned Corporations and privately-owned companies when in direct competition with each other. Additional case studies examined the effectiveness of other methods of achieving competitive neutrality and considered the tax allowance set by a price regulator in comparison to the tax paid by an organisation. Also, a specific number of NTER features (for example, the removal of pre-CGT provisions for NTER entities on their entry to the NTER) were examined and their impact quantified. Although the number of participants studied in case study 5.3: Comparison with NTER entity with their privately-owned counterparts was small, this was a good representation of the market and findings were supported in the case study in section 6.5: Comparison of tax paid by NTER entity with privately-owned entity. The findings were also consistent with those by the Australian Energy Regulator (AER) and PwC in the Regulatory Tax Review (refer to section 6.4.4). In that review, the AER and PwC had access to the data of more players in the market.

1.6 Chapter outline

Chapter 1 provides a brief introduction to the key issues and background of the research and outlines the objectives which will be answered throughout this thesis.

Chapter 2 is the first of the literature review chapters. It provides an outline and history of the National Tax Equivalent Regime (NTER). As part of this, it provides details of the market environment that resulted in the need for a national competition

[50] Ibid.

policy and the recommendations of the Hilmer Report. Further, the chapter covers the introduction of the National Competition Policy in Australia, and both benefits and criticism of the National Competition Policy and the Hilmer Report. In addition, the OECD recommendations about what constitutes a good competitive neutrality framework are also discussed.

Chapter 3 continues the discussion about competitive neutrality and defines competitive neutrality based on the Hilmer Report, the Competition Principles Agreement, the National Competition Policy, and State and Territory definitions. The chapter also considers who should be subject to competitive neutrality measures and provides a brief background to alternative tools available to achieve competitive neutrality, including corporatisation, commercialisation, cost reflective pricing and privatisation.

Chapter 4 moves from a discussion of competitive neutrality to focusing more specifically on the NTER, dividend policies relating to State and Territory Treasuries, and other matters relating to the taxation of the public sector. It considers specific features of the NTER which might advantage or disadvantage NTER entities. Chapter 4 also provides the first case studies of the thesis. The first case study considers instances where the ATO will stray from applying the tax law to the advantage of NTER entities. The second involves the treatment of capitalised labour and whether entities needed to amend prior year returns and pay any outstanding tax on the release of ATOIDs, outlining the correct tax treatment of this expense.

Chapter 5 examines different regulatory structures and compares NTER entities with their privately-owned counterparts. It considers different regulatory structures in the form of debt neutrality and privatisation. It looks at why state-owned businesses are required to borrow from their owner State or Territory Treasury where there are other financing options available in the market. It also quantifies the impact on financial ratios of classifying the gains made on the privatisation of Ausgrid and Transgrid in a tax neutral manner.

Chapter 5 also examines why tax was the policy used to achieve competitive neutrality, and considers monopolies and competition policy, and looks specifically at the water and electricity industries and how they operate in Australia. A further case study in chapter 5 considers whether tax neutrality can be abolished and instead

replaced with a larger dividend payment, thus removing the tax equivalent payments and replacing them instead with a larger dividend payment.

Lastly, chapter 5 compares NTER entities with their privately-owned counterparts and considers whether NTER entities do pay more tax than their privately-owned counterparts, and whether they are less efficient overall. These case studies rely on the financial statements, annual reports, and the tax transparency data available in reports released by the ATO each year.

Chapter 6 looks at price regulation, the tax allowance and tax payable. It examines the role of the price regulator in competitive neutrality, by setting prices it deems to be efficient for businesses operating in monopoly markets. It also looks at whether the tax allowance can be used in the place of the current tax equivalent regime. Further, this chapter looks at work currently undertaken by the Australian Energy Regular (AER) in comparing the tax allowance with the tax paid by regulated entities in the electricity network sector.

Lastly, chapter 7 provides a conclusion and outlines the limitations of the study, areas for further research, and recommendations resulting from this research.

2 An outline and history of the NTER and competitive neutrality

2.1 The need for a national competition policy

The federal government aims to create competitive markets wherever possible.[51] The perceived advantage of competitive markets is that they advocate efficiency and advance community well-being. Although this section presents the reasons competition is beneficial to the economy and the reasons for needing a national competition policy, creating a competitive market is not the solution in all circumstances. Instances where the introduction of a competitive market would be of limited value include those sectors which are subject to natural monopolies and those with a high level of research and development (R&D). The creation of a competitive market may be of little benefit in naturally occurring monopolistic markets. The reason for this is that the threat of any competition entering into the market is low due to the very nature of those industries. That is, a monopolistic market is characterised by high fixed upfront costs and smaller subsequent marginal costs which ensure that the market can be served for a lower cost by being serviced by only one organisation rather than by more than one organisation. A competitive market is of little value in a market that contains a high level of R&D activities, or any other significant externalities, as these externalities are un-priced by-products.[52]

The need for a competition policy was summarised by the then Chairman of the Trade Practices Commission, Professor Allan Fels, at a conference on the National Competition Policy, as follows:

- "Competition in markets for goods and services is a prerequisite for economic efficiency
- Markets left on their own very often achieve competitive outcomes
- But in many cases, market forces need to be supplemented by the active application or pro-competition policies

[51] National Competition Council, above n 6, xv–xvi and Terms of Reference, Annex A.
[52] Productivity Commission, *Review of National Competition Reforms*, Report No 33 (2005) 10.

- And that in certain other cases, competition can best be achieved by government withdrawal from markets, for example by deregulation, privatisation and by abolishing licensing provisions."[53]

However, the advantage of creating a competitive market over an administered market arrangement relates to the issue of efficiency. A competitive market provides an incentive to operate more efficiently, whereas an administered market arrangement does not.[54] A discussion of monopolies and their place in competitive neutrality will take place in a later section of this thesis, in section 5.2.1.

The economic concept of efficiency is a significant social goal as it aims to ensure maximum economic surplus.[55] Briefly, efficiency occurs when the allocation of resources achieves the maximum output possible. Competition policy plays a substantial role in encouraging efficiency, innovation and flexibility.[56]

The Hilmer Report[57] gave three main reasons for the need for a national competition policy. The first is that Australia largely operates as one national market where boundaries between the States and Territories are weakening with advancement in communication and transport. Secondly, certain markets have been sheltered from competition, for example, public utilities, some specific professions and sectors of the agriculture industry. Lastly, competition reforms have been implemented by sector, rather than there being a consistent national approach.

As noted in section 1.3, the need for a national competition policy arose because government-owned entities have advantages over their privately-owned counterparts. These advantages can include, for example: exemption from taxation and charges; government guarantee on debts; lower interest rates on loans; and no requirement to achieve a commercial rate of return on their assets.[58] Further advantages arising from government ownership can include cross-subsidisation, protection from bankruptcy, and favourable regulatory conditions.[59]

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[53] Professor Allan Fels, cited in John Kain, 'National Competition Policy: Overview and Assessment' (Research Paper No 1, Department of Parliamentary Library, Parliament of Australia, 1994) 3-4.
[54] Productivity Commission, *Review of National Competition Reforms*, Report No 33, above n 52.
[55] Bernanke, Olekalns and Frank, above n 4.
[56] Clarke and Corones, above n 5.
[57] National Competition Council, above n 6, xvii-xviii.
[58] National Competition Council, above n 6, 296.
[59] Hoque and Moll, above n 7.

It has been found that competitive neutrality becomes an issue for consideration where the following situations exist:

- There are differences between publicly and privately-owned organisations providing the same good or service;
- This difference occurs only as the result of the ownership of the organisation; and
- The difference results in either an advantage or disadvantage to the publicly owned organisation when supplying the good or service to the market.[60]

Where a government-owned entity enjoys a net advantage over its privately owned counterpart, it can set its prices below its private sector rival, even though the lower prices might not necessarily be reflective of any efficiencies in production.[61] This main advantage that public sector entities have over private sector entities could result in the government-owned entity being able to undercut private sector entities because of a reduced cost of production resulting from these advantages, and possibly to put up a barrier to entry for potential competitors.[62] In other words, the government-owned entity is able to use the advantages by virtue of its ownership to be able to price privately owned entities out of the market where those entities may have, in effect, been more efficient than the government-owned entity. This demonstrates an inefficient use of resources which could, potentially, be put to better use in the private sector.

The main competitive advantages that were targeted by the implementation of a national competition policy in Australia include:

- Transparency and accountability: this requires state-owned corporations to have the same level of disclosure to shareholders and directors as is required by the private sector.
- Taxation neutrality: this ensures that state-owned corporations and businesses are either subject to actual tax or tax equivalent payments,

[60] Department of Treasury and Finance South Australia, *A guide to the implementation of competitive neutrality policy*, (1998) 7.
[61] National Competition Council, above n 6, 297.
[62] The Treasury, *Australian Government National Competition Policy Report 2005-07*, above n 9, 46.

thereby being made to operate in the same or similar tax environment as is required by the private sector.

- Debt neutrality: this requires both the private and public sectors to be subject to the same debt financing costs.
- Rate of return neutrality: this requires the same rate of return on assets to cover the appropriate costs of the organisations so that publicly owned corporations are not able to undercut privately owned corporations (to be expanded in a later discussion).
- Regulatory neutrality: ensuring that the regulatory requirements and conditions are the same for all organisations, regardless of ownership.[63]

There are also disadvantages associated with being a government-owned entity. These disadvantages can include: greater accountability obligations; requirements to provide various community service obligations; and a greater superannuation expense.[64] Further disadvantages of government ownership can include government control over employee matters (including wages and industrial relations matters) and the management and running of the organisation.[65]

In order to create a level playing field and achieve competitive neutrality, the OECD recommends that the following steps be taken:

1. To take into account the way the business operates with the intention of increasing the possibility of creating a level playing field;
2. To make appropriate disclosure of commercial activities to regulators and the general public; and
3. To give special consideration to areas of non-neutrality.[66]

The difficulty in determining the best competitive neutrality measure for state-owned corporations is that they face multiple demands which are usually not a consideration for privately owned corporations. This entails having to operate efficiently and meet equity requirements, while at the same time being able to achieve and maintain social

[63] Matthew Rennie and Fiona Lindsay, OECD, *Competitive neutrality and state-owned enterprises in Australia: Review of practices and their relevance for other countries*, (2011) 41.
[64] National Competition Council, above n 6, 297.
[65] Hoque and Moll, above n 7.
[66] OECD, *Competitive neutrality: Maintaining a level playing field between public and private* business, (2012) 26.

welfare goals which might not meet the test of profitability. The efficiency goal considers the delicate balance between reaching a desired level of efficiency while at the same time limiting the amount of pressure on public funds to provide such a level of efficiency. Meanwhile, meeting equity targets involves guaranteeing widespread access to services by making losses or providing services to areas which may be unprofitable. Lastly, being able to separate the social welfare and developmental goals is important in order to be able to determine whether the state-owned corporation is meeting its performance targets.[67]

Further, the OECD (2011) argues that perhaps state-owned corporations are anti-competitive by design. Capobianco and Christiansen argue that the reason States have continued to own the organisations is due to those organisations having to perform differently to private organisations. As an example, the majority of industries with a natural monopoly continue to be held by the government.[68] This may not be entirely correct as a majority of water corporations in the United Kingdom are privately owned, and the last few years have seen a large number of state-owned infrastructure corporations privatised in Australia.

By requiring government businesses to be corporatised into State-owned enterprises (SOEs), the government must:

1. Specify the legal status, relationship with the government, regulatory frameworks and any exemptions or special treatment the entity will receive.
2. Make sure that the markets in which private and public companies compete are operating in a competitive environment which is equal to both sectors to avoid market distortions and inefficiencies.
3. Ensure a segregation between the State's role as owner of the SOE and other State responsibilities that influence the market conditions under which the SOE operates.[69]

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[67] Maria Vagliasindi, 'Governance arrangements for state owned enterprises' *World Bank Policy Research Working Paper 4542* (2008) 4-5.
[68] Antonio Capobianco and Hans Christiansen, *Competitive neutrality and state-owned enterprises: Challenges and policy options*, (2011) 7.
[69] Capobianco and Christiansen (2011) cited in OECD, *Competitive neutrality: Maintaining a level playing field between public and private* business, above n 66, 28.

A challenge of implementing a regime which tackles the difficulties presented by competitive neutrality is knowing that often State-owned organisations will need to depart from the competitive neutrality measures. The main reasons State-owned corporations need to depart from competitive neutrality measures are:

- In order to meet public service obligations
- To use the state-owned corporation as an instrument for industrial policy
- In order for the State to continue receiving a large cash flow from the organisation
- To respond to public pressure related to state-owned corporations.[70]

Prior to the introduction of the National Competition Policy (NCP) in Australia, there was no choice of electricity or gas providers, and consumers were often left with poor customer service. Also, Telstra held a monopoly over the telecommunications sector in Australia. There were supply restrictions and price control over consumer staples such as eggs, milk, rice and sugar; and retail trading hour restrictions and limited trading hours on weekends limited consumer shopping hours. Lastly, land conveyancing work could only be performed by lawyers prior to the introduction of the NCP.[71] This has changed since the introduction of the NCP, conveyancing work being able to be performed by, for example, qualified conveyancers who are not required by law to be lawyers. Although these are small items, which are outside the scope of this paper (the focus of this paper being infrastructure), it serves as an illustration as to how far-reaching the NCP was throughout the economy, having an impact on most sectors that reach the domestic consumer directly.

2.2 The need for tax neutrality

Government-owned corporations cannot be subject to the same tax system as the private sector.[72] The only way to subject the government-owned corporation to a tax system similar to the private sector is through the payment of tax equivalents instead of actual taxation. Tax equivalent payments should closely mirror the system under which the private sector pays taxes.[73] However, it can be appreciated that the tax regime that governs tax equivalents will not exactly mirror that of the tax regime that

[70] Ibid 22-23.
[71] Commonwealth of Australia, *Competition Policy Review Draft Report*, (2014) 11.
[72] s.114 of The Constitution.
[73] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12.

governs the payment of tax by the private sector. One could question whether the differences in the two systems have resulted in any advantages to either the private sector or the public sector. It has already been seen that not all the advantages that come with government ownership can be removed through the introduction of a competition policy. This research will look at whether any advantages still exist, or if there are any disadvantages.

Of concern is that tax is not considered to play a significant role in competition policy and is largely ignored or seen to be of lesser importance when compared to other tools which are used to achieve competitive neutrality. Freebairn believes that different taxation policy options are considered to be of secondary importance in competition policy.[74] Furthermore, when considering the taxation issues surrounding public-private partnerships, Lehman and Tregoning believe that although tax is a large feature of regulation, it attracts very little consideration in most texts and studies on the matter.[75] Although tax is rarely the subject of any considered study, taxation can stand in the way of achieving social goals and infrastructure development.[76]

Charities

There is a benefit to having a tax neutrality regime. A study undertaken by Sadiq and Richardson compared tax paying entities to charities. Registered charities are exempted from tax in Australia. It was found that some of these charities carry on commercial business activities that put them in direct competition with other taxpaying entities. Having a tax advantage enabled those charities to produce the same product as the taxpaying entities but at a lower cost, and not necessarily more efficiently. This compromised the consistency and integrity of the taxation regime.[77]

Phoenix trading

Phoenix trading is the practice of setting up a company with the intention of incurring debt, including taxes, and then winding up the company to avoid repaying that debt and the directors then setting up another company which acquires the assets

[74] Freebairn, above n 31.
[75] Lehman and Tregoning, above n 32.
[76] Ibid.
[77] Sadiq and Richardson, above n 34.

of the recently wound-up company and trades in a very similar manner. Phoenix trading abuses the limited liability available to directors of companies.[78] The Cole Royal Commission in 2003 found that phoenix trading in the building and construction industry is a significant issue. Phoenix trading results in competitive neutrality issues. By avoiding paying debts, companies engaged in phoenix trading have a competitive advantage over those which do not engage in that illegal practice.

There has been evidence of net tax tendering in the building and construction industry, where tenders are submitted without the inclusion of tax as part of the costs of delivering the tendered job because there is an intention to liquidate the company and thereby avoid paying the company tax.[79] In the building and construction industry, businesses which "play by the rules" are unable to compete with those businesses which engage in phoenix trading. It has been found that businesses which engage in phoenix trading as a way of avoiding payment of their tax liabilities have a 20% competitive advantage over those that do not.[80]

This example illustrates the competitive advantage that can be enjoyed by those who are able to avoid tax and illustrates why tax neutrality is important in all industries.

Competitive neutrality

In applying the results of this study to the tax neutrality of publicly owned corporations compared to privately owned corporations, one can conclude that the integrity of the taxation regime can also be considered compromised if public corporations are not taxed in at least a comparable manner to privately owned corporations.

However, there will be times when tax neutrality is either not an option or not achievable. In these circumstances, the OECD suggests considering the before and after-tax rate of return targets. For example, if a State-owned corporation is exempt from tax but is using an after-tax rate of return on its assets, it would be able to charge lower prices than its privately-owned counterparts, since the tax component

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[78] Murray Roach, 'Combating the phoenix phenomenon: An analysis of international approaches' (2010) 8(2) *eJournal of Tax* Research 90, 92.
[79] The Senate: Economics References Committee. *Insolvency in the Australian Construction industry*, (2015) 73.
[80] Wolters Kluwer, 'Combatting illegal phoenix activity with ASIC and the ATO' (Speech delivered at Combatting illegal phoenix activity webinar, 23 May 2018).

built into the after-tax rate of return would not be payable. In this circumstance, requiring the use of a before-tax rate of return puts both privately owned and publicly owned entities on equal footing, since there isn't an additional tax component (from which the publicly owned entity is exempt) in the target rate of return.[81] Using an after-tax rate of return on assets will give state-owned corporations an advantage. This is because an after-tax rate of return will include an inbuilt allowance for tax liabilities. Where a government-owned corporation pays no tax, this allowance will give that corporation an advantage over its privately-owned counterparts, since the government-owned corporation receives an allowance for a tax that it has not actually paid and one for which it is not liable to pay. However, if a before-tax rate of return is used to determine prices, both privately owned and publicly owned corporations are put on the same level playing field because a before-tax rate of return does not allow a state-owned corporation to recover a tax allowance where it is not liable for tax. As a result, a before-tax rate of return does not allow a state-owned corporation to set prices lower than privately owned corporations as a result of a tax allowance it does not and is not liable to pay.[82]

2.3 The Organisation for Economic Co-operation and Development (OECD) recommendations

In 2009, the OECD released a paper[83] relating to competitive neutrality principles and state-owned corporations and recommended that the best way to implement a competitive neutrality framework is by starting with an evaluation of current legislation and administration in which the State-owned enterprises operate, and then making changes that will attempt to have those entities operating in the same legislative and administrative environment as privately-owned entities. This is important in order to be able to compare the costs of the public and private sectors.

A competitive neutrality framework seeks to reform the economic setting in which privately and publicly owned organisations compete. The aim of introducing a competitive neutrality framework is to create an environment whereby all entities can compete on the same equal footing regardless of their ownership structure. A further

[81] OECD, *Competitive neutrality: Maintaining a level playing field between public and private* business, above n 66, 79.
[82] Ibid.
[83] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12.

aim of the competitive neutrality framework is for costs to be reported in such a way as to enable easy comparison of financial results between public and private sectors.[84]

The OECD (2012) recommends considering the following issues when addressing the question of whether and how to implement a competitive neutrality framework:

- *Levels of government*: When introducing a competitive neutrality framework, it needs to be decided which levels of government should be subject to those competitive neutrality measures. This means a decision needs to be made on whether to include national, regional and/or local governments in the competitive neutrality framework.

- *Commercial nature of the activity*: For an entity to be commercial in nature it needs to operate in a commercial manner and uphold the principles of commerciality.[85] This means that all social objectives that provide no profits, and sometimes even losses, need to be excluded from the competitive neutrality framework.

- *Actual/potential competitors*: It is not a requirement that there be actual competitors in the market in order for the competitive neutrality framework to be relevant. The importance is around there being no legislation which prohibits competitors or competition.[86] The industry in which an entity operates can sometimes exclude any real competition, however, so long as the legislation does not prohibit any potential competition from entering the market, and there is scope for that entity to have potential competitors at some time in the future.

- *Cost/benefit analysis*: The benefits of introducing a competitive neutrality framework must outweigh the costs of introducing the said framework. If there are to be substantial costs and change to administration for little benefit, the result would not be cost effective.[87] In this scenario, competitive

[84] Capobianco and Christiansen, above n 68, 11.
[85] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12, 327.
[86] Ibid.
[87] Ibid.

neutrality measures would not be introduced. There will be further discussion in following sections as to how this was done in Australia.

2.4 Competitive neutrality in Australia

The Hilmer Report[88] found that competition law alone would not address all the issues raised by the subject of competitive neutrality. The competitive neutrality policy aimed to address the issues that could not be covered by competition law. The policy is implemented by government policy agencies because:

- Competition law does not cover the topic of competitive neutrality. The *Competition and Consumer Act 2010* and its preceding *Trade Practices Act 1974* do not contain any provisions for competitive neutrality. Competitive neutrality falls under the Australian Treasury and has been developed and implemented within the government. It consists mainly of policies and inter-government agreements.

- The policy seeks to encourage and aid implementation while allowing for flexibility.

- The National Competition Council operates a complaint mechanism which includes the possibility of monetary fines for breaches of competitive neutrality.[89]

Hence the National Competition Council and Competitive Principles Agreement were put in place to fill the gap that was not covered by competition law. This view is supported by the OECD, which states that "many competitive neutrality issues would not be reached by competition law, either because the relevant government businesses do not have market power or the advantages they receive do not qualify as abuses covered by competition law."[90]

Hilmer considered whether competition law should cover all aspects of competitive neutrality, or whether to implement a system that relies on the co-operation of the States and Territories. The decision was made to rely on a more cooperative style.[91]

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[88] National Competition Council, above n 6.
[89] Capobianco and Christiansen, above n 68, 15.
[90] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12.
[91] John Kain, 'National Competition Policy: Overview and Assessment' (Research Paper No 1, Department of Parliamentary Library, Parliament of Australia, 1994) 26.

However, it was found that there was a need to implement some legislation to cover the field of competitive neutrality in order to achieve a "level playing field".[92] In the words of the Hilmer Report when considering the use of legal rules or cooperative approaches for the implementation of competitive neutrality:

"The Committee considered a range of possibilities in this area, including the development of a national law that prohibited government agencies from competing against private firms unless they met requirements based on the above principles. The Committee ultimately favoured a more cooperative approach, however, reflecting considerations of comity in a federal system as well as concerns that the threat of legal sanctions might deter desirable pro-competitive reforms."[93]

Most of the competitive neutrality measures concerning State-owned businesses were made via agreements between the States and the Commonwealth, for example, the Competition Principles Agreement made through the Council of Australian Governments (COAG) or via the use of regimes, for example, The National Tax Equivalent Regime. There is a heavy reliance on cooperation between the States and the Commonwealth for implementation and administration of the competitive neutrality policies.

The outline of competitive neutrality in Australia is further discussed in section 2.5, below.

2.5 Timeline of competition policy in Australia

This section serves to provide a brief timeline of events which occurred as part of the introduction of competition policy in Australia. It will provide a brief summary and map which will be a useful guide for the sections that follow.

Appendix 9.1 provides a diagrammatical timeline of the main events leading to the introduction of the NTER in mid-2001.

As outlined in Appendix 9.1, a Committee of Inquiry was first formed in October 1992, which was tasked with developing a national competition policy for Australia.

[92] Rennie and Lindsay, above n 63, 7.
[93] National Competition Council, above n 6, 307.

This Committee then released its "*National Competition Policy*" ('The Hilmer Report') in 1993.

Following on from the recommendations of The Hilmer Report, the States, through the Council of Australian Governments (COAG) went on to sign the Competition Principles Agreement ('CPA') in 1995. The CPA set out the aims of the competition principles but allowed each State to determine how and to whom to apply the competitive neutrality principles.

It was around this time, and in keeping with the objectives of The Hilmer Report, that the States each created their own Tax Equivalent Regimes ('TER's). The National Tax Equivalent Regime ('NTER') was then introduced in 2001 to nationalise the tax regime for certain elected government-owned entities. The entities which enter the NTER are nominated to do so by their State or Territory Treasury.

Given that there have been many changes in the Australian economy since the Hilmer Report and the introduction of the National Competition Policy in 1993, the Government decided to re-examine the role of competition in the economy and update the competition policy. The announcement to review the competition policy was made on 4 December 2013 by the Prime Minister and Minister for Small Business.

The Terms of Reference paper was released on 27 March 2014 by the Minister for Small Business. This was followed by an Issues Paper on 14 April 2014, which called for submissions by interested parties to be submitted by 10 June 2014.

The Competition Policy Review Draft Report was issued at the end of September 2014, with the Competition Policy Final Report released on 31 March 2015.

2.6 The background of the National Competition Policy

In October 1992, the then Prime Minister, Paul Keating, formed a Committee of Inquiry whose task it was to formulate a national competition policy. Headed by Professor Frederick Hilmer, *National Competition Policy* ('The Hilmer Report') was released in 1993.[94] The policy sought to implement a consistent national approach to

[94] National Competition Council, above n 6, v.

encourage greater competition in the Australian economy. One of the ways it sought to do this was by removal of any competitive advantage government-owned businesses might have over their private sector counterparts by way of tax advantages.[95]

The Hilmer Report (1993) made recommendations regarding the implementation of a national competition policy in Australia. At the time, it was hoped that the removal of any net advantages enjoyed by government-owned businesses, and the creation of a level playing field would result in a fairer market environment and improved efficiency and productivity.[96] The terms of reference of the report outline the four principles, as follows:

- No anti-competitive conduct is permitted if it is not in the public interest.
- If anti-competitive conduct is in the public interest, it should be able to be proved in a review and assessment.
- The same rules are to apply across the market, regardless of ownership.
- Any changes or amendments to the competition policy should:
    - remove unessential barriers to trade and competition with the aim of establishing open, integrated domestic markets, and
    - reduce complication and administrative duplication.[97]

The above principles formed the basis of the conclusions and recommendations of the Hilmer Report.[98]

2.7 The six recommended elements of a National Competition Policy

The Hilmer Report recommended six elements of a national competition policy, as follows:

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[95] Department of Treasury and Finance (Vic), *Guide to National Competition Policy*, above n 1, 3.
[96] Department of Treasury and Finance (Vic), *Competitive Neutrality Policy Victoria*, above n 16, 4.
[97] Robert Troedson, *Competition Policy: Hilmer, Governments and Business* (Background Information Brief No 30, Queensland Parliamentary Library, Parliament of Queensland, 1995) 4.
[98] Ibid.

1. Put restrictions in place which limit anti-competitive behaviour among organisations
2. Ensure that there are no restrictions on competition unless they are needed
3. Change publicly owned monopolies to create an environment that encourages competition
4. Open up avenues for third-party access to better enable a competitive environment
5. Discourage monopolistic pricing
6. Encourage "competitive neutrality" between privately and publicly owned corporations.[99]

To encourage the States and Territories to implement the competitive neutrality measures, the Australian Government introduced tranche payments. These payments were made to states and territories which had implemented the recommendations of the National Competition Policy. Payments in the first tranche in 1994-95 were $200 million. In the second tranche in 1999-2000, payments totalled $400 million. The third tranche in 2001-02 saw payments increased again to $600 million. These payments were ceased after 2005-06.[100]

When considering competitive neutrality, two important points need to be made here. Firstly, the introduction of competitive neutrality does not mean that all government-owned entities need to be privatised. Secondly, outsourcing of government operations is not required in order for an entity to comply with the competitive neutrality guidelines. The only thing that is required is that the government-owned corporations behave in a manner that is as competitive as the private sector.[101] Nor does the NCP recommend the abolition of community service obligations, the sale of public assets or the reduction of infrastructure services to rural and regional areas of Australia.[102]

[99] Ibid 6.
[100] National Competition Council, National Competition Policy *About the National Competition* Policy http://ncp.ncc.gov.au/pages/about.
[101] The Treasury, *Australian Government National Competition Policy Report 2005-07*, above n 9, 49.
[102] Productivity Commission, *Review of National Competition Reforms*, Report No 33, above n 52, 13.

2.8 Issues in implementation

A number of issues might arise during the implementation of competitive neutrality measures, including:

- "The determination of the appropriate rate of return on capital employed;
- The valuation of assets which will include the adoption of a deprival valuation methodology;
- The determination of the period for recovery of competitively neutral costs;
- The identification of the base for cost recovery; and
- The adoption of private sector pricing practices, including the adoption of practices recognising other than full cost only in the short term."[103]

Where an entity is subject to price regulation, most of these issues are addressed by the price regulator. This is discussed further in chapter 6: Price regulation, the Tax Allowance and Actual Tax Payable.

2.9 Benefits of the National Competition Policy and the Hilmer Report

The OECD has commented that Australia has the most comprehensive competitive neutrality framework in the world. This framework is supported by separate implementation and a complaints handling mechanism.[104]

In 2011, the OECD noted[105] that Australia's competitive neutrality policy has been a success because:

- it significantly developed the restructuring and improvement of government organisations in Australia;
- significant efficiency gains were realised when the competitive neutrality policy was implemented by large state-owned organisations; and

[103] Department of Treasury and Finance South Australia, above n 60, 5.
[104] OECD, *Competitive neutrality: Maintaining a level playing field between public and private* business, above n 66, 107.
[105] Capobianco and Christiansen, above n 68, 16.

- it was found that the introduction of a competitive neutrality policy in Australia considerably eradicated any advantages associated with government ownership.[106]

2.9.1 Lower prices

Hamilton and Denniss assert that one of the main aims of the National Competition Policy (NCP) is to produce goods and services at a lower cost, especially those goods and services produced by government-owned entities.[107] They argue that because public companies produce essential services that are then used by industry to produce other goods and services, it will automatically follow that a reduction in costs and improvement in efficiency of these public sector entities will have a flow-on effect and be of more significant benefit to the economy.[108] Hamilton and Denniss believe that the outcome of this will be an overall lower price for the final product, an increase in exports, and an increase in employment.[109]

The Productivity Commission conducted a study in 2005 which sought to quantify the benefits of the introduction of the NCP to that date. That study found that the introduction of the NCP resulted in lower prices, as follows:

- A reduction in electricity prices of 19% between the early 1990s and 2005.
- In the second half of the 1990s, rail freight charges fell by 8% for wheat and up to 42% for coal.
- A reduction in port charges by up to 50% throughout the 1990s.
- A reduction of greater than 20% in telecommunications charges since the mid-1990s.
- Since deregulation in 2000, the cost of milk had fallen by 5% between 2000 and 2005 notwithstanding an 11 cent per litre levy to finance an assistance package for farmers.[110]

However, the Productivity Commission also noted that it is not possible to attribute all these price reductions solely to the introduction of the NCP.[111] This means that it

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[106] Ibid.
[107] Clive Hamilton and Richard Denniss, above n 22.
[108] Thomas, above n 23.
[109] Clive Hamilton and Richard Denniss, above n 22.
[110] Productivity Commission, *Review of National Competition Reforms*, Report No 33, above n 52, XIX.
[111] Ibid.

is not possible to isolate the benefits derived by the introduction of the NCP, but rather to assume that the introduction of the NCP played a part in creating an economic environment where such price reductions were the outcome.

Although this study is not current, it is the only one of its kind that has sought to measure the impact of the introduction of the NCP. Subsequent studies have focused on specific areas and industries. Where relevant, these are discussed in future sections of this thesis. For example, since 2005, there has been a dramatic increase in electricity prices throughout Australia. This is covered in more detail in section 5.2.2.2: The electricity industry.

2.9.2 Efficiency

The implementation of regulatory reform under the National Competition Policy (NCP) has resulted in greater efficiency. This can be seen in the instance of pricing regulators. Pricing regulators set the maximum price a utility can charge for the goods or services based on the most efficient cost of providing that good or service, as determined by the pricing regulator.[112] The utility is then faced with the task of finding ways of lowering its cost of production to be as closely in line with the price determination as possible or otherwise risk making a loss.

The initial effect of the Hilmer Report on efficiency improvements has been demonstrated in the electricity industry. Findings on initial efficiency improvements resulting from the introduction of the NCP found that capital productivity, labour productivity, and total factor productivity have all improved by over 20% between the introduction of the NCP and 1999.[113] This figure reflects the early efficiencies gained as a result of the introduction of the NCP. Since this time, electricity prices have seen a dramatic increase. The electricity industry and the reasons for price increases in recent years are discussed in section 5.2.2.2: The electricity industry.

It has also been found that there has been an increase in output, and therefore a resultant increase in income, across regional Australia.[114]

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[112] Breunig et al, above n 39, 69.
[113] John Whiteman, 'The potential benefits of Hilmer and related reforms: Electricity supply' (1999) 32(1) *The Australian Economic Review* 17, 24.
[114] Productivity Commission, *Review of National Competition Reforms*, Report No 33, above n 52, XXI.

All these improvements in efficiency are believed to be due to the market changes as a result of the implementation of the NCP.

2.9.3 Economic performance

The Productivity Commission asserts that the introduction of the NCP has been paramount for Australia's strong economic performance. Vital economic improvements attributed to the NCP at the time of publication of that report include:

- Strong uninterrupted economic growth of over 13 years (at date of writing, it has been 27 years of strong uninterrupted economic growth);
- An increase in household income; and
- The lowest unemployment rate in three decades.[115]

The flow-on effect of this has been increased taxation revenue.[116]

2.9.4 Other benefits

Scales[117] found that there were four main benefits as a result of the introduction of the NCP. Firstly, the NCP has resulted in a stronger economy, with an increase in the GDP of 5.5% per annum[118], the creation of jobs, and an increase in wages. Furthermore, these benefits are extensive. Thirdly, the State and Federal government will see an increase in their revenue. And lastly, contribution to the reform will differ according to government hierarchy.[119]

The introduction of competition into the energy and telecommunications markets has provided consumers with a choice of supplier. This has improved products and services as the market players try to attract new customers and retain their existing customers.[120]

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[115] Ibid XVI-XVII.
[116] Ibid.
[117] Bill Scales, 'National competition policy' (1996) 55(2) *Australian Journal of Public Administration* 68, 71-2.
[118] Robert Troedson, *Competition Policy: Hilmer, Governments and Business* (Background Information Brief No 30, Queensland Parliamentary Library, Parliament of Queensland, 1995) 21; Bill Scales, 'National competition policy' (1996) 55(2) *Australian Journal of Public Administration* 68, 71-2.
Productivity Commission, above n 38.
[119] Scales, above n 117, 71-2.
[120] Productivity Commission, *Review of National Competition Reforms*, Report No 33, above n 52, XX-XXI.

Further benefits from the NCP include the more efficient use of water as a result of water reforms; and an increased return to producers as a result of decreased government control surrounding the marketing of lamb and grain.[121]

The NCP was implemented on a national scale and sought to provide a consistent approach to competition.[122] This has, therefore, fostered greater cooperation between the State governments.[123]

Although there have been transitional costs, it has largely been found that the benefits the NCP has produced have outweighed the costs of implementation. Furthermore, most of the costs of implementation have now been incurred, whereas the benefits of the NCP will be ongoing.[124]

2.10 Criticisms of the National Competition Policy

Although the introduction of the NCP has delivered many benefits to the economy, some researchers argue that there have also been a number of disadvantages or omissions from the NCP.

Firstly, although the aim of introducing the NCP was to remove any competitive advantage public entities might have over private entities, the Queensland Department of Treasury argues that the introduction of the NCP will not remove all the advantages that publicly owned entities enjoy.[125]

Furthermore, although the CPA states that "competition policy is not about maximising competition per se, but about using competition to improve the community's living standards and employment opportunities,"[126] Hess and Adams argue that, in the search for cost efficiency, the NCP has failed to consider the role of

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[121] Ibid XXI.
[122] Stephen P. King, 'National competition policy' (1997) 73(222) *Economic Record* 270, 282; Peter Collins, 'Public sector-private sector cooperation and competition as government prepares for the twenty-first century – The 1994 Spann oration' (1995) 54(1) *Australian Journal of Public Administration* 12, 16.
[123] Catherine Althaus, 'National competition policy: Progress and prospects' (1996) 55(2) *Australian Journal of Public Administration* 65.
[124] Productivity Commission, *Review of National Competition Reforms*, Report No 33, above n 52, XXIII.
[125] Queensland Department of Treasury, cited in Zahirul Hoque and Jodie Moll, 'Public sector reform: Implications for accounting, accountability and performance of state-owned entities – an Australian perspective' (2001) 14(4) *The International Journal of Public Sector Management* 304, 314.
[126] *Competition Principles Agreement*, signed 25 February 1994, (entered into force 11 April 1995) 4.

public interest.[127] The NCP contains no policies to improve or maintain social outcomes.[128] The Hilmer Review, whose recommendations resulted in the creation of the NCP, also did not consider the public interest, instead considering driving economic efficiency as being the main means of achieving public interest. However, the Committee accepted that circumstances would arise which would require disregarding competition and efficiency goals in favour of other community objectives.[129]

Hess and Adams believe that practical problems disregarded in the introduction and implementation of the NCP include:

- unclear scope;
- a need to expand the skillset to understand competition and NCP requirements; and
- the public benefits tests contain policy and implementation deficiencies.[130]

This would suggest that the NCP is limited in what it can reasonably achieve and perhaps other alternatives that can contribute to the goals need to be considered.

2.11 Criticisms of the Hilmer Report

2.11.1 Economics

Although the subject of economics in general is outside the scope of this thesis, a discussion of the principles that underpin the Hilmer Report is necessary. This is because it has been argued that the Hilmer Report was built around economic theories that do not exist in practice.

The economic theory of second best holds that all the elements required in order to maintain equilibrium in a market cannot occur at the one time. The second-best equilibrium is what results when market imperfections are present. In the context of the national competition policy, this means that it is incorrect to assume that an

[127] Michael Hess and David Adams, 'National Competition Policy and (the) public interest' (Research Paper No 3, National Centre for Development Studies, ANU, 1999) 4.
[128] Ibid 3.
[129] Kain, above n 91, iv.
[130] Hess and Adams, above n 127, 4.

increase in competition will result in an increase in welfare because the market is not perfect.[131]

A further criticism of the Hilmer Report surrounds its use of economic models. Economic models are used to estimate the outcome of making policy changes. The use of these economic models involves a number of assumptions that do not exist in the real world. It is argued that these models should not be used as the basis for setting government policy.[132] The models used by Hilmer Report made a number of assumptions as a basis for setting national competition policy. The concern is that the Hilmer Report cannot be assumed to make correct conclusions as the assumptions in its economic models are simplified and incomplete.[133] One cannot rely on an economic model to provide certainty in an unknown situation.[134] This means that while, in theory, the recommendations of the Hilmer Report would work, in practice this may not be the case because the recommendations of the Hilmer Report were designed for a perfect world but are operating in an imperfect world.

This is further considered in discussions of the economic theory of perfect competition. Perfect competition holds that the more competition there is in the market, the closer the prices will be to marginal cost. This, therefore, results in greater efficiency in the allocation of resources. However, because the market is not perfectly competitive, all the participants need to be made perfectly competitive in order for this theory to work in practice.[135] Limitations to the operation of perfect competition in this environment have been identified as industry structures (monopoly, oligopoly, duopoly[136]), taxes, and too much competition.[137] This is of concern in regard to the Hilmer Report as it was based only around models of perfect competition. The recommendations, therefore, need to be tested to determine whether what was proposed has worked in practice. The relevance of the above discussion is

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[131] Clive Hamilton and Richard Denniss, above n 22, 25; Maddock cited in Ted Kolsen, 'Microeconomic reform and national competition policy: Misconceptions and problems' (1996) 55(2) *Australian Journal of Public Administration* 83, 85.
[132] Ted Kolsen, 'Microeconomic reform and national competition policy: Misconceptions and problems' (1996) 55(2) *Australian Journal of Public Administration* 83, 84.
[133] Scales, above n 117, 71.
[134] Ibid.
[135] Kolsen, above n 132, 85.
[136] In a monopoly, one player controls the market. In an oligopoly, there are a small number of competitors in the market. In a duopoly, only two players control the market.
[137] Kolsen, above n 132, 83.

that the thesis will look at whether the assumptions of the Hilmer Report in regard to tax neutrality worked in practice.

2.11.2 Community Service Obligations (CSOs)

Of importance in implementing competitive neutrality and encouraging commercialisation are issues of full cost pricing; how community service obligations (CSOs) are accounted for; and the removal of inconsistencies that arise as a result of government ownership.[138]

CSOs are those activities that, under normal business circumstances, an organisation would choose not to provide, or would provide at a much higher cost to the consumer because they are deemed uncommercial. However, because the public sector provides services deemed to be essential to society, these services need to be provided regardless of whether the decision to provide them makes commercial sense.[139] Under the Hilmer Report, these subsidised CSOs do not need to be removed for the purpose of determining competitive neutrality.[140] This could put the government-owned corporations at a disadvantage when compared to privately owned corporations.

2.11.3 Other Hilmer Report concerns

In addition to the above criticisms and concerns, another concern is that the model proposed in the Hilmer Report will be of benefit to the Commonwealth at the expense of the States.[141] It relies greatly on co-operation between the Federal and State/Territory Governments, and a willingness from the States and Territories to sacrifice sovereignty in economic activities for the national good.[142] Lehman and Tregoning point out that this structure does not exist in the United Kingdom and, as such, this has led to a more lenient view towards tax minimisation.[143]

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[138] Local Govt Finance Std 1994, cited in Zahirul Hoque and Jodie Moll, 'Public sector reform: Implications for accounting, accountability and performance of state-owned entities – an Australian perspective' (2001) 14(4) *The International Journal of Public Sector Management* 304, 312.
[139] The Treasury, *Australian Government National Competition Policy Report 2005-07*, above n 9, 50.
[140] Scales, above n 117, 71.
[141] Peter Collins, 'Public sector-private sector cooperation and competition as government prepares for the twenty-first century – The 1994 Spann oration' (1995) 54(1) *Australian Journal of Public Administration* 12, 12. Bill Scales, 'National competition policy' (1996) 55(2) *Australian Journal of Public Administration* 68, 68.
[142] Kain, above n 91, iv.
[143] Lehman and Tregoning, above n 32, 85.

A further concern is that the Hilmer Report has provided a "one shoe fits all" approach. This is a problem when applying the "one shoe fits all" approach to different industries. There is an argument that there should be industry-specific regulation rather than applying the same simplified rules to all industries.[144] This has ended up being the case with price regulation for some industries. This issue will be covered in 'The electricity industry' section 5.2.2.2.

Lastly, a weakness of the Hilmer Review is its strong focus on domestic issues at the expense of considering the global market of which Australia is also a player.[145] This became a major issue in the time since the Hilmer Review was released, and was one of the reasons for the 2013 review of the competition policy (refer to section 2.14).

2.11.4 Criticisms of efficiency

Costs need to be measured on an equivalent basis in order to determine which entity has the lowest cost of production. The allocation of resources to the corporation that does not have the lowest cost of production would be an inefficient allocation of resources, regardless of whether the corporation was publicly or privately owned.[146] This underpins the reason for the introduction of the concept of a level playing field – that an adequate and reasonably accurate comparison can be made in order to determine the most efficient, and therefore most reasonably priced, goods and services.

Hamilton and Denniss believe that "debate about what is 'efficient' in Australia has been confused by discussion of what is competitive, and when market failure exists this will result in policy failure".[147] This suggests that an increase in competition does not necessarily mean an equivalent increase in efficiency. In particular, when considering environmental issues, an increase in efficiency is not necessarily a good thing as it has resulted in an increase in additional greenhouse emissions. This will be discussed further below.

2.11.5 Environmental issues

Hamilton and Denniss argue that a big concern of the introduction of the competition policy has resulted in a substantial increase in greenhouse gas emissions in the

[144] Kolsen, above n 132, 86.
[145] Kain, above n 91, iv.
[146] The Treasury, *Australian Government National Competition Policy Report 2005-07*, above n 9, 46.
[147] Clive Hamilton and Richard Denniss, above n 22, 17.

electricity sector. They maintain that while competition policy involves the setting of an economic environment that allows for the lowest prices, the economic tools used to combat environmental issues are through the raising of prices. This means that the two objectives are incompatible. They maintain that the environmental impact has not been taken into account in determining main objectives of the NCP (being to lower costs and increase efficiency).[148] This view is supported by Kain, who states that the Hilmer Review "pays scant regard to the non-pecuniary social costs of economic growth such as environmental degradation and increased traffic accidents, yet these are legitimate economic costs which should figure prominently in any concept of the 'public interest'."[149]

This example illustrates that the market is not perfect and that there are concerns that the National Competition Policy is having undesired effects in some situations. Although the main reason for the introduction of the NCP has been to achieve the best level of efficiency in the market, and therefore the lowest possible prices, there are times when this is not the best outcome. Particularly when it comes to environmental issues, higher prices can produce the best outcomes of achieving a consumer's most efficient use of resources, in this case electricity. This can be seen in the discussion on electricity prices in section 5.2.2.2.1 where South Australia has higher electricity prices because its electricity is generated using "greener" methods.[150]

2.12 Tax neutrality in Australia

Under the Australian Competitive Neutrality Guidelines, there are three methods of achieving tax neutrality in Australia. The first involves government owned businesses paying actual tax. Many government owned businesses are already separate legal entities which pay Commonwealth and State taxes. The second method of achieving tax neutrality is through a taxation equivalent regime. This method involves calculating a tax liability according to current taxation legislation and making tax equivalent payments to the Official Public Account. This is explained further in the following section. The third method of achieving tax neutrality is

[148] Ibid 15.
[149] Kain, above n 91, iv.
[150] However, discussion about the carbon tax and environmental impact is outside the scope of this thesis.

through making tax neutrality adjustments. This method involves calculating tax as though it were payable, but no actual physical tax payment is made.[151] This third method, the Tax Neutrality Adjustment (TNA) method, is to be considered only when determining a pricing strategy. It is to apply to baseline costing for public sector bids.[152] This thesis will examine mainly the second method – achieving competitive neutrality using a tax equivalent regime.

2.13 The National Tax Equivalent Regime (NTER)

As a result of the recommendations of The Hilmer Report, the Tax Equivalent Regime (TER) was introduced. The TER was introduced to ensure that government owned entities were subject to paying tax equivalents. TERs use an Accounting Profit Model to derive the taxable income and subsequent tax payable and are administered by each State's Office of State Revenue.[153] The Accounting Profit Model requires the government business to make tax equivalent payments equal to applying the company tax rate to the accounting profit. It does not consider the complexities of the tax system and tax legislation and does not require adjustment for tax to accounting differences. In addition, TERs are administered by each State.

A number of years later, in 2001, the National Tax Equivalent Regime (NTER) was introduced. Whilst both regimes are still in operation and have the same objectives, being that they sought to tax government owned entities in the same or a similar manner that privately-owned entities are taxed, thereby removing any advantage that government owned entities had previously enjoyed by virtue of not having to pay any tax, they do have their differences. The NTER is administered nationally by the Australian Taxation Office and is based on the *Income Tax Assessment Act 1936* and *Income Tax Assessment Act 1997*.

The NTER is an administrative arrangement between the Federal and State governments under which the Federal income tax laws are notionally applied to selected government business entities owned by the States and Territories as if they were subject to those laws. This is done with the aim of achieving competitive

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[151] Australian Government, Competitive Neutrality – Guidelines for Managers (2004) cited in OECD, *Competitive neutrality: Maintaining a level playing field between public and private business,* (2012).
[152] The Treasury, Department of Finance and Administration. *Australian Government competitive neutrality guidelines for managers*, (2004), 18-19.
[153] New South Wales Treasury, *Tax Equivalent Regimes for Government Business*, above n 27.

neutrality. The resulting NTER tax is a liability owed and paid by these entities directly to the Owner State and Territory Governments – it does not form part of the actual Federal income tax base. Apart from some specific modification, NTER entities are treated in the same way as privately-owned corporations. For example, NTER entities are required to lodge income tax returns, make quarterly or monthly PAYG instalment payments, are subject to audit and/or other compliance assurance activities by the Australian Taxation Office, have the ability to seek private rulings and are subject to penalties and interest charges.[154] In order for an entity to be part of the NTER, the owner State or Territory must nominate the entity for inclusion into the NTER. Any government owned entities that are not subject to the NTER are automatically governed by their respective State's TER, unless an exemption from paying tax equivalent has been granted.

2.14 The Competition Policy Review

There have been many changes in the Australian economy since the Hilmer Report and the introduction of the National Competition Policy. At the time of the release of the Hilmer Report, global competition was fairly new to Australia and technology was not as advanced. With the advances in technology and greater availability of information, competition policy and law needed to be updated to reflect these changes. Competition policy and law needs to be adaptable to new products entering the market and also to new methods of distribution and not stand in the way of new sources of competition.[155]

On 4 December 2013, the Prime Minister and Minister for Small Business announced that there would be a review of the competition policy. It had been twenty years since the Hilmer Report and the Government felt that it was time to re-examine the role of competition in the economy and update the competition policy for all the changes that had occurred over the past twenty years. This review has been referred to as a "Hilmer Mark II" review. The review was intended to be a "root and branch" review with the aim of examining current laws and the competition framework with the intention to increase productivity and efficiency. It was hoped that the review

[154] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 6.
[155] Professor Ian Harper, 'Key issues for the Competition Policy Review' (Speech delivered at the University of New South Wales, 6 August 2014).

would uncover a means by which to improve the economy, create more jobs and encourage investment. The ultimate outcome was hoped to result in a rise in the living standards in Australia.

The review was led by Professor Ian Harper and was supported by a Review Panel ("The Panel").

The Terms of Reference paper was released on 27 March 2014 by the Minister for Small Business. This was closely followed by an Issues Paper on 14 April 2014. This paper sought submissions by interested parties by 10 June 2014.

The Draft Report was issued at the end of September 2014, with the Final Report released on 31 March 2015.

The aim of the review was not to formulate an entirely new competition policy, but rather to revive the competition reform that had waned somewhat over the previous decade.[156]

The Review Panel concentrated on three principal areas. Firstly, the panel was concerned with examining the unfinished remaining National Competition Policy reforms. In particular the panel considered areas in which competition can be applied further. Secondly, the Review Panel examined institutional and governance arrangements. This was done with the intention of directing the path of the reform for the next twenty years. Lastly, the Panel focused on competition law and whether it was adequate for the required objectives.[157]

The Competition Review Final Report highlighted three main drivers of change in the future. The first is the industrialisation of developing nations, the rise of Asia and the expanding middle class in Asia. The second is the ageing Australian population. Lastly, the effect digital technology has on the economy has been identified as a major driver of change in the future.[158]

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[156] Stephen P. King, 'Competition Policy and the Competition Policy Review' (2015) 48(4) *The Australian Economic Review* 402, 403.
[157] Prof Ian Harper, 'Key issues for the Competition Policy Review', above n 155.
[158] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 20.

The Issues Paper sought submissions from interested parties and the general public. The Paper discussed competitive neutrality and asked the following questions of those who chose to respond:

- "Does competitive neutrality policy function effectively, and does it apply to the appropriate government business activities?
- Has the method of implementing competitive neutrality principles improved competition and productivity?
- What are the disadvantages that private businesses face when competing with government business activities?
- Could the mechanism for dealing with competitive neutrality complaints be improved?"

The top five issues raised in the submissions were competition law, competitive neutrality, misuse of market power, small business concerns, and the operation of the ACCC.[159]

The top five issues identified in the final report were misuse of market power, retail trading hours, road transport, planning and zoning, and supermarkets.[160]

A number of the recurring themes in the submission made by interested parties will be discussed below.

2.14.1 Competitive neutrality complaints

The comments around competitive neutrality complaints fell into four main areas:

- The lack of incentive for compliance with the removal of the tranche payments.
- The lack of a formal requirement to enforce any competitive neutrality complaint recommendations.
- No enforcement outcomes for those who choose not to comply with the competitive neutrality recommendations resulting from an investigation into a competitive neutrality complaint.

[159] Commonwealth of Australia, *Competition Policy Review Draft Report*, above n 71, 1.
[160] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 1.

- No uniform agreed upon method of treating complaints across the States – each State has in place its own rules on dealing with competitive neutrality complaints.

These common themes formed part of the submissions from a number of organisations, including the Australian Chamber of Commerce and Industry, the Business Council of Australia, the Productivity Commission, the Law Council of Australia – Business Law Section, the Chamber of Commerce and Industry in Queensland and the Australian Competition and Consumer Commission.

2.14.2 Submissions about the NTER

The Water Services Association of Australia (WSAA) discussed the NTER in their submission to the review.[161] They submit that the NTER has been largely successful and outline that, because of the introduction of the NTER, each respective State government receives two streams of payment – one resulting from a dividend payment from the State-owned corporation (SOC) to the State, and the other from NTER tax equivalent payments to the State.

However, as a result of privatisation, the State stops receiving the NTER tax equivalent payments as the tax payments after privatisation are no longer tax equivalent payments and become "real" tax payments to the Federal government once an entity is privatised. Once privatised, the state forgoes the tax equivalents that were received from the SOC when it was under State ownership and, as a result, loses an income stream.

WSAA argues that the loss of the income stream reduces the incentive for State governments to privatise and recommends that tax payments by privatised entities should continue to be made to the State.[162] This view was first mentioned in a report by the Productivity Commission on Public Infrastructure.[163] This will be further expanded in section 5.1.2.2.

[161] Water Services Association of Australia, Submission to The Treasury, *Competition Policy Review*, 10 June 2014.
[162] Ibid 22.
[163] Productivity Commission, *Public Infrastructure*, Inquiry report, No. 71, May 2014, 260.

Further, WSAA reasons that there is no loss of value associated with privatisation – that the taxation income stream is transferred from the State government to the Federal government.[164]

This author argues that this is incorrect. Various elections, especially around the tax depreciation of assets at the time of privatisation, can result in a large difference in tax deductions claimed, and as such, result in a much lower tax income stream, particularly where the entity being privatised has a large asset base, which is often the case in government businesses, especially infrastructure. In addition, tax structuring is available to privately owned organisations which is not available to NTER entities, enabling privately owned organisations to legally minimise their tax in ways that are not available to NTER entities. This would also reduce the tax revenue collected from privatised entities, as will be demonstrated later in case studies comparing tax paid by state-owned and privately-owned organisations.

2.14.3 Who should be subject to competitive neutrality measures

Competitive neutrality measures should apply to significant government businesses only where the benefits of applying the measures outweigh the costs involved. However, the threshold for what is considered a 'significant' business activity varies across the states.[165]

> **"Box 13.1: Significant government business activity**
> The Australian Government Competitive Neutrality Complaints Office asks two questions to
> determine whether government entities are operating a significant business activity.390
> **Question 1: Is the entity conducting a business?**
> a) Does it charge for goods or services (not necessarily to the final consumer)?
> b) Is there an actual or potential competitor (either in the private or public sector), noting that
> purchasers are not to be restricted by law or policy from choosing alternative sources of
> supply?
> c) Do managers of the activity have a degree of independence in relation to the production or
> supply of the good or service *and* the price at which it is provided?
> If the answer is yes to all these questions, then the entity is conducting a business.
> **Question 2: Is the business significant?**
> The following business activities are automatically considered significant for the purposes of

[164] Water Services Association of Australia, above n 161, 22.
[165] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 256.

competitive neutrality policy:
• all government business enterprises and their subsidiaries;
• all Australian Government companies;
• all business units;
• baseline costing for activities undertaken for market-testing purposes;
• public sector bids over $10 million; and
• other government business activities undertaken by prescribed agencies or departments
with a commercial turnover of at least $10 million per annum.
Competitive neutrality arrangements apply to significant business activities but only to the extent
that the benefits of the arrangements to the community outweigh the costs."[166]

This definition creates a problem where government business activities are not considered to be significant, but are still in competition with the private sector. This is discussed in section 2.15.4: Competitive neutrality.

2.15 The Competition Policy Review Final Report

The Competition Policy Review Draft Report was released on 22 September 2014. Submissions to this Draft Report were due back to the Panel by 17 November 2014. The Competition Policy Review Final Report was released on 31 March 2015. This section will discuss the sections of that report which are relevant only to competitive neutrality.

2.15.1 Competition policy

Competition policy has traditionally mainly applied to public monopolies and government businesses. The Panel believes that competition policy should not be limited to just these sections of government, but rather should apply to all government services.[167] The government services targeted by this recommendation include all areas of government which might be in competition with the private sector. For example, health and education[168], and human services[169]. In addition to expanding the scope of competition policy to include government services, the Panel also believes that competition policy should also continue to apply to local government.[170]

[166] Extracted from Commonwealth of Australia, *Competition Policy Review Final Report*, (2015) 256.
[167] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 31.
[168] Ibid 24.
[169] Ibid 31.
[170] Ibid 32.

Restrictions to competition should be introduced only where they are in the public interest; and only if the costs outweigh the benefits of introducing competition policy.[171]

The Panel recommends that the following principles should be applied when implementing competition policy:

- "Competition policies, laws and institutions should promote the long-term interests of consumers.
- Legislative frameworks and government policies binding the public or private sectors should not restrict competition;
- Governments should promote consumer choice when funding or providing goods and services and enable informed choices by consumers;
- The model for government provision of goods and services should separate funding, regulation and service provision, and should encourage a diversity of providers;
- Governments should separate remaining public monopolies from competitive service elements, and also separate contestable elements into smaller independent business activities;
- Government business activities that compete with private provision, whether for-profit or not-for-profit, should comply with competitive neutrality principles to ensure they do not enjoy a net competitive advantage simply as a result of government ownership;
- A right to third-party access to significant bottleneck infrastructure should be granted where it would promote a material increase in competition in dependent markets and would promote the public interest; and
- Independent authorities should set, administer or oversee prices for natural monopoly infrastructure providers."[172]

The Panel recommends allowing jurisdictions the flexibility to implement policies based on the above principles as they see fit.[173]

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[171] Ibid.
[172] Ibid 99.
[173] Ibid 98.

2.15.2 A new National Competition Body

The Panel recommended that the National Competition Council should be abolished and a new national competition body, named the Australian Council for Competition Policy (ACCP), should be established. The role of the ACCP would be to provide leadership and aid in implementation of the competition policy.[174] The panel will be formed by an inter-governmental agreement, which will outline the process for appointing members, and the scope of the functions of the ACCP. It will be overseen by a Ministerial Council, and will be accountable to all the jurisdictions. The members' goal is to take into account how the competition policy will apply nationally rather than campaigning for the issues that affect their own jurisdictions. Member responsibilities are to be allocated to Treasurers.[175] Funding for the ACCP will come from the Commonwealth, States and Territories.[176]

The ACCP should:

- Promote and educate about the competition policy.
- Monitor the progress of the implementation of the agreed reforms and provide an annual report on the progress of this implementation.
- Find areas where competition could possibly be improved in all of government.
- Advise the government on regulatory matters and market strategy, for example privatisation.
- Research new developments in competition policy, both within Australia and internationally.
- Implement ex-post assessment of merger decisions[177]

The ACCP will take the role of advocator, which often falls by default on the ACCC. This recommendation will see the role of advocator being removed from the ACCC and will occupy the main purpose of the ACCP.[178] The ACCP will also have an

[174] Ibid 76.
[175] Ibid.
[176] Ibid.
[177] Ibid 77.
[178] Ibid 76.

advisory role as it seeks to advise governments on changes and how to adapt the competition policy accordingly.[179]

2.15.3 Competition payments

As part of Recommendation 48, the Productivity Commission will be required to research the effect of the reforms on revenue. If the effect of the implementation of these reforms is inconsistent across the jurisdictions, the Panel recommends the reintroduction of competition policy payments to ensure that the benefits are flowing to those earning them.[180]

2.15.4 Competitive neutrality

It has been over a decade since some jurisdictions have updated their competitive neutrality policy statements. The Australian Government's competitive neutrality policy statement was last revised in 1996.[181] As such, the Panel recommends that a review and update of competitive neutrality policies is required. In addition, there is also scope to improve the guidelines regarding competitive neutrality when applied to the commencement of government business and the timeframe allowed before which the government business begins to earn a commercial rate of return.[182]

An additional review of the conditions used to define significant business activities is also required.[183] As discussed in section 3.1.8: Definition of Government Commercial Entity and section 2.14.3: Who should be subject to competitive neutrality measures, it can be seen that the definition of what constitutes a government commercial entity is not consistent across the States. It is hoped that this Competition Policy Review will allow for a clearer and more consistent approach. However, it is not merely the significance of the business activities which should qualify it for competitive neutrality measures. There have been instances where the government activities would not qualify as significant, but these activities cause problems for small business wanting to compete against them.[184] Examples of this include:

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[179] Ibid.
[180] Ibid 79.
[181] Ibid 264.
[182] Ibid 50.
[183] Ibid.
[184] Commonwealth of Australia, *Competition Policy Review Draft Report*, above n 71, 175.

- Instances where local councils have charged for waste collection through council rates, thereby blocking the private sector from being able to compete at lower prices, more services and more choice for ratepayers.[185]
- Where local councils compete with private businesses in the field of child care centres, aged care facilities and gyms.[186]
- Local councils which provide free access to council grounds for use by motorhomes, which makes it difficult for local caravan parks to compete with the free access the council is providing.[187]

The Panel believes that it is possible that some of the above complaints fall outside the current policy, for example, if the government activity does not meet the current definition of a significant government business.[188] However, this problem can be remedied by applying the full-cost pricing principles.[189]

Although each State will still be enabled to adopt its own approach to competitive neutrality, the Panel hopes that through improved transparency by public reporting on compliance with the competitive neutrality policy and complaints handling, the States will be able to determine best practice in regard to competitive neutrality policies.[190]

2.15.5 Competitive neutrality complaints

The number of competitive neutrality complaints has fallen drastically. Between 1996 and 2012, 112 competitive neutrality complaints were investigated. This fell to only five complaints during 2011-12.[191] Whilst it could be argued that this is due to

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[185] Chamber of Commerce and Industry Queensland, Submission to Commonwealth of Australia, *Competition Policy Review*, 2014 cited in Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3 259.
[186] Small Business Development Corporation, Submission to Commonwealth of Australia, *Competition Policy Review*, 2014 quoted in Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 259.
[187] Chamber of Commerce and Industry Queensland, Submission to Commonwealth of Australia, *Competition Policy Review*, 2014 cited in Commonwealth of Australia, *Competition Policy Review Final Report*, above n 186, 259. Also discussed in Victorian Caravan Parks Association and Joyce Routledge submissions to Commonwealth of Australia, *Competition Policy Review*, 2014.
[188] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 260.
[189] Australian Local Government Association submission to Commonwealth of Australia, *Competition Policy Review*, 2014 quoted in Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 258.
[190] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 50.
[191] Victorian Competition and Efficiency Commission, *Competitive Neutrality Inter-jurisdictional Comparison Paper*, (2013) 6 quoted in Commonwealth of Australia, *Competition Policy Review Draft Report*, (2014) 172.

the improvement in government businesses compliance with competitive neutrality requirements[192], it could also be an indication that the general public is not aware that there is a requirement of government businesses to adhere to competitive neutrality obligations.[193]

The need for better reporting of competitive neutrality complaints was raised in a number of submissions.[194]

As a result, the Panel recommends that competitive neutrality complaints processes should become more transparent and effective. There should be a competitive neutrality complaints body which is independent of government. The government should be required to respond publicly in response to the outcome of a competitive neutrality complaint. Lastly, the independent complaints body will be required to submit an annual report regarding the complaints and their investigation into the newly formed Australian Council for Competition Policy.[195]

2.16 Inquiry into the competitive neutrality of the National Broadcasters

On 29 March 2018, a review into the competitive neutrality of the National Broadcasters commenced. This Inquiry was tasked with examining whether the ABC and SBS were complying with the principles of competitive neutrality.[196]

The Inquiry received 6,839 submissions and was completed in September 2018. It was found that "the national broadcasters are applying a 'best endeavours' approach to competitive neutrality requirements but recommended they improve their

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[192] Commonwealth of Australia, *Competition Policy Review Draft Report*, above n 71, 172.
[193] Alexandra Merrett and Rachel Trindade, "Has competitive neutrality run its course?", *The State of* Competition (2013) 13, 5 quoted in Commonwealth of Australia, *Competition Policy Review Final Report*, (2015) 262.
[194] For example, The Productivity Commission, Submission to Commonwealth of Australia, *Competition Policy Review*, 2014 34; The Business Council of Australia Summary Report, Submission to Commonwealth of Australia, *Competition Policy Review*, 2014 14; Australian Chamber of Commerce and Industry, Submission to Commonwealth of Australia, *Competition Policy Review*, 2014 24; Australian Competition and Consumer Commission, Submission 1 to Commonwealth of Australia, *Competition Policy Review*, 2014 26; Queensland Competition Authority, Submission to Commonwealth of Australia, *Competition Policy Review*, 2014 13.
[195] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 50.
[196] Australian Government: Department of Communication and the Arts, *ABC and SBS* <https://www.communications.gov.au/what-we-do/television/abc-and-sbs>.

transparency, reporting and other processes relating to their competitive activities and Charter performance."[197]

National Broadcasters are exempt from tax under their own governing Acts. However, the Panel "notes that to the extent that taxation issues are relevant to Competitive Neutrality Policy relating to the National Broadcaster, the evidence is that the National Broadcasters in effect comply with competitive neutrality requirements."[198]

2.17 Conclusion

This chapter provided an outline and history of the National Taxation Equivalent Regime and competitive neutrality. It examined the competitive environment that drove the need for competitive neutrality, and the reports and agreements made in Australia that put a competitive neutrality structure and tax equivalent regime in place. It also considered circumstances where competitive neutrality was not an adequate solution; and briefly considered alternative tools to achieving competitive neutrality. In addition, it considered the impact of the Competition Policy Review in 2013-15, and the impact this had on competitive neutrality and the NTER.

The following chapter will provide more detail about the NTER and the taxation of government-owned organisations. It will seek to outline differences between the application of tax laws to public and private organisations, and will expand to examine laws which are outside the scope of the NTER.

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[197] Minister for Communications and the Arts, *ABC/SBS Competitive Neutrality Inquiry Released* <https://www.minister.communications.gov.au/minister/mitch-fifield/news/abcsbs-competitive-neutrality-inquiry-released>.

[198] Department of Communication and the Arts, *Inquiry into the Competitive Neutrality of the National Broadcasters – report by the Expert Panel*, (2018) 22.

3 Definition of Competitive Neutrality and alternative tools to achieve competitive neutrality

3.1 Definition of Competitive Neutrality

The term "competitive neutrality" has been given a number of different definitions. This section will outline the different definitions.

3.1.1 The OECD

The OECD states that "competitive neutrality occurs where no entity operating in an economic market is subject to undue competitive advantages or disadvantages".[199]

3.1.2 The Hilmer Report

The Hilmer Report defines competitive neutrality as:

> "Competition policy does not require that all firms compete on an equal footing; indeed, differences in size, assets, skills, experience and culture underpin each firm's unique set of competitive advantages and disadvantages. Differences of these kinds are the hallmark of a competitive market economy.
>
> In some cases, however, firms competing in the same market face different regulatory or other requirements, potentially distorting competition and raising efficiency and equity concerns. While some submissions to the Inquiry expressed concern at such differences operating between private firms, by far the most systematic distortions appear to arise when government businesses participate in competitive markets. In particular, government businesses were often seen as enjoying a unique set of competitive advantages by virtue of their ownership, including exemption from tax. Policies dealing with these kinds of distortions can be described as elements of "competitive neutrality"…"[200]

[199] OECD, *Competitive neutrality: Maintaining a level playing field between public and private* business, above n 66, 50.

[200] National Competition Council, above n 6, 293.

3.1.3 The Competition Principles Agreement

The States entered into the Competition Principles Agreement (CPA) on 11 April 1995. Each State and the Commonwealth entered into the agreement which

> "set out a comprehensive nationally-coordinated microeconomic reform program (the National Competition Policy) that broadly aligned with the Hilmer Committee recommendations. The agreements also contained undertakings to implement pre-existing intergovernmental reform agreements in the sectors of electricity, gas, water and road transport (the Related Reforms)."[201]

The CPA defines competitive neutrality as:

> "The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities."[202]

3.1.4 The National Competition Policy

The National Competition Policy said of competitive neutrality:

> "Competitive neutrality principles seek to encourage competition and better use of the community's resources by ensuring that government businesses operating in a market in which there are actual or potential competitors do not gain any net competitive advantage because of their public ownership. In essence, competitive neutrality principles are aimed at ensuring that significant government owned businesses operating in contestable or potentially contestable markets face the same market disciplines as their private sector competitors."[203]

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[201] National Competition Council, Council of Australian Governments, *Major areas of reform* <http://ncp.ncc.gov.au/pages/reform>
[202] *Competition Principles* Agreement, above n 126.
[203] National Competition Council, Council of Australian Governments, *NCP Second Tranche Assessment* <http://ncp.ncc.gov.au/docs/AST2V1Pb-004.pdf >

3.1.5 The States and Territories definitions

The CPA did not put in place a national implementation plan for the implementation of the competitive neutrality principles. Each State was then free to implement and interpret the competitive neutrality principles as they saw fit. Various definitions of competitive neutrality were adopted by each State, as outlined in Appendix 9.2. The key similarities in the definitions used by all States are centred around the concept of public and private organisations competing on an equal footing, thereby enabling fair competition. A number of the States also touch on efficiency and the most efficient use of resources.

However, as can be seen from Appendix 9.3, there are a range of different criteria that each State Government uses to determine whether the activities of that government's business would qualify it to be subject to the competitive neutrality measures. The most commonly used criterion is the importance of competition in their relevant market (which then begs the question of why monopolies are subject to competitive neutrality measures at all if they do not have, and are unlikely to ever have, any direct competition – this will be discussed in more detail later), and the scale of operations, as the cost would outweigh any benefit of subjecting a small scale operation to the competitive neutrality measures.

In CPA, NCP, Hilmer Report and State-by-State definitions, the common theme of competitive neutrality is that no publicly owned entity should enjoy a net competitive advantage against its privately owned counterparts, merely as a result of its government ownership. Furthermore, the interest around putting in place a competitive even footing in which both publicly and privately-owned entities can compete is based around resource allocation and ensuring that resources are used in the most efficient manner possible.

3.1.6 Cost/Benefit analysis

Whilst all the States have these as their fundamentals, the CPA does not specify how the States should go about implementing competitive neutrality and to which departments or organisations they should apply. This lack of a national implementation plan has resulted in variation between States as to determining who should be subject to competitive neutrality measures.

The CPA requires competitive neutrality measures to be put in place and to apply to government-owned businesses only where the benefits of putting in place such measures outweigh the costs involved.

Potential benefits to be gained by putting in place competitive neutrality measures can include:

- greater competition in the market;
- an improvement in the comparability of financial performance between government business activities and their private sector equivalents; and
- a well-defined separation between commercial and non-commercial objectives, resulting in transparency around whether the business is able to meet its objectives.[204]

Expenses associated with the introduction of competitive neutrality measures can include:

- administrative costs relating to the introduction of competitive neutrality, for example, costs associated with the drafting of legislation and regulation, and changes to policies;
- costs involved with changing an organisation's culture and management approach;
- replication of the regulatory and commercial environment faced by private sector entities in order to ensure that the government business is competing in the same environment;
- costs of compliance associated with competitive neutrality; for example the cost of ensuring compliance with the tax equivalent regime; and
- overseeing conformity with competitive neutrality measures, and administering a department to take care of complaints.[205]

3.1.7 To whom (or what) should competitive neutrality measures apply?

The OECD discusses the problem with defining a government commercial entity. Due to the lack of a clear definition of the term, in some jurisdictions, competitive

[204] Department of Treasury and Finance (NT), *Policy Statement on Competitive Neutrality*, (2016) 9.
[205] Ibid.

neutrality policies are only applied to State-owned enterprises (SOEs) whereas in other jurisdictions the competitive neutrality policies are applied to all commercial government activities.[206]

The range of entities that should be subject to competitive neutrality is extensive. The OECD (2012) considers that all government owned entities operating as a commercial entity with either actual or potential competitors should be subject to competitive neutrality measures.[207]

There are a number of factors that can affect the level and degree of competitive neutrality. These include the ownership structure, the institutional form or explicit aims for particular economic agents. Issues of competitive neutrality relate not only to public versus private ownership. As discussed in Chapter 2, issues of competitive neutrality can also arise in the not-for-profit sector, where a competitive advantage can be realised by the non-for-profit sector by virtue of special exemptions arising from its non-for-profit status.[208]

The reasons for striving for competitive neutrality are twofold. Firstly, there is the economic aspect, which aims to enhance allocative efficiency in the economy. Allocative efficiency holds that only goods which are in the highest demand will be produced in an economy. Allocative efficiency ensures that goods and services are produced at the lowest possible cost to the consumer. Secondly, the political aspect seeks to ensure public service obligations are met and ensures that the government acts as regulator to make sure that all market players are playing by the rules.[209]

The OECD (2012) considers that "the most effective way of obtaining competitive neutrality is arguably to establish an encompassing policy framework, including suitable complaints handling, enforcement and implementation mechanisms and in consistency with international commitments."[210] Australia, and a number of European countries, have been the best examples of this to date.

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[206] OECD, *Competitive neutrality: Maintaining a level playing field between public and private* business, above n 66, 15.
[207] Ibid 18.
[208] Ibid 17.
[209] Ibid 9.
[210] Ibid 13.

Australia has an Australian Government Competitive Neutrality Complaints Office (AGCNCO) which sits within the Productivity Commission. The AGCNCO investigates complaints related to competitive neutrality and then publishes its findings on its website. AGCNCO will not investigate complaints that are not related to Australian Government business, or complaints that:

- "are frivolous, vexatious, not made in good faith, or are made by someone with an insufficient interest in the matter of the complaint
- do not warrant investigation having regard to all the relevant circumstances."[211]

Since 2008, there have been three complaints which have been investigated and published on the Productivity Commission's website. The complaints were brought against NBN Co, PETNET Australia Pty Ltd, and Defence Housing Australia. The complaint investigated across all three government-owned organisations was regulatory neutrality. Both PETNET and NBN Co were investigated for possible pricing and earning a commercial rate of return breaches. In addition, PETNET was also investigated for a possible breach of debt neutrality.

In investigating regulatory neutrality, the AGCNCO found that Defence Housing Australia did not gain a regulatory advantage merely as a result of government ownership. NBN Co had no breach of regulatory neutrality as no determinations of the kind had yet been made. However, PETNET was found to be disadvantaged by tighter regulations than those which apply to its privately owned counterparts.

Both PETNET and NBN Co were found to have fair pricing models, however both were not expected to achieve a commercial rate of return because they had not begun operating fully as a business at the time of the investigation. It is to be expected that commercial rates of return and making profits are difficult to achieve during the start-up phase of a business and are not necessarily a breach of the competitive neutrality guidelines.[212] It was noted for both that there was a need to adjust their

[211] Productivity Commission, *How complaints are investigated* <http://www.pc.gov.au/agcnco/complaint/investigation>
[212] Productivity Commission, Australian Government Competitive Neutrality Complaints Office: NBN Co, Investigation No. 14 (2011) 35.

cost base for any advantages they may have received as a result of government ownership.

3.1.8 Definition of government commercial entity

There is a lack of clear definition as to what constitutes a government commercial entity, or even what constitutes commercial or non-commercial activities as evident in each State's interpretation of the CPA. As discussed previously, given that the CPA has not specified which departments or entities should implement competitive neutrality policies, there has been variation between the States as to which entities should be subject to competitive neutrality measures.

Appendix 9.3 outlines the main methods used by each State to determine which of each State's departments and entities should be included in competitive neutrality measure. The second section of that appendix outlines what each State defines as its significant business activities.[213] It is these activities to which each state applies its competitive neutrality policies.

As can be seen in Appendix 9.2, the definitions of which activities to apply competitive neutrality policies to varies greatly between the States. This disparity could mean that competitive neutrality policies could be implemented in some States but not necessarily in others.

The definition of a commercial entity and which entities should be subject to competitive neutrality measures was raised in a number of submissions to the Issues Paper relating to the Competition Policy Review. Issues raised in these submissions then formed part of the Competition Policy Review Draft Report. The Panel stated that:

> "Concerns around competitive neutrality were raised with the Panel, particularly where businesses, in many instances small businesses, compete with local government. While the government activities may not be 'significant' as judged by relevant guidelines, the breadth of sectors where key

[213] Based on Andrew Trembath, *Competitive Neutrality: Scope for Enhancement*, (National Competition Council Staff Discussion Paper, AusInfo, Canberra, 2002).

issues were raised points to this as a potential obstacle to small business competing in a range of markets."[214]

This was discussed in section 2.15.4.

3.1.8.1 Government business and Australian Consumer Law

The question of what defines a government business is not covered by legislation. Rather, reliance is made on court decisions to determine whether an activity can be considered to be a business. For a government agency to be conducting a business, its activities need to be "sufficiently systematic and regular, and sufficiently similar to commercial activities that private persons might engage in, to justify being characterised as a business".[215]

The definition of government business is important as it determines whether the *Trade Practices Act* applies to government entities. A number of cases considered what defined a government business, including *JS McMillan Pty Ltd v Commonwealth*,[216] *Corrections Corporation v Commonwealth of Australia*,[217] *NT Power Generation v Power and Water Authority*,[218] and *ACCC v Baxter Healthcare*.[219] Justice Griffiths asserts that the difficulty in defining the term "carrying on a business" when applied to government activities comes about as a result of taking into account what the courts have considered to satisfy requirements compared to those which failed the tests for being considered to be carrying on a business.[220] In the *JS McMillan* and *Corrections Corporation* cases[221], it was held that the government activities did not constitute carrying on a business. In *JS McMillan*[222], Justice Emmett stated that it cannot be held that the repetition of an activity constitutes the carrying on of a business; there are government functions that

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[214] Commonwealth of Australia, *Competition Policy Review Draft Report*, above n 71, 175.
[215] *New South Wales v RT & YE Falls Investments Pty Ltd* [2003] NSWCA 54, [131] per Hodgson JA cited in Justice John Griffiths, 'Application of the Australian Consumer Law to government commercial activities' (Paper presented at Commercial Law and Government Conference, NSW State Library, 16 September 2016) 3.
[216] (1977) 77 FCR 377.
[217] (2000) 104 FCR 448.
[218] (2004) 219 CLR 90.
[219] (2007) 232 CLR 1.
[220] Justice John Griffiths, 'Application of the Australian Consumer Law to government commercial activities' (Paper presented at Commercial Law and Government Conference, NSW State Library, 16 September 2016) 12.
[221] *JS McMillan Pty Ltd v Commonwealth* (1977) 77 FCR 377; *Corrections Corporation v Commonwealth of Australia* (2000) 104 FCR 448.
[222] *JS McMillan Pty Ltd v Commonwealth* (1977) 77 FCR 377.

cannot be considered to constitute the carrying on of a business; and there needs to be a distinction between those activities of government which are purely regulatory or governmental, and those which could be considered to be running a business. However, in the *NT Power Generation*[223] case, which concerned NT Power Generation's refusal to allow access to its power lines, the High Court reversed the decision of the Full Court and, in doing so, stated that NT Power Generation denying access constituted the carrying on of a business and constituted a misuse of market power under section 46 of the then TPA. In the *Baxter Healthcare*[224] case, Baxter Healthcare argued Crown Immunity. The Court said there was "a risk of confusing governmental, commercial or even political interests with legal, equitable or statutory rights and interests." It was held that Crown immunity did not apply and the Court found that Baxter Healthcare breached both section 46 and 47 of the then TPA.

To remedy this, the Harper review sought to replace the term "carrying on a business" with "engaging in trade or commerce" when seeking to apply the *Competition and Consumer Act* (2010) to government endeavours.[225]

It could be a recommendation that instead of relying on government to determine who should be subject to the NTER, these guidelines and framework developed for the TPA instead be applied.

3.1.9 The building blocks of competitive neutrality

The OECD recommends that governments wishing to implement competitive neutrality policies should consider the following eight building blocks:

1. Streamlining government business can influence the playing field. Where a natural monopoly exists, the competitive activities can be separated from the non-competitive activities to enable competitors to enter the competitive part of the market.[226] In Australia, this is evident in the electricity sector, which consists of the network and the retail branches. The network sector relates to the infrastructure – the cables, poles, electricity substations, and so

[223] *NT Power Generation v Power and Water Authority* (2004) 219 CLR 90.
[224] *ACCC v Baxter Healthcare* (2007) 232 CLR 1.
[225] Commonwealth of Australia, *Competition Policy Review Final Report*, above n 3, 278-282.
[226] OECD, *Competitive neutrality: Maintaining a level playing field between public and private* business, above n 66, 9-11.

on. The electricity retail sector comprises the direct sales of electricity to the end user.

2. Identifying and allocating costs of business activities to encourage transparency.
3. Rates of return (ROR) requirements for SOCs should be the same as those for private corporations in commercial and competitive activities.
4. There should be transparency relating to any compensation provided for public policy activities.
5. & 6. As much as possible, SOCs should be subject to the same tax and regulatory requirements as privately owned corporations.
7. Debt neutrality also needs to be explored and considered as a means of creating a level playing field.
8. Procurement policies and procedures need to be transparent and competitive.[227]

3.1.10 Criticisms of competitive neutrality

The Queensland Government presents three issues against introducing competitive neutrality.[228] Firstly, there is a concern of declining services and increases in pricing if government monopolies are corporatised. Furthermore, not all government activities will result in profitable decisions. This is due to the fact that, when providing essential services (for example, electricity or water), some decisions that are not profitable need to be made in order to meet the needs of the public. It is the role of the government to provide them, regardless of whether or not it is a sound commercial decision to do so. Lastly, if governments were to charge according to what it was costing them, a price increase might result where they were providing services at below cost.[229]

On the second point, it should be noted that competitive neutrality principles require that CSOs be separated and excluded from the application of competitive neutrality measures. On the last point, price regulators decide what a monopoly can charge and

[227] Ibid.
[228] Queensland Government (1996c), cited in Zahirul Hoque and Jodie Moll, 'Public sector reform: Implications for accounting, accountability and performance of state-owned entities – an Australian perspective' (2001) 14(4) *The International Journal of Public Sector Management* 304, 310.
[229] Hoque and Moll, above n 7.

will only allow for efficient costs to be passed on to the consumer. This is discussed further in Chapter 6: Price regulation, the tax allowance and actual tax payable.

The OECD recommends that competitive neutrality problems "could be reduced by reforming the governance arrangements of government businesses so that these businesses have a commercial focus, operate efficiently, and face all normal business costs, such as requirements to earn a rate of return and pay taxes"[230] It could be argued that this is not enough, especially if the Hilmer Report recommendations are based on models of perfect competition that do not exist in the real world. However, critiques of perfect competition are outside the scope of this thesis.

3.2 Alternative tools to achieve competitive neutrality

There are a number of different policy approaches which can be used to achieve the aim of competitive neutrality, being:

- taxation neutrality, which will involve removing any tax exemptions enjoyed by State-owned entities;[231]
- debt neutrality, which will require State-owned businesses to pay similar borrowing and financing costs as their privately-owned counterparts;[232]
- rate of return requirements, which require that significant government owned organisations earn a commercial rate of return over the long-term, and pay a commercial dividend;[233]
- regulatory neutrality, which requires that both publicly-owned and privately-owned businesses be subject to the same regulatory environment;[234] and
- full cost pricing principles.[235] Full cost pricing refers to a price calculated by adding the direct cost of producing a unit of output with a mark-up to allow

[230] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12, 330.
[231] The Treasury, *Commonwealth Competitive Neutrality Policy Statement*, above n 25, 16.
[232] Ibid 27.
[233] Ibid 17.
[234] Ibid 18.
[235] Ibid 19.

for overheads and profits. It is typically used in instances where it is difficult to forecast demand and to ascertain a market price.[236]

However, competitive neutrality can also be achieved by implementing one of the following measures:

- Corporatisation
- Commercialisation, or
- Cost reflective pricing.[237] Cost reflective pricing reflects the true cost of producing a unit of output without relying on government subsidisation to cover any shortfalls.[238]

Some of these measures (corporatisation, commercialisation, or cost reflective pricing) are used in conjunction with the policy approaches mentioned above (taxation neutrality, debt neutrality, rate of return requirements, regulatory neutrality, and full cost pricing principles). For example, many government-owned enterprises have been corporatised, but are also subject to tax neutrality, debt neutrality, and so on.

The measure selected will be dependent on "a number of factors including the costs and benefits of applying the policy, the organisational context of the activities exposed to competition, the level of resources used in the supply of the good or service, and any special requirements such as increased accountability."[239] Although there are a number of measures available to achieve competitive neutrality, the preferred method is corporatisation.[240]

The position taken by Coates was that if a public company was to be in competition with a private company, then the public company should take the same form and structure as a private company.[241]

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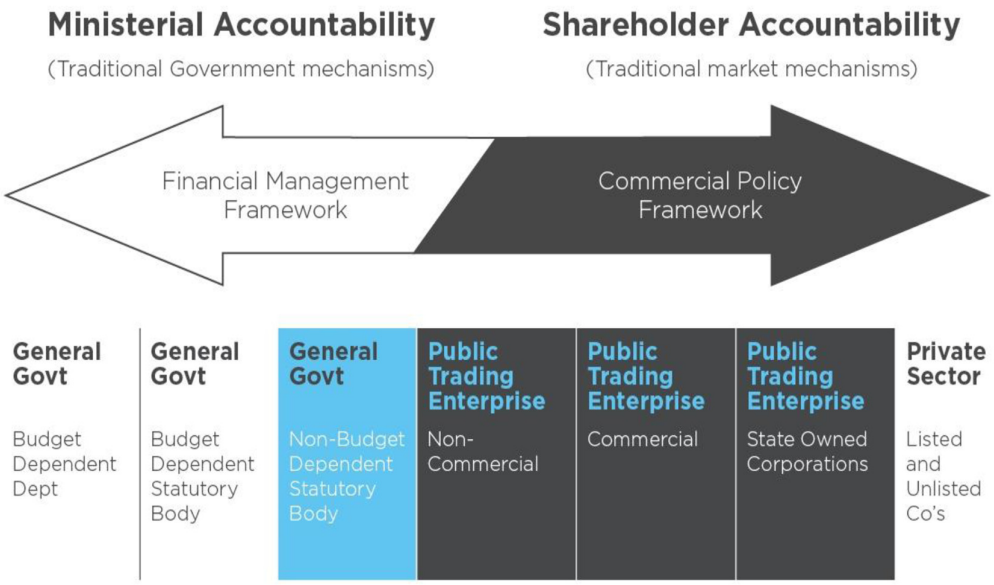
[236] OECD, *Glossary of Statistical Terms* <https://stats.oecd.org/glossary/detail.asp?ID=3223>
[237] Department of Treasury and Finance South Australia, above n 60, 1.
[238] Horizon Power, *Miscellaneous: What is cost reflective pricing?* <https://horizonpower.com.au/help-support/miscellaneous/what-is-cost-reflective-pricing/>
[239] Department of Treasury and Finance South Australia, above n 60, 1-2.
[240] Ibid 3.
[241] Coates, 1990 quoted in Stephen Bottomley, 'Regulating government-owned corporations: A review of the issues' (1994) 53(4) *Australian Journal of Public Administration* 521, 525.

In addition to the above measures, this section will also consider the privatisation of typically state-owned businesses.

3.2.1 Corporatisation

In Australia, there are a number of vehicles through which government can deliver its services to the community. Government entities operate on an accountability spectrum, illustrated below.



New South Wales Government, *Review of the legislative framework that provides for the governance and accountability of state-owned corporations,* (2013) 24. http://www.dpc.nsw.gov.au/__data/assets/pdf_file/0009/159093/SOC-Review_Issues-Paper.pdf

Government services can be delivered using a department structure through to taking the form of a state-owned corporation (SOC). The Commercial Policy Framework covers public trading enterprises (also known as 'public non-financial corporation sector') which are non-commercial, commercial, and state-owned corporations.

Corporatisation aims to increase the rate of return on public assets when compared to the returns available on other similar market investment opportunities.[242]Corporatisation is considered the best method to use for achieving competitive neutrality. Corporatisation is used in instances where the organisation has:

[242] Christopher Sheil, 'Running the risks: The rationalisation of Australia's water' (2000) 59(3) *Australian Journal of Public Administration* 11, 12.

- "clear and non-conflicting objectives;
- managerial responsibility, authority and autonomy;
- effective performance monitoring;
- effective rewards and sanctions related to performance; and
- competitive neutrality in input and output markets."[243]

Corporatisation involves running the organisation as though it were a private sector organisation, and the introduction of various measures to enable this goal to be achieved. Corporatisation typically involves the introduction of a number of the tools used to achieve competitive neutrality, including the payment of taxation equivalents, achieving a commercial rate of return, the introduction of debt guarantee fees and compliance with the same regulations that apply to organisations in the private sector.[244]

Corporatisation often involves using the SOC model. There are two types of SOC models – the company SOC model and the statutory SOC model.

A company SOC is limited by shares and subject to the Corporations Act. It is also regulated by ASIC. Shares in a company SOC are held by eligible Ministers and voting shareholders have the power to run the company SOC. The sale of a company SOC can only take place under an Act of Parliament.[245] Company SOCs are registered as public companies limited by shares.[246]

A statutory SOC is not subject to the Corporations Act. Voting shares are held only by the Treasurer and one other minister appointed by the Premier. The Minister is able to have more control over the running of a statutory SOC than a company SOC.[247]

Currently, only Victoria, Tasmania and the Commonwealth allow for both statutory and company SOCs. The rest only allow for statutory SOCs, except NSW, which is

[243] Department of Treasury and Finance South Australia, above n 60, 3.
[244] Ibid.
[245] New South Wales Government, *Review of the legislative framework that provides for the governance and accountability of state owned corporations,* (2013) 24.
[246] Ibid 25.
[247] Ibid.

currently undertaking a review of the SOC Act legislation and structure of state-owned corporations.[248]

Where corporatisation is not suitable, competitive neutrality can be achieved through the introduction of other competitive neutrality measures, including debt neutrality, tax neutrality, regulatory neutrality and full cost pricing.[249]

3.2.1.1 Criticisms of corporatisation

There have been a number of criticisms levelled at corporatisation. Sheil (2000) disagrees with the use of rate of return as an accurate measure for determining efficiency and productivity. Sheil notes that one can only increase the rate of return by either increasing revenue or decreasing expenses. However, there may be barriers to doing so in those industries concerned.[250] These measures are usually determined by pricing regulators in Australia. So many of these measures, including debt to equity ratio, are set by the pricing regulator, which will only allow for price increases based on an ideal, well-managed, privately owned organisation model.

A further criticism comes in the form of political influence. A State government can influence indirect power and control over a State-owned corporation by appointing the directors who then sit on the board and control the State-owned organisation. These directors may feel indebted to the Minister but, at the same time, have to comply with all the legislative duties required of directors.[251] This means that some directors of SOCs may never be truly independent because of conflicting duties of running the organisation in the best way possible, whilst at the same time being obligated to make decisions that will result in a favourable outcome for the Minister who appointed them.

Smith[252] (2000) presents the Sydney water scare as an example of this. In 1998 unsafe levels of Cryptosporidium and Giardia were found in Sydney's drinking water. This contamination left Sydney's water unsafe to drink for approximately two weeks. An inquiry into the incident later found that Sydney Water was faced with

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[248] Ibid 26.
[249] Department of Treasury and Finance (NT), above n 204, 5.
[250] Sheil, above n 242, 12.
[251] Stephen Bottomley, 'Regulating government-owned corporations: A review of the issues' (1994) 53(4) *Australian Journal of Public Administration* 521, 526.
[252] Stewart Smith, 'State owned corporations: A review' (Briefing Paper No 11/2000, NSW Parliamentary Library Research Service, Parliament of NSW, 2000).

two conflicting objectives – the first being to operate as a commercial business and achieve its business objectives. The second was to produce quality drinking water that was safe to drink. These two objectives were not always compatible. It was found that these objectives and the business structure as a result of corporatisation had led to there being a communication barrier between the managing director, the board of directors, and the State government. This was partly to blame for the water crisis and has since been used as an example of how corporatisation of government owned entities may have failed.[253]

However, Hoque and Moll argue that public sector entities that have been corporatized operate in an environment similar to that of the private sector. They state that this implies that any advantages or disadvantages as a result of government ownership are abolished.[254] The public sector, by mere government ownership, is protected from the threat of takeover or bankruptcy.[255]

A paper by PwC questions the objectives of private and public companies, arguing that the two have different objectives which cause the main differences seen in public and private companies.[256] Privately owned companies, it argues, have a primary objective of maximising financial wealth, and thereby maximising dividends to shareholders. However, SOEs should strive towards strengthening the economy and maximising wellbeing and jobs.[257]

PwC go on to state

> "SOEs should not be purely evaluated only on the basis of financial results (the profit and loss account), but more widely on how they contribute to societal value creation, taking an integrated and holistic view of their impact.[258]

Therefore, PwC believes the following principles should be relevant for SOEs:

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[253] Ibid.
[254] Hoque and Moll, above n 7, 313.
[255] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12, 330.
[256] PwC, *State-owned enterprises: Catalysts for public value creation?*, April 2015, 20 https://www.pwc.com/gx/en/psrc/publications/assets/pwc-state-owned-enterprise-psrc.pdf
[257] Ibid.
[258] Ibid 6.

- "SOEs should not be run as a private company given the different business logic.
- SOEs need to be actively owned, directed and evaluated in a more holistic way to include a wider range of impacts.
- Cost-revenues are not enough. The SOE also needs to consider the impact on society.
- SOEs need new principles for corporate governance.
- SOEs must be bigger strategic players linked to the ambition of creating new jobs, growth and innovation.
- SOEs can be an instrument for exponential value creation."[259]

3.2.2 Commercialisation

The Financial and Performance Management Standard 2009 (FPMS) provides the framework under which statutory bodies operate in Queensland. It defines commercialisation as:

> "the process by which a department or a commercialised operation of a department, charges for the goods or services it provides and adopts, in varying degrees, other features of the commercial environment, including the principles of competitive neutrality, clear and non-conflicting objectives, an appropriate level of management responsibility, authority and autonomy and accountability for performance."[260]
>
> "The commercialisation policy is built around 4 key principles:
>
> 1. Competitive neutrality (competition with alternative providers on equal terms)
> 2. Clear and non-conflicting objectives
> 3. Management responsibility, authority and autonomy
> 4. Accountability for performance."[261]

Commercialisation involves the implementation of measures that do not go as far as corporatisation. The main difference between commercialisation and corporatisation

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[259] Ibid 29.
[260] Financial and Performance Management Standard 2009, cited in Queensland Treasury, *Commercialisation of Government Business Activities in Queensland*, (2010) 10.
[261] Queensland Treasury, *Commercialisation of Government Business Activities in Queensland*, (2010) 6.

is that, under commercialisation, the entity is not a separate legal entity and does not have its own board of directors.[262] Commercialisation can include a number of the following attributes:

- "Definition of commercial and non-commercial activities (in a business plan);
- Clear, commercial performance targets;
- Separate definition and funding of non commercial activities;
- Removal of regulatory functions from the entity;
- Valuation of assets based on deprival value;
- The introduction of commercial gearing;
- Payment of tax equivalents to the Treasurer;
- Payment of applicable guarantee fees to the Treasurer;
- Defined reporting requirements;
- Ring-fenced (i.e.. Separated) accounts from the host agency (if any); and
- A dividend policy based on agreed indicative payout ratio reflecting the cash needs of the owner government and the business."[263]

Commercialisation "entails the establishment of separate business units, full recovery of all costs, separate financial statements and rate of return requirements."[264]

The introduction of commercialisation involves a number of steps. The first involves "establishing a general business environment between clients and service providers". Following on from this, partial commercialisation involves "establishing formal commercial relationships between clients and service providers and a more commercial approach to the planning and management of the business unit and the agency." This stage is most suitable to developing markets. Full commercialisation "involves the move to a competitive environment where clients have freedom to choose the source of supply." This is best in mature markets which have a healthy level of competition.[265]

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[262] Department of Treasury and Finance (NT), above n 204, 6.
[263] Department of Treasury and Finance South Australia, above n 60, 4. http://dpc.sa.gov.au/documents/rendition/B18578
[264] Department of Treasury and Finance (NT), above n 204, 6.
[265] Queensland Treasury, *Commercialisation of Government Business Activities in Queensland*, above n 261, 14.

Where commercialisation is not suitable, other methods might be more attractive for improving efficiency. These include corporatisation, "greater utilisation of the private or community sector as a supplier or provider" or "franchises or alliances".[266]

3.2.3 Cost reflective pricing

The use of the Cost Reflective Pricing method involves putting a dollar value on all the costs and benefits gained as a result of government ownership in order to obtain a net competitive advantage (or disadvantage). An output price is then determined taking into account this net competitive advantage. As per competitive neutrality in general, this method will only be used if the cost exceeds the benefits.[267]

The costing process used in the Cost Reflective Pricing method involves:

- "definition of the output, including measurement, verification and purpose of the output;
- costing the output which will include full attribution of all costs, such as direct costs, overhead costs, IT support, administration and depreciation applicable to the output;
- estimating the net competitive advantages (if any) resulting from government ownership; and
- estimating an offsetting accounting adjustment for the net competitive advantage."[268]

3.2.4 Privatisation

Privatisation usually involves the sale of state-owned enterprises to the private sector. The shift towards privatisation throughout the world began in the 1970s and 1980s. Privatised assets were subsequently subject to regulation. Efficiency gains resulting from privatisation outweighed the costs of regulation.[269] This will be discussed further in section 5.1.2: Privatisation.

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[266] Ibid 13.
[267] Horizon Power, above n 238.
[268] Ibid.
[269] Joseph E. Stiglitz and Jay K. Rosengard, *Economics of the Public Sector* (W. W, Norton Company Inc, 4th ed, 2015) 207.

Reasons for privatising state-owned business can include reducing State debt, using the money generated by the sale to fund other infrastructure projects, and encouraging efficiency.

Abbott discussed the benefits of privatisation. [270] His work compared the privatisation of the electricity and gas industries in Victoria with the state-owned gas and electricity industries in New South Wales. Abbott found that the greatest benefit to privatisation was that the Victorian government was able to use the funds resulting from the sale of gas and electricity infrastructure to reduce debt and increase spending on other essential services.

It has been argued that public owned entities are more likely to be less efficient than privately owned entities in the same industry, [271] mainly as a result of performance not being linked to pay. As such, there is no real incentive for a manager to maximise the wealth of a publicly owned organisation as they do not stand to benefit financially, and do not face the risk of insolvency or being taken over. However, when a comparison is made to those industries which have been privatised and are now privately owned, one can see that the result of private ownership has resulted in much of the wealth of the organisation being transferred to shareholders, dividends, and executive salaries, rather than maintaining the essential infrastructure.

A study by Gowland and Aiken[272] considered the cultural changes that occur when a state-owned corporation is subsequently privatised. They found that, despite popular belief, long-serving employees who were subsequently offered a position in the newly privatised organisation were not less efficient than private sector employees. Further, the newly privatised organisation shifted focus to becoming more commercial in its approach to controlling staff, profitability, and tax implications.

There is further discussion about the effectiveness of privatisation in section 5.2.2.2: The electricity industry.

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[270] Malcolm Abbott, 'The impact of energy asset privatisation on State government debt management and service provision in Victoria and New South Wales' (2011) 70(1) *Australian Journal of Public Administration* 94, 103.
[271] Bottomley, 'Regulating government-owned corporations' above n 251, 529.
[272] David Gowland and Max Aiken, 'Privatisation – A history and survey of changes in organisational structures, cultural and environmental profiles' (2003) 62(1) *Australian Journal of Public Administration* 55.

3.3 Conclusion

Chapter 3 provided the background to how competitive neutrality was established in Australia. It first considered the OECD recommendations, and then moved to discuss the Hilmer Review which recommended taking steps to ensure that public businesses were governed in such a way as to enable competition from privately-owned entities to be on an equal footing. This chapter also detailed the steps and options available to the Government in deciding which methods to use in order to enable better competition between the public and private sectors. Furthermore, the chapter outlined criticisms of competitive neutrality and corporatisation.

The next chapter will focus on the National Tax Equivalent Regime and how the taxing of the public sector has been put into practice since the introduction of competitive neutrality measures.

4 The NTER, Dividend Policies, and the Taxation of the Public Sector

This chapter examines aspects of the NTER and other tax laws which are targeted specifically at state owned corporations and businesses. These are instances where the ATO or Treasury may choose to modify the application of existing legislation, or where specific rules or legislation targeting only State-owned entities have been put in place.

Underpinning the application of taxation laws to state-owned enterprises is s 114 of The Constitution. Although a detailed examination of s. 114 is beyond the scope of this thesis, the relevant issues are summarised below. Section 114 of The Constitution provides that the Commonwealth cannot impose any tax on the property belonging to any State.

Section 114 of The Constitution states that:

> "A State shall not, without the consent of the Parliament of the Commonwealth….impose any tax on property of any kind belonging to the Commonwealth, nor shall the Commonwealth impose any tax on property of any kind belonging to a State."[273]

There have been a number of cases that considered the taxing of property between the State and Commonwealth. The key cases were *Queensland v Commonwealth*[274], *South Australia v Commonwealth*[275], and *The State Bank* case.[276]

In *Queensland* v *Commonwealth*, the Court considered whether the State of Queensland was liable to pay Fringe Benefits Tax on the fringe benefits it provided its employees. The Court held that fringe benefits on cars and housing did not violate s114 because the tax is imposed on the benefit, rather than on property.

South Australia v *Commonwealth* considered whether the State's superannuation fund would be liable for tax on interest earned and capital gains tax made. It was held

[273] Section 114 of The Constitution.
[274] 87 ATC 4029.
[275] 92 ATC 4066.
[276] 92 ATC 4079.

that the superannuation fund was taxable on interest earned but was not liable for tax on the capital gains it made.

In the *State Bank* case, the Court determined that the State Bank was not liable to sales tax, as sales tax was considered to be a tax on property.

Above, the taxing rights of the Commonwealth on the State were considered. The following will examine the NTER and why tax imposed on State-owned corporations can only be in the form of tax equivalents, and why the taxes are remitted back to the State rather than the Commonwealth.

4.1 Features of the NTER

The ATO administers the NTER in accordance with the ITAAs, subject to a number of modifications as set out in the NTER Manual. This section sets out those modifications and examines how they impact the NTER entities which are subject to them.

4.1.1 Lack of ability to appeal

Under the *Taxation Administration Act* 1953, taxpayers have rights to seek review of unfavourable decisions regarding the application of taxation laws. A disadvantage for NTER entities is the lack of appeal rights under the Tax Administration Act. The reason for this may be so that public funds are not wasted on cases involving two opposing governments. An NTER entity can apply for a private ruling under paragraphs 75-78 of the NTER Manual.[277] Private ruling requests may be made to clarify the tax position an NTER entity should take in relation to an arrangement or transaction, and are to be made in accordance with Division 359 in Schedule 1 of the *Taxation Administration Act 1953.*

However, under paragraph 82 of the NTER Manual:

> "NTER entities will not be entitled to seek an external review of, or appeal against, an NTER related decision of the Commissioner, whether under a provision of the relevant taxation laws, including section 14ZZ of the TAA

[277] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 18.

1953, or otherwise. Divisions 4 and 5 of Part IVC of the TAA 1953 will not apply accordingly."[278]

This provision is based on the nature of the agreement between NTER entities and the Tax Office, that is, that there is an informal relationship. This paragraph of the NTER Manual puts NTER entities at a serious disadvantage when compared to their private sector counterparts. A privately-owned company can appeal an ATO decision and take the matter to the Administrative Appeals Tribunal (AAT), whereas for an NTER entity, the ATO's decision is final and there is no further recourse or option available to the NTER entity. If the aim of the NTER is competitive neutrality, and issues being examined by the NTER are likely to also affect the private sector, to disadvantage an NTER entity by denying appeal rights means that it is less likely for an NTER entity to seek advice on issues that might affect both private and public sectors; rather it will wait for the private sector to do so because the private sector has the option of appeal should the outcome be undesirable. For example, the tax treatment of gifted assets has been disputed. Rather than apply for a private ruling, the affected NTER entities waited for the private sector to raise this matter with the ATO. This is currently the subject of appeal in the Federal Court.[279] This is discussed further in section 4.2.4: Case study: Gifted assets.

The lack of ability to appeal was also a feature in the State Tax Equivalent Regime. Burton examined the intricacies and complexities of a State Tax Equivalent Regime which was administered by the Treasurer.[280] In it, he explained that by assuming the position of tax authority and having the power to determine estimated tax equivalent payments resulted in the inability of State Authorities to challenge any determinations of the Treasurer. This is a problem for "where there is uncertainty as to the proper interpretation of the ITAA, the Treasurer is entitled to adopt the view most favourable to the Treasury, without fear of such a determination being challenged in the courts with any real prospect of success."[281] Interestingly, this policy continued to be a feature of the NTER despite the NTER being administered

[278] Ibid 19.
[279] Spark Infrastructure, 'ATO Settlement Deed on labour and other costs for Victoria Power Networks and SA Power Networks' (21 September 2018).
[280] 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.
[281] Ibid 117.

by the ATO, and there being an availability of resources to enable challenge and appeal. This is because it would be deemed to be an inefficient use of resources (that is, a waste of taxpayer money) for government to challenge government in this field, and this matter in addition would generate negative publicity.

4.1.2 Government imposed restructures or privatisations: A specific issue relates to the application of CGT

At times, the owner State or Territory government can direct an NTER entity to restructure or privatise its business. Recent examples of State or Territory imposed privatisations include the privatisation of desalination plants, the sale of the "poles and wires" of the electricity network (in effect, the infrastructure of the electricity industry comprising the poles and wires which deliver electricity to homes and businesses) and the ports. These privatisations have taken place across the country, although to varying degrees. Some States have privatised many of their major assets in recent years, whereas others have not been subject to extensive privatisation. In these circumstances, NTER Manual paragraph 103A states that:

> "Such an imposed renegotiation, restructure or privatisation will be treated in a tax neutral manner for NTER purposes. (For example, on an imposed transfer of CGT assets, there will be no CGT consequences for the transferor and the transferee will inherit the CGT cost bases of the transferor.)"[282]

However, paragraph 103B allows the NTER Administrator to approve a tax treatment it considers appropriate in the circumstances, after considering whether the NTER entity will receive an unfair tax advantage over its competitors and "the arrangements and structures that have previously existed in relation to the business operations of the NTER entities involved."[283]

Whilst this seeks to remedy the issue of tax arising as part of a decision that was not made by the NTER entity, it makes no sense as to why such a transaction will be made on a CGT neutral basis. If both tax and dividend payments are being made to the State or Territory treasury, allowing a transaction to be treated in a CGT neutral manner potentially distorts the return on equity for Treasury on privatisation of the

[282] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 24.
[283] Ibid.

asset. When an equivalent privately-owned corporation sells an asset, it is expected that the company would have to pay tax on the sale, and any difference could then be available to either be returned to shareholders or put to another use. So, to treat the transaction in a different manner for an NTER entity means that, although the total financial amount being received by the State or Territory treasury is the same, the amount being received is not being classified correctly as income from the tax expense or a return on equity. This then results in the return on equity being inflated.

Example – Sale of Sydney Desalination Plant

Sydney Desalination Plant was built and operated by Sydney Water during the 2008 – 2012 years. It was operated as a subsidiary under the parent entity, Sydney Water Corporation. The New South Wales Treasurer made the decision to refinance the Sydney Desalination Plant to use the funds generated by such a refinancing for vital infrastructure projects in NSW.[284] The successful refinancing deal generated $2.3 billion and, after repaying existing debt on the plant, saw over $300 million returned to the State.[285]

Given that this was a State imposed privatisation, exemption could have been sought under paragraph 103 of the NTER Manual to exempt the transaction from capital gains tax and have the purchaser, a consortium including the Ontario Teachers' Pension Plan Board, inherit the existing CGT cost base of the assets which formed part of the sale. Paragraph 103 of the NTER Manual was amended a few months prior to the privatisation to limit the treatment to, amongst other things, "…(i) a privatisation by way of an asset sale, an entity sale, the grant of a long term lease, the grant of a long term licence, or the grant of a long term statutory or other right."[286] This option was not pursued, and it enabled the consortium to apply Division 58 (Capital allowances for depreciating assets previously owned by an exempt entity) of the Income Tax Assessment Act 1997 to the tax value of assets the consortium acquired.

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[284] NSW Treasurer, 'NSW Government calls for Registration of Interest for Refinancing of Sydney's Desalination Plant' (Media Release, 16 November 2011).
[285] NSW Treasurer, 'Successful Lease of the Sydney Desalination Plant Announced' (Media Release, 11 May 2012)
[286] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 24

As a result of not seeking the exemption, income tax paid by Sydney Water on the gain on sale of Sydney Desalination Plant assets was $78.398 million.[287] Although the transaction was completed in the 2012 financial year, any dividends or taxes relating to the transaction were paid in the 2013 financial year.

This example seeks to quantify the impact on the dividend received by the State, and the impacts on equity ratios if the CGT exemption had been taken up:

Dividend payout ratio: Where no tax exemption was granted

The dividend payout ratio is calculated using the formula:

Dividend payout ratio = Dividends / Net income

The net income after tax for 2013 is $415.179 million.[288] During the 2013 financial year, Sydney Water paid a total dividend of $368 million to New South Wales Treasury. This dividend comprised $242 million as the normal dividend from operations, and an additional dividend of $126 million being the net proceeds of the refinancing of Sydney Desalination Plant.[289]

Under the current arrangement, where tax of $78.398 million was paid, and $368 million was returned as a dividend:

Dividend payout ratio = $368m / $415.179m

= 88.64%

Using the above data, and assuming that all the tax would have been repatriated as an increase in the dividend, in addition to the total dividend returned to the state in 2013, the dividend payout ratio is as follows.

Dividend payout ratio: Where there was a tax exemption

Had Sydney Water sought to apply the tax-neutral option under paragraph 103A of the NTER Manual, the dividend paid to NSW Treasury as a result of this transaction would have been $446.398 million (an addition of the total dividend of $368 million,

[287] Sydney Water Corporation, *Financial Statements for the year ended 30 June* 2012, (2012) 52.
[288] Sydney Water, *Annual Report* 2013, (2013) 65.
[289] Ibid 21.

and the tax of $78.398 million), and the dividend payout ratio would be calculated as follows:

Dividend payout ratio = $446.398m / $415.179m

= 107.52%

Rather than a dividend payout ratio of 88.64%, this would have risen to a dividend payout ratio of 107.52% had the tax neutral treatment been applied, an increase of 18.88%.

Earnings per share: Where no tax exemption was granted

This same percentage increase is reflected in the earning per share ratio. Earnings per share is calculated as: net income / average outstanding common share. The total ordinary shares in Sydney Water in 2013 (and 2012) was 3,108,354,000.[290]

Under the existing arrangement, where tax was paid on the refinancing, the earnings per share is calculated as:

= $415,179,000 / 3,108,354,000

= $0.1335688

Earnings per share: Where there was a tax exemption

Had no tax been paid on the refinancing of Sydney Desalination Plant, the net income would have increased from $415,179,000 to $493,577,000 (an increase of $78,398,000, being the tax paid on the transaction). The earnings per share under this scenario would have been:

= $493,577,000 / 3,108,354,000

= $0.15879

The increase in earnings per share as a result of not taxing the transaction is $0.02522, or an increase of 18.88%.

Conclusion

[290] Ibid 137.

As can be seen from the above example, although NSW Treasury would have received the same income stream whether it had been paid one lump sum dividend, or as a split between income and tax, applying paragraph 103A would have resulted in a massive distortion of the ratios and gives a false picture of the overall financial health of the company. This also contravenes the principles of competitive neutrality because had a privately-owned entity engaged in a similar transaction, where a major part of the business was to be divested, there would have been no similar tax exemptions or favourable tax treatments available.

This paragraph of the NTER Manual was used in order to grant a tax-neutral status to the privatisation of Ausgrid and TransGrid. All income and losses arising from those sales were treated in a non-assessable, non-deductible manner for tax purposes. Refer to section 5.1.3 for further discussion and analysis of these transactions.

4.1.3 An informal relationship with the ATO

The NTER Manual states that, while the relationship between the ATO and the NTER entities will be largely the same as that between the ATO and privately-owned organisation, the intention is "for the NTER to be carried on in a spirit of cooperation between the Commissioner, the States and Territories and the NTER entities. As such, the relationship between the Commissioner and the entities should be less formal than a relationship based purely on the law."[291]

This informal relationship will be discussed further in the case study which focuses on letters the ATO is willing to provide to NTER entities regarding tax treatments of transactions which might not strictly follow the letter of the law.

4.1.4 Lack of ability to participate in structuring to minimise tax

A major limitation of the NTER is that it does not allow for tax structuring opportunities that would otherwise be available to privately owned entities. For example, for private sector owned infrastructure, tax affairs are typically structured through the use of either a stapled company-trust structure, or a corporate structure funded by shareholder loans or redeemable preference shares (RPS). The result of such structuring typically enables many privately-owned infrastructure entities to achieve either nil, or close to nil, tax payable as a result. However, this type of tax

[291] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 8.

structuring is not permitted in the NTER and NTER entities typically have simpler tax structures, with many operating either as a standalone company, or as a simple and small consolidated tax group. Refer to case study 5.3: Comparison of NTER entities with their privately owned counterparts for more discussion of this issue.

Trust structures are not permitted in the NTER. Structuring involving the use of trusts and various vehicles has enabled privately owned entities to minimise tax payable. This puts NTER entities at a disadvantage when compared to their private sector counterparts. This is because the opportunities to legally minimise tax are not available to NTER entities and, as such, it is expected that any comparisons between tax paid by an NTER entity and tax paid by a similar private sector counterpart in the same industry will show that the NTER entity pays considerably more tax and so appears to be less efficient from a tax perspective. However, the inefficiencies may not be due to things within the control of the NTER entity, but rather, due to competitive neutrality having failed in this instance. This is examined in section 5.3: Case study: Comparison of NTER entities with their privately owned counterparts, and section 6.5.1: Comparison of tax paid between privately owned and publicly owned companies in the electricity industry.

If such tax structuring were to be permitted, all State and Territory governments would need to agree to the change. This would be unlikely because the States and Territories receive the tax equivalent payments and, as such, are unlikely to approve anything which would reduce their tax receipts.

In addition, it appears that tax minimisation strategies employed by price regulated entities have not resulted in a lower tax allowance in the building block framework utilised in setting prices. This has resulted in privately owned entities receiving a tax allowance in their prices that is greater than tax paid. This is discussed further in section 6.4.4: The AER review of the regulatory tax approach in the energy sector.

4.1.5 Imputation (franking) credits

Imputation credits (also referred to as franking credits) were introduced to ensure that company profits were no longer taxed twice – once in the hands of the company, and a second time in the hands of the shareholder who received dividends from the company. Since dividend imputation was introduced in Australia in 1987, a shareholder in receipt of a company dividend distribution “grosses up” that

distribution for the franking credit (or company tax already paid). This franking credit is then allowed as a tax offset against the tax liability of the shareholder. Although excess franking credits are refunded to individual shareholders, companies are not entitled to franking credit refunds.

Therefore, company tax can be considered to be a combination of corporate tax and personal tax.[292] Officer states:

> "The proportion of company tax that can be fully rebated against personal tax liabilities is best viewed as personal income tax collected at the company level. In effect, the tax collected at the company level is a mixture of personal tax and company tax, the company tax being that proportion of the tax collected which is not credited (rebated) against personal tax."[293]

The NTER manual discusses the effect of franking credits on NTER entities twice. Firstly, paragraph 111A of the NTER manual states:

> "The 'gross-up' and tax offset treatment provided for by Division 207 of ITAA 1997 will apply to franked dividends paid to NTER entities after 30 June 2002. An NTER entity must gross up any dividend by an amount equal to the franking credit on the dividend. The grossed up amount is included in assessable income and the NTER entity is entitled to a tax offset (non refundable) equal to the amount of the gross up."[294]

This treatment mirrors that available to the private sector. Private companies must also gross up a dividend and are then entitled to a non-refundable tax offset.

However, on dividends paid, paragraph 112 of the NTER Manual states:

> "The issue of franking credits in relation to dividends is not expected to arise in the NTER since ultimately the only shareholder in NTER entities will be a State or Territory government."[295]

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[292] John C. Handley, 'Report prepared for the Australian Energy Regulator: Advice on the value of imputation credits' (2014) *Melbourne University*, 4.
[293] R. R. Officer, 'The cost of capital of a company under an imputation tax system' (1994) 34(1) *Accounting & Finance* 2.
[294] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 26.
[295] Ibid.

Privately-owned companies are required to keep a record of tax paid in order to facilitate the passing on of these credits to their shareholders. They are required to keep a franking account and can pass on the franking credits to shareholders as part of a dividend distribution.

Under this paragraph of the NTER Manual, NTER entities pay their dividends to their owner State or Territory treasuries without attaching any imputation credits. This is not an issue because the State and Territory Treasuries are government departments and, therefore, are not taxpayers or subject to any tax equivalents. There is no need for the State or Territory Treasuries to reduce their taxes by imputation credits received, because they are not subject to tax at all. Also, when considering this in line with Officer's view above, this makes sense because none of the tax equivalents paid by an NTER entity can be considered to be personal tax payments at a company tax level. However, imputation credits are taken up when the price regulator sets prices for entities operating in a monopoly market. The effect of this is discussed further in section 6.5.4.

4.2 Non NTER features affecting NTER entities

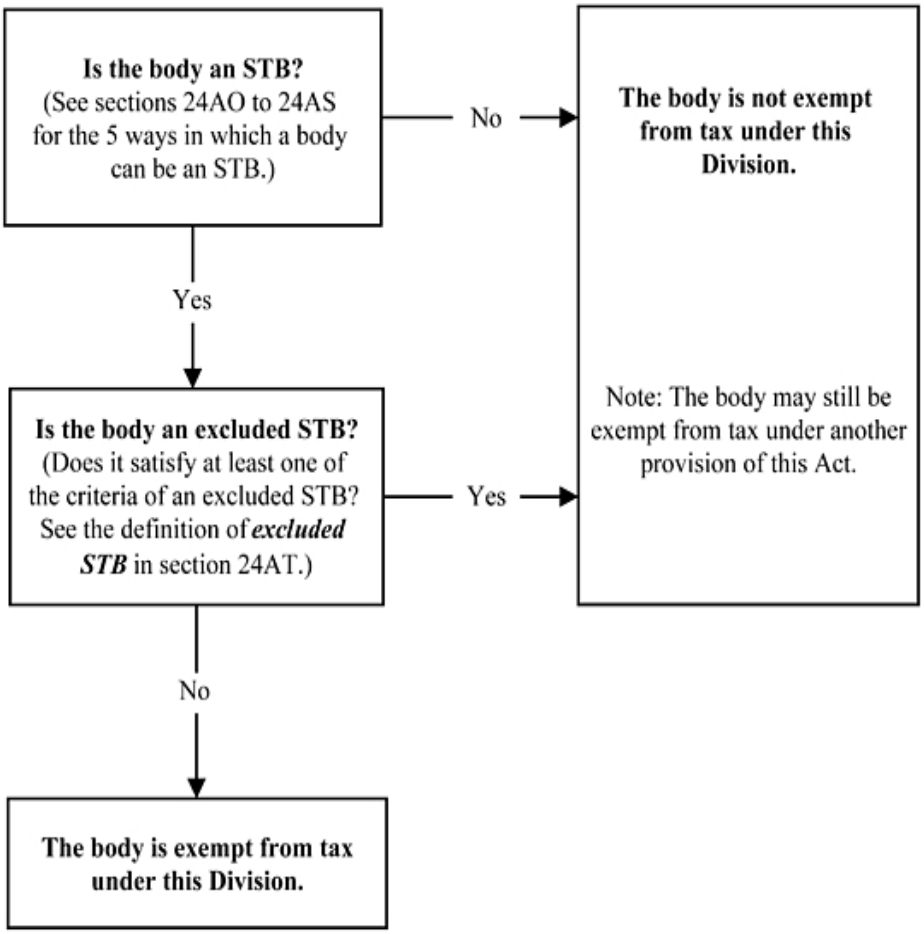
Not all matters that influence the taxing of state-owned enterprises come from the NTER. Some matters extend beyond the NTER Manual and are contained in the tax legislation This section examines these sections of the tax legislation and the affect they have on state-owned corporations in a manner that is outside the reach of any tax equivalent regime.

4.2.1 Division 1AB

Division 1AB (s 24AK to 24AZ) of the *Income Tax Assessment Act 1997* exempts certain wholly-owned state and territory bodies (STBs) from income tax, thereby leaving these bodies as payers of tax equivalents. Therefore, for income tax purposes, NTER entities are exempt from income tax. Thus, any tax paid is in the form of "income tax equivalents" rather than income tax. Prior to the introduction of Div. 1AB, and the NTER, section 23(d) of the ITAA1936 provided that the revenue of a public authority was exempt from income tax.

Under s 24AK, the income of a wholly-owned state or territory body is exempt from income tax (unless the body is an excluded STB). To determine whether an entity is exempt from income tax under this division, s 24AL provides the following diagram:

Section 24AL provides the following diagram as a guide to help work out whether a body is exempt from income tax under this Division:



An excluded STB is defined under section 24AT as an entity which:

> "(a) at a particular time, is prescribed as an excluded STB in relation to that time; or
>
> (b) is a municipal corporation or other local governing body (within the meaning of section 50-25 of the Income Tax Assessment Act 1997); or
>
> (c) is a public educational institution to which any of paragraphs 50-55(1)(a) to (c) of the Income Tax Assessment Act 1997 applies; or
>
> (d) is a public hospital to which any of paragraphs 50-55(1)(a) to (c) of the Income Tax Assessment Act 1997 applies; or

(e) is a superannuation fund."[296]

All NTER entities essentially fall into one of these categories and are not actual federal taxpayers, but rather, are subject to tax equivalents. This ties back to section 114 of The Constitution which does not allow the Commonwealth to tax the property of the States. Therefore, any tax payable cannot be payable to the Federal government, and any tax assessed cannot be an actual "real" tax, but rather, in the form of tax equivalents.

However, to allow for the administration of the NTER, the NTER manual provides for the following:

> "86. The relevant taxation laws are to be applied in all respects as if the following provisions were not applicable to the NTER entities:
>
> (i) Section 50-25 of the ITAA 1997 (dealing with the income tax exemption afforded to public authorities); and
>
> (ii) Division 1AB of the ITAA 1936 (dealing with the income tax exemption afforded to State/Territory bodies)
>
> 87. For example, whether or not a tax deduction is allowed under section 8-1 of the ITAA 1997 is to be considered as if the reference in paragraph 8-1(2)(c) to gaining or producing exempt income did not apply to the extent that the above exemptions are involved.
>
> 88. As a further example, section 51AD of the ITAA 1936 and Division 16D of the ITAA 1936 and Division 250 of the ITAA 1997, to the extent that these provisions might otherwise apply in relation to various arrangements (e.g. leases) under the NTER, do not apply if they are invoked only by virtue of the above exemptions applying to NTER entities."[297]

This paragraph of the NTER manual means that the tax laws will apply to nominated state-owned enterprises as though that division (Division 1AB) did not apply. However, instead of paying "real" tax (because on a Federal level, those laws exempt

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[296] *Income Tax Assessment Act 1997* s 24AT.
[297] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 21.

the NTER entities from paying Federal income tax), the entities pay tax equivalents under the NTER manual.

Although Div. 1AB exempts certain STBs from income tax under the *Income Tax Assessment Act 1997* and *Income Tax Assessment Act 1936*, it does not exempt STBs from other indirect taxes. These STBs retain their classification as a tax-exempt entity for other indirect taxes but are liable for those taxes. This has resulted in disadvantages to those STBs, discussed in section 4.2.3: Fringe benefits tax.

4.2.2 Division 57 of ITAA 1936

Division 57 of ITAA 1936[298] applies in circumstances when tax exempt entities become taxable. Under this Division, when a tax-exempt entity becomes taxable each asset is deemed to be disposed and purchased at the adjusted market value at that time.

Although not a technical feature of the NTER, the result of the application of this Division meant that all NTER entities, either on entry into the NTER or the predecessor STER, had to treat all assets as disposed of prior to entry into the NTER or STER and acquired on the date of entry into the NTER or STER. Despite the advantage of a higher cost base because of a deemed acquisition in either 1995 (for those that entered an STER) or from 2001 onwards (for those that entered the NTER), for many State-owned corporations which held old assets in their asset register, the application of this division meant that they lost the pre-CGT exemption for all assets purchased prior to 19 September 1985.

This has disadvantaged all State-owned corporations by making all assets subject to capital gains tax and ignoring the purchase date of many assets acquired prior to the introduction of the capital gains tax legislation.

Burton[299] believes that this "spared the considerable expense of creating records to comply with the capital gains regime" but also agrees that this left State Owned Corporations at a disadvantage when compared to their private sector counterparts. However, he goes on to state that "there seems little point in the State Government

[298] *Income Tax Assessment Act* 1936 (Cth) s 57-25.
[299] Burton, above n 280, 115.

expending considerable amounts of its precious financial resources upon resolving complex taxation issues arising from this implementation."[300]

This treatment was mirrored at the national level, when Division 10 of Part IX ITAA36, which was passed in 1988, held that superannuation funds were taken to have acquired all their capital assets at market value on 30 June 1988, the date they became taxable for the first time.[301]

4.2.3 Fringe Benefits Tax (FBT)

In addition to the disadvantage affecting State owned corporations due to the operation of Division 57 ITAA36, above, there is an additional disadvantage resulting from being a State-owned corporation which is not as a direct result of the operation of the NTER. This disadvantage relates to the operation of the Fringe Benefits Tax legislation and specific provisions within aimed at state-owned businesses.

State-owned businesses are subject to Fringe Benefits Tax (FBT) in the same manner as privately-owned organisations. Although s 114 of The Constitution does not allow the Commonwealth to tax the property of the States, it has been held that FBT is a tax on transactions rather than a tax on property, and therefore falls outside the reach of this section.[302]

This has created some disadvantages to the state-owned enterprises, as they still classify as tax-exempt entities for the purposes of the FBT legislation.

The Proof Committee Hansard: Joint Committee of Public Accounts and Audit on 25 August 2006 stated that competitive neutrality has not been applied in a small area of fringe benefits tax law.

Fringe benefits tax is a Federal tax and its administration in relation to State-owned enterprise is not part of the NTER. The Fringe Benefits Tax legislation was introduced in 1986, prior to the introduction of the NTER.[303] The Fringe Benefits Tax legislation points back to section 11.5 of the *Income Tax Assessment Act 1997* for the definition of tax-exempt body. That section lists State and Territory bodies as

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[300] Ibid 120.
[301] Ibid 115.
[302] *Queensland v Commonwealth* 87 ATC 4029.
[303] *Fringe Benefits Tax Assessment Act 1986.*

one of the types of entities that are tax exempt and refers back to Division 1AB of the *Income Tax Assessment Act 1936*. The fringe benefits tax legislation does not recognise the NTER and so government-owned corporations are considered tax-exempt bodies under Federal income tax laws.[304]

The potential disadvantage of being classified as a tax-exempt body pertains only to the treatment of entertainment fringe benefits. When calculating the taxable value of meal entertainment, a non-tax-exempt entity has the option of three valuation methods: the 50/50 split method, the 12 week register method, or the actual cost method.

For tax-exempt body entertainment, a fringe benefit arises, even if it would have otherwise qualified as a minor benefit. The tax-exempt body may elect to use the 50/50 split method or the 12-week register method under Division 9A FBTAA. A fringe benefit will only occur for non-deductible expenditure for income tax purposes. For non-tax-exempt entities, the gross-up rules will treat expenditure in providing a fringe benefit as tax deductible. However, this is not the case for tax-exempt bodies – the expenditure will retain its classification as non-deductible. In addition, a tax-exempt body is unable to reduce the taxable value of the fringe benefit by any employee contributions.

Therefore, as a result of this section of the legislation not recognising the payment of tax equivalents, NTER and any other entities which pay tax equivalents are left at a disadvantage as the legislation still treats them as a non-tax payer. Although not a feature of the NTER, it still serves to illustrate how state-owned corporations can be at a disadvantage when compared to privately owned corporations.

4.2.4 Case study: Gifted assets

Objective 3 of the thesis considers variation from State-to-State as a result of differences arising from the workings of each State or Territory's Treasury. This section will extend that examination further to consider variations resulting not only from state-to-state variations resulting from treasuries, but also from price regulator variations.

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[304] Commonwealth, *Parliamentary Debates*, Proof Committee Hansard. Joint Committee of Public Accounts & Audit. Reference: Certain taxation matters, (25 August 2006) 36.

Gifted assets are typically an issue in the infrastructure sector. Assets can be gifted to either the private sector or the public sector alike. Gifted assets usually arise when:

- Developers build infrastructure assets on common land which that developer is not permitted to own or operate under law. For example, a developer may build water, wastewater, stormwater or recycled water assets on common land as part of a development being built in Sydney. Under NSW laws, unless that developer has a Water Industry Competition Act (WICA) licence, the developer is not permitted to own or operate such assets. A WICA licence is needed by any person or entity who wishes to construct, maintain or operate any water industry infrastructure, or supply water or provide sewerage services by means of any water industry infrastructure, unless an exemption applies.[305] Assuming the developer did not have a WICA licence (which is likely for most property developers), that developer would be required to transfer the asset to the State's water utility, Sydney Water. If the water utility does not want to pay for the asset, the developer is left with no other choice but to transfer the asset at no cost, or "gift" the asset to the water utility. This type of scenario is common throughout the infrastructure industry, and would also apply if that developer had constructed electricity assets as part of the development.

- Other government agencies might undertake public works that require existing infrastructure assets to be moved or rebuilt. For example, works on the construction of a new road might require existing water pipes to be dug up and relocated. When these assets have been moved or rebuilt, they are often transferred to the utility at no cost.

- Improvements to existing assets can also be gifted. This can come about where, for example, a developer might require improvements to an existing asset or expansion of that asset in order to enable it to meet the needs of the development under construction. In these circumstances, the developer could carry out the work required or alternatively, pay for the improvements to be made by the owner of the asset.

[305] *Water Industry Competition Act 2006* (NSW).

These gifted assets can also be referred to as "developer contributions" and "capital contributions" (which can also refer to circumstances where cash is given to the utility rather than the developer performing the capital works). These terms are used interchangeably here.

There is mismatch in treatment of these assets or contributions, which will be expanded further below.

4.2.4.1 Regulatory treatment

As outlined earlier, the regulated asset base (RAB) only includes assets that a utility has either purchased for consideration or constructed. The cost of these assets is recovered through prices that the price regulator sets. Since gifted assets have no element of cost to the regulated entity, they are excluded from the RAB. Therefore, the result is that prices set by the price regulator do not recover the capital costs of gifted assets. When considering these capital contributions in relation to the water sector, the Essential Services Commission of Victoria states that the regulatory framework aims to ensure that water businesses are able to recover the cost of their capital investments through prices. However, the revenue requirement to recover these capital costs is not changed by assets which have been covered by partial payments by customers or for assets which are outright gifted and pose no cost to the water business receiving them.[306]

However, some price regulators are allowing for the value of these gifted assets to be included in the tax allowance. By doing so, the price regulator is allowing for the tax impact of these assets to be included in prices. This will be discussed further in the examples below.

4.2.4.2 Accounting treatment

Under AASB Interpretation 18, paragraph 11 states that "if an entity concludes that the definition of an asset is met, it shall recognise the transferred asset as an item of property, plant and equipment in accordance with paragraph 7 of AASB 116 and measure its cost on initial recognition at its fair value in accordance with paragraph 24 of that Standard". Therefore, for accounting purposes, any gifted assets are recognised as revenue in the year they are received and are included in the asset

[306] NERA, *Regulatory asset valuation and pricing: a report for the Essential Services Commission*, (5 February 2014) 18.

register at the fair value of that asset. Fair value is considered to be the replacement cost of the assets as at the date of acceptance of the gifted asset. This is usually an estimate of the developer's cost to construct the asset.

Then, as at 1 July each year, a cash-generating unit test (CGUT) is performed. This test compares the potential revenue from assets existing at that point in time (less operating costs) to the accounting book value of the assets. Any differences between the potential revenue and the accounting book value of assets are then adjusted in the accounting asset register through either revaluations or impairments.

Regulated assets relate to assets required in the delivery of monopoly-related services, and so are subject to price regulation by a pricing regulator. Non-regulated assets relate to assets which provide services that are subject to competition by other market participants. These services are not regulated by the price regulator. Most utilities have a portion of regulated and unregulated activities.

In a simplified environment where a utility has only regulated assets which are all included in the RAB, potential revenue (less operating costs) of the existing assets will be the present value of the return on and return of the RAB. Therefore, if the book value of assets is greater than the present value of the future net cash inflows generated by the assets in the RAB, the book value of the assets will be impaired down.

Unlike the simple example above, most regulated entities also have some non-regulated revenue. The present value of non-regulated revenue is added to the present value of the return on and return of the RAB to determine the utility's revenue potential for existing assets.

In both situations above, the gifted assets are effectively impaired to zero in the book value via the CGUT, because there is no return on or return of expected for these assets.

For example, the book value of assets as at 1 July 2009 might have been $100 million, and throughout 2009-10, $1 million of gifted assets might have been received, bringing the total accounting book value of assets to $101 million. Assuming nothing else has changed during the year, when performing the CGUT test on 30 June 2010, the $100 million RAB is compared to the accounting book value of

$101 million, and the excess $1 million is written off as an impairment. This means the net effect of the gifted assets is nil – the $1 million included as income has been effectively matched by a $1 million impairment expense, giving a nil effect on profit (assuming no revaluation of assets has previously taken place in this simplified example).

4.2.4.3 Tax treatment

For tax purposes, any gifted assets are treated as assessable income under section 21A – Non-cash business benefits.[307] Section 21A(2) states that "if a non-cash business benefit (whether or not convertible to cash) is income derived by a taxpayer:

(a) The benefit shall be brought into account at its arm's length value reduced by the recipient's contribution (if any); and
(b) If the benefit is not convertible to cash – in determining the arm's length value of the benefit, any conditions that would prevent or restrict the conversion of the benefit shall be disregarded."

Using the example above, the $1 million would be treated as assessable income. However, any impairment is not deductible for tax purposes, so the $1 million impairment will be added back during the preparation of the tax return as a non-deductible expense. The net effect then results in $300,000 in tax payable on assets that generate no income for the business.

However, the inclusion of the $1 million in assessable income then entitles the entity receiving the asset to a tax depreciation deduction over the life of the asset.

As it currently stands, the inability of an asset to be converted to cash is not considered when determining arm's length value.[308] This presents a potential problem where the reason that most of these assets are gifted to begin with is because legally they are not allowed to be sold or to be run by any entity without the required licenses.

A number of entities have begun grossing up any gifted assets for the tax payable as a result of receiving these assets, thereby shifting the tax liability to the entity

[307] *Income Tax Assessment Act 1936* (Cth).
[308] Paul Naglan and Charles Ferraro, 'A hidden tax cost for infrastructure projects' (2014) 49(6) *Taxation in Australia* 337, 338. S 21A(2)(b) ITAA36.

transferring the asset. In addition, these grossed up amounts are likely to be included as revenue too, resulting in the 30% tax also needing to be grossed up and effectively taking the total amount required from the developer to 43%.[309] This can present its own problem as the price regulator may include an allowance for gifted assets when arriving at its tax building block allowance, only to have the regulated entity then seek to a gross up tax payment from the provider of a gifted asset. This potentially represents double-dipping of the amount of tax, both by way of inclusion in the tax allowance, and then by an additional cash contribution from the developer transferring the asset.

Prior to the NTER, the STER (State Tax Equivalent Regime) had a special provision that exempted gifted assets from tax. Gifted assets are still being treated as exempt from tax in Queensland's Local Government Tax Equivalents Manual. In that manual, Local Government Income Tax Equivalents Ruling (LITER) 98/20: Assets Acquired Free of Charge (Contributed Assets) holds that gifted assets are to be treated in a revenue neutral manner – that is, the gifted asset or contribution will not be treated as assessable income, and no deductions will be allowed in respect of the initial value.[310] This treatment relates to those entities which selected Option 1 of LITER 98/19: Adoption of Current Cost Accounting,[311] which involves applying all income tax laws in respect of the entity's non-current assets. (Option 2 involves the use of the accounting asset register as a replacement for maintaining a separate tax asset register. This is outside the scope of this thesis.)

4.2.4.4 Attempts to overcome the problem

There have been a number of different ways of overcoming the issues that arise from gifted assets. These can include:

- The price regulator allows for tax on the gifted assets when determining prices. This results in the cost of gifted assets being recovered through prices in the bills that all consumers pay. The overall effect is an increase in revenue and therefore taxable income.

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[309] PwC, 'Capital contributions and infrastructure projects' (1 May 2014) *PwC TaxTalk Monthly* 2; Paul Naglan and Charles Ferraro, 'A hidden tax cost for infrastructure projects' (2014) 49(6) *Taxation in Australia* 337, 339.
[310] Queensland Treasury, *Local Government Tax Equivalents Manual*, (2010) 86.
[311] Ibid 83.

- In some instances, the price regulator advises the regulated entity to charge the tax back to the entity doing the gifting. This results in the gifted asset also being recognised in the form of increased revenue; however, this time it is payable by the developer rather than by the bill payers.
- The State owned entity's State or Territory Treasury can adjust the dividend to reduce the tax effect of these gifted assets. In this case the return on equity ratios are affected as they are adjusted for the value of gifted assets received.
- Or the State Treasury and the price regulator can do nothing, and the State-owned corporation can end up worse off. This ultimately results in the entity "wearing" the cost of the gifted assets.

Once gifted assets have been reported as income, and tax paid on the value, the receiving entity can claim tax depreciation deductions over the useful life of the asset. Therefore, the only real difference is the time value of money of the tax depreciation deductions versus the tax paid upfront. Because infrastructure assets are typically long-lived, this could be a significant loss for the receiving entity.

4.2.4.5 Western Power – Capital contributions

Western Power commenced charging a tax recovery rate on capital contributions from 5 January 2015. Previously, Western Power used to absorb any tax relating to capital contributions. However, after consultation with their regulator, the Economic Regulation Authority (ERA), it was decided that the tax on such contributions should be borne by the entity gifting the asset or making the contribution, rather than borne by the customer through increased prices.[312]

The rate charged to the gifting entity is 13.9% of the value of the gifted asset or cash contribution.[313] This is calculated by taking into account the upfront tax on the value of the asset or contribution, and the net present value of the future tax depreciation deductions allowed.

[312] Western Power, Land Development Industry: Recovery of tax on capital contributions http://3ece.com.au/wp-content/uploads/2014/04/WP-Tax-2014.04.02.pdf
[313] Ibid.

4.2.4.6 Water Corporation – Capital contributions and dividends

The Economic Regulation Authority (ERA) issued a report which considered developer contributions relating to the Water Corporation.[314] In this report, the ERA also considered the tax treatment of developer contributions. The ERA noted that tax is payable on any developer contributions, however, dividends paid to the State Treasury are paid exclusive of revenue from gifted assets.

The ERA did note that over the life of the asset there is no net tax impact.[315] This is because any amount assessed upfront will be deductible over the life of the asset. I argue that this is too simplistic a view because it does not take into account the time value of money; and that the tax paid upfront will be greater than the net present value of the depreciation deductions claimed over the life of the asset.

4.2.4.7 Conclusion – Gifted assets/Developer contributions

As can be seen through the various case studies and examples above, there is a discrepancy in the overall treatment of gifted assets and developer contributions. Whilst the tax treatment is fairly straightforward – the value of the asset or contribution is assessable upfront – the impact of the discrepancies between the treatment of different price regulators, and the treatment of different State and Territory Treasuries has resulted in an uneven playing field. However, this not only relates to an uneven playing field between publicly versus privately owned entities, but also between like entities.

4.3 State to State variations arising from the workings of each State and Territory Treasury

4.3.1 State treasuries and dividend policies

State Treasuries each set their own policies relating to the setting of dividends. The *Financial Distribution Policy* 'requires Government businesses to determine an appropriate distribution policy based on a 'modified' residual approach.'[316] This policy enables Government businesses to agree on dividend targets and capital repayments.

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[314] Economic Regulation Authority (WA), *Inquiry into Developer Contributions to the Water Corporation: Final Report*, (2008).
[315] Ibid 116.
[316] New South Wales Treasury, *Financial Distribution Policy for Government Businesses (applies until 30 June 2010)*, above n 40.

This could impact the extent to which the NTER has achieved competitive neutrality given that, State-by-State, the approach to taxation might be different depending on how the dividend is calculated, or whether the entity can expect to receive any tax refunds it is due. For example, an entity might be more diligent in applying favourable tax positions if it paid a set dividend, when compared to an entity that paid a dividend that was set as a percentage of post-tax profits.

It is argued that requiring State or Government Owned Enterprises to pay dividends is effectively removing any advantages they might have by being State owned and putting these entities on the same footing as privately owned organisations.[317] In addition, Queensland Treasury argues that "the adoption of an explicit dividend policy will help dispel any misconception that the cost of equity finance is zero and facilitates comparison with private and public sector benchmarks"[318]

The following will provide a comparison of each State and Territory's Treasury regarding their dividend setting policies.

4.3.1.1 New South Wales

The dividend-setting policy for NSW Treasury is contained in its Financial Distribution Policy for Government Business. It provides a negotiation mechanism for the setting of dividends but sets a benchmark dividend payout ratio of 70% of post-tax profit. In doing so, however, NSW Treasury does not rule out the requirement for businesses to pay greater than 70% if that business has the capacity to do so.[319] "Dividends should be expressed as a percentage of post-tax profits and adjusted where required for items including non-cash fair value movements in financial instruments."[320]

NSW Treasury is not in favour of any State-owned businesses keeping any cash or financial assets on hand that are in excess of its requirements.[321]

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[317] New South Wales Treasury, *Financial Distribution Policy for Government Businesses*, (2016) 3.
[318] Queensland Treasury, *Commercialisation of Government Business Activities in Queensland*, above n 261, 24.
[319] New South Wales Treasury, *Financial Distribution Policy for Government Businesses*, above n 317, 2.
[320] Ibid 5.
[321] Ibid 2.

4.3.1.2 Victoria

Victoria's dividend setting guidelines are contained in its Corporate Planning and Performance Reporting Requirements guidelines.

Victorian Government Business Enterprises (GBEs) have two guidelines regarding the setting of dividends, these being:

- 50% of net profit after tax; or
- 65% of pre-tax profit (where the GBE is not required to pay tax equivalents, or where there is a significant difference between income tax payable and income tax expense).[322]

4.3.1.3 Queensland

Dividends paid by entities owned by the State in Queensland are negotiated on an annual basis. There are no percentage guidelines as there are for other State or Territory Treasuries, but instead rely on an expectation that "once the capital structure and required rate of return on assets have been set, dividends would effectively be determined as a residual matter as the return on debt is fixed and debt has priority over equity in the distribution of revenues."[323]

4.3.1.4 Northern Territory

The Northern Territory has a dividend guideline of 50% of after-tax profits. However, the Treasurer may alter this if the GBE has high debt levels, or there is high forecast future capital expenditure.[324]

4.3.1.5 Tasmania

The general dividend policy of Tasmania requires Tasmanian Government businesses to pay a dividend of 90% of net profits after tax, unless a lower percentage can be justified.[325]

A lower dividend ratio may be considered in circumstances of:

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[322] Department of Treasury and Finance (Vic), *Corporate planning and performance reporting requirements: Government business enterprises*, (2009) 13.
[323] Queensland Treasury, *Commercialisation of Government Business Activities in Queensland*, above n 261, 24.
[324] Department of Treasury and Finance (NT), above n 204, 9.
[325] Department of Treasury and Finance (TAS), *Guidelines for Tasmanian Government Businesses – Dividends*, (2014) 3.

- "the progression towards, or maintenance of, an appropriate capital structure;
- cash flow requirements for working capital;
- funding requirements for capital expenditure; and/or
- contingency required for financial flexibility."[326]

4.3.1.6 Western Australia

The West Australian dividend policy, as contained in the West Australian Government's Statement of Corporate Intent for 2014/15, provides that a dividend is calculated based on 65% of the WATC's after tax profits, subject to adjustments allowed by the Treasurer.[327]

4.3.1.7 Conclusion

The above section outlined the differences that State and Territory Governments take in setting dividends. Differences in how State and Territory Treasuries require dividends (percentage, set, and so on) will impact whether entities are more or less likely to pursue tax saving opportunities. For example, if an entity were likely to keep a greater percentage of any savings as a result of minimising their tax, they would be more likely to pursue tax savings than an entity that was paying out 90 or 100% of post-tax profits in dividends.

4.4 Case studies: Non-neutral treatment under the NTER

4.4.1 Letter from the ATO

Several NTER entities have entered long standing contracts. These old agreements were typically Build Own Operate (BOO) or Build Own Operate Transfer (BOOT) type contracts. Some of these contracts were entered into prior to the introduction of any tax equivalent regimes. The aim of these agreements was to encourage the private sector to invest in the public sector, either by building, owning and operating (BOO) infrastructure assets, or by building, owning, operating, and then transferring (BOOT) these assets at an agreed date in the future.

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[326] Ibid.

[327] West Australian Treasury Corporation, *Statement of Corporate Intent 2014/15*, (2015) 16.

At the time the old standing contracts were entered into, government owned entities sought to make these types of agreements more appealing to the private sector by structuring them in such a way to shift all tax benefits to the private sector. At the time, this seemed a favourable thing to do – the government owned entities were not subject to any sort of tax equivalent regimes and were not taxpayers in any form, so any tax advantages would have been wasted; and the structuring of tax advantages made the agreements more appealing to the private sector.

However, problems arose when the government introduced tax equivalent regimes. Once government owned entities were turned into taxpayers, they were disadvantaged by old agreements and contracts that benefited the private sector and saw these state-owned corporations at a significant disadvantage from a tax perspective.

Even more so, when it came time to renegotiate old contracts, State owned corporations were put in an even more difficult position of attempting to negotiate an even remotely favourable outcome when the private sector party was unwilling to let go of previously won tax advantages.

To attempt to remedy this problem, the NTER section of the Tax Office came up with a solution. With the agreement of the State treasury of the NTER entity in question, the ATO was willing to provide a letter of assurance to the NTER entity. This letter provides that the entity can treat these transactions in an agreed way without it being subject to any further audit or questioning by the ATO or their State Treasury. This is more favourable than applying for a formal tax ruling because these agreements would not result in a favourable outcome for the NTER entity if the strict letter of the tax law were to be applied. Thus, the ATO and the State or Territory treasury are willing to overlook the strict application of the tax law to allow for a more favourable outcome for the NTER entity.

Appendix 9.4 outlines the specific circumstances relating to the issuing of one of these letters.

Since this type of letter was made available within the NTER, there have been several letters of this type issued. Not all of them have related to agreements or contracts put in place prior to the introduction of the NTER or any State tax

equivalent regimes. They have also been allowed in instances where State or Territory directives have caused negative tax outcomes for NTER entities. In these cases, the State or Territory treasuries have given the NTER directives to structure agreements in certain ways, which then result in an undesirable tax outcome, which the NTER entity would never have entered had their owner Treasury not directed them to do so. However, there has been no mention of such agreements in the NTER Manual. The NTER Manual only covers government-imposed restructures and privatisation. It states:

> "103. A renegotiation of arrangements or a restructure by an NTER entity may be the result of requirements externally imposed on the NTER entity by its State or Territory government. This includes a renegotiation or a restructure involving the transfer of assets for no consideration from an NTER entity to another entity of its State or Territory government that does not have commercial returns as a primary objective and is not an NTER entity.
>
> A privatisation of an asset owned, or business activity carried on by an NTER entity may be externally imposed on the NTER entity by its State or Territory government….
>
> 103A. Such an imposed renegotiation, restructure or privatisation will be treated in a tax neutral manner for NTER purposes…
>
> 103B. Alternatively, such an imposed renegotiation, restructure or privatisation may be treated in a manner which the NTER administrator approves as appropriate in the circumstances, including taking into account;
>
> - Whether the proposed tax treatment gives an NTER entity involved an unfair advantage over its competitors in other States or Territories; and
> - The arrangements and structures that have previously existed in relation to the business operations of the NTER entities involved."[328]

[328] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 23-24.

It is a recommendation of this research thesis that the ATO should amend the NTER manual to include a section on these types of letters and agreements to enable transparency.

4.4.2 Capitalised labour

The ATO considered the issue of the deductibility of salary and wages paid to employees involved in the construction of capital assets. This was an issue mainly in those industries where large capital assets were constructed, that is, mainly infrastructure. However, this issue affected both privately owned corporations and several NTER entities alike. As part of their consultations with industry, the ATO discovered the salary and wages of those staff engaged in the construction of capital assets was being treated several different ways. Some companies were deducting the entire cost outright, others were capitalising the expense as part of the cost of construction of the asset, whilst others took the middle ground and capitalised the cost of those solely dedicated to the construction of capital assets and deducted the cost of those only partly dedicated to the construction of capital assets.

In seeking to introduce a uniform method of treatment for the salary and wages related to the construction of capital assets, the ATO released two ATO Interpretive Decisions:

- ATO ID 2011/42: Deductibility of salary or wages to the extent that employees are engaged in the self-construction of depreciating assets; and
- ATO ID 2011/43: Deductibility of labour on-costs to the extent that employees are engaged in the self-construction of depreciation assets.

The result of these ATOIDs was to rule that all salary and wage costs relating to the construction of capital assets were to be treated as capital and were not to be deducted for tax purposes. However, the privately owned federal taxpayers were advised that they had to go back and amend the prior four years of tax returns and pay any outstanding taxes resulting from the introduction and back-dating of this treatment. Meanwhile, State owned corporations in the NTER were advised that these changes would apply prospectively and therefore there was no need to go back and amend prior year tax returns.

In this example, the State-owned corporations were given an advantage despite the existence of the NTER, which has the role of putting the state owned and privately-owned corporations on the same footing. They were left with an advantage over their privately-owned counterparts by not having to pay any additional tax on overclaimed salary and wage expenses.

4.5 Conclusion

Chapter 4 examined key features of the NTER, both those that might be an advantage to NTER entities, such as the tax neutral treatment of government imposed restructures and an informal relationship with the ATO, and those that could be a disadvantage to NTER entities, for example, the lack of ability to appeal, the lack of the ability for NTER entities to participate in tax structuring with the intention of minimising tax, and the non-requirement to abide by laws regarding imputation credits.

Further, this chapter considered non-NTER related tax issues that affect NTER entities, for example, the operation of Division 1AB, Division 57 ITAA 1936, and gifted assets. This chapter was the first to contain the case studies utilised in this research. The first case study was the "letter of comfort" from the ATO, whereby the tax treatment of particular transactions is agreed upon (not to the strict letter of tax law), and NTER entities are given the assurance that the ATO will not challenge the treatment in future. The second case study examined the tax treatment of capitalised labour. It was found that, on the introduction of the ATOIDs relating to capitalised labour, NTER entities were permitted to apply this treatment on a prospective basis, whereas privately-owned entities were required to amend the prior four years of tax returns and pay any tax outstanding.

The following chapter will continue to expand the literature to examine different regulatory structures. It will also involve the use of case studies and will analyse and interpret data to compare NTER entities with their privately-owned counterparts.

5 Examination of privatisation, and a comparison of NTER entities with their privately-owned counterparts

5.1 An examination of privatisation and the impact on competitive neutrality

This section will involve an examination of other tools which may be used to achieve competitive neutrality, and how these tools were used in Australia. This section will also consider how effective these tools were in achieving competitive neutrality. This section will firstly focus on the use of debt neutrality and the impact it had on competitive neutrality. It will then move to a discussion and case study of privatisation.

As previously discussed in the opening of chapter 3, the Hilmer Report and Harper Review both recommend the use of privatisation, corporatisation, the reform of specific advantages and disadvantages, and pricing directions to achieve competitive neutrality. This section will examine whether these strategies were successful in achieving competitive neutrality and whether they could be considered to be more successful than the introduction of the NTER in achieving competitive neutrality, and how the NTER interacted with these other methods. For example, we will examine some case studies which consider the interaction of paragraph 103A: 'Government imposed restructures and privatisations' of the NTER Manual and how this paragraph was applied to the privatisations of Ausgrid and TransGrid.

In addition, this section will examine the effect joining the NTER had on a state-owned corporation. It will seek to examine the changes that needed to be made, and whether there were any efficiency gains as a result of needing to pay tax. In addition, it will explore whether tax forms a major part of contract negotiation and business decisions.

5.1.1 Debt neutrality

Debt neutrality is one of the competitive advantages that was targeted in the implementation of the national competition policy in Australia. It was believed that state-owned enterprises had an advantage over their privately-owned counterparts by

way of paying less for debt either through lower interest rates or subsidies. In targeting debt neutrality as an area of focus to achieve competitive neutrality, it was hoped that with the introduction of debt neutrality measures public and private sectors would both be subject to the same debt financing costs.

However, each State treasury has its own financial institution which State-owned entities are required use for borrowing and financing. This financial institution operates in a sector where competition is readily available (through banks and other financial institutions) and yet it has no competition because its only clients are State-owned enterprises which are discouraged from going to the private sector and seeking more competitive borrowing rates. Although entities might be able to obtain cheaper financing by going to the private sector (borrowing through banks), they are unable to do so without the approval of their State or Territory treasury. This has put State owned entities at a potential disadvantage when compared to their private sector counterparts. This could be an area for further research. It is merely being mentioned here as a comparison, and to illustrate instances where competitive neutrality measures might have failed.

The details of each State's borrowing corporation are as follows:

- NSW: New South Wales Treasury Corporation (TCorp) https://www.tcorp.nsw.gov.au/html/
- Western Australia: Western Australian Treasury Corporation (WATC) http://www.watc.wa.gov.au/
- Victoria: Treasury Corporation of Victoria (TCV) https://www.tcv.vic.gov.au/
- Queensland: Queensland Treasury Corporation (QTC) https://www.qtc.com.au/
- Northern Territory: Northern Territory Treasury Corporation (NTTC) http://www.treasury.nt.gov.au/BorrowingAndInvestment/Pages/default.aspx
- South Australia: South Australian Government Financing Authority (SAFA) http://www.safa.sa.gov.au/
- Tasmania: The Tasmanian Public Finance Corporation (TASCORP) http://www.tascorp.com.au/

In addition, "significant government businesses in Australia are liable to factor in debt neutrality adjustments to their borrowing if they benefit from debt advantages due to their public sector ownership."[329] These debt neutrality adjustments ensure that competitive neutrality requirements are met, and that State-owned corporations do not receive any advantages by virtue of their government ownership.

Australia's system of debt neutrality is similar to the one in place in the United Kingdom. In the United Kingdom, SOEs are not permitted to borrow from the open market. The reason for this is to ensure SOEs do not gain any advantages from an implicit government guarantee. Instead, all financing by the SOEs must be attained from the National Loans Fund (NLF).[330]

For this type of arrangement, where borrowing is required to be made from the State, the OECD recommends ensuring that the borrowing is done according to market rates and terms.[331]

Australia ensures debt neutrality is met by engaging debt rating agencies to provide a credit evaluation of SOCs under the same criteria used for privately-owned entities.[332]

An example of the level of government control over the State-owned corporations can be seen in Treasury Circulars. NSW Treasury has issued Treasury Circular TC98/07: Structured Finance Transactions, which puts restrictions around State-owned agencies from entering any complex financing transactions, including:

- "operating leases
- finance leases
- cross-border leases
- securitisations
- structured asset acquisitions; and
- other similar transactions."[333]

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[329] OECD, *Competitive neutrality: Maintaining a level playing field between public and private business*, above n 66, 95.
[330] Ibid 94.
[331] Ibid.
[332] Ibid.
[333] New South Wales Treasury, Treasury Circular TC98/07, *Structured finance transaction*, (2007).

Requirements are in place under this Treasury Circular to ensure that agencies submit proposals for such transactions to NSW Treasury for assessment prior to committing to any form of this type of structuring. This results in State-owned corporations not being entirely independent of the State. The State is still able to influence control and exercise decision-making powers over the running of the entity. In this way, the State is also able to determine the level of risk the entity is allowed to take, and therefore can also have a part in decision-making.

A comparison of the debt levels and high-level interest rates between publicly-owned and privately-owned energy companies is made in section 5.3: Case study: Comparison of NTER entities with their privately-owned counterparts.

5.1.2 Privatisation

The discussion of privatisation in this thesis is two-fold. The first part considers privatisation in the context of competition and competitive neutrality, and its effectiveness therein. In addition, it will consider examples and studies from overseas experiences with privatisation, and the effect of the regulatory regime on the effectiveness of privatisation. The second part considers the interaction of the NTER when NTER entities undergo privatisation.

The OECD states that the definition of privatisation differs between OECD countries. For the purposes of its work, the OECD defines privatisation as:

> "As privatisation may be considered any material transaction by which the state's ultimate ownership of corporate entities is reduced. This definition includes direct divestment by the state, divestment of corporate assets by government-controlled investment vehicles as well as the dilution of state positions in SOEs by secondary share offerings to the non-state shareholders. It may also include divestment of subsidiaries by SOEs, though this is more of a gray area: if SOEs for example shed subsidiaries in consequence of government decisions then the resultant transactions would normally be considered as privatisation. However, if partly state-owned enterprises decide to divest based on commercial considerations then it makes little sense to speak of privatisation – lest any merger and acquisition of

> the said enterprises should be considered as "privatisation" and "nationalisation".[334]

For Australian purposes, privatisation involves the full or partial transfer of assets owned by the State to the private sector. Rather than including the sale of land or buildings, privatisation refers to the transfer of a business as a 'going concern'. However, privatisation is not the private financing of large infrastructure projects, leasing or contracting out of services.[335]

Privatisation raises cash for the State and eliminates subsidies by the government to the State-owned entity.[336] However, where the State receives the initial cash injection by the sale of the assets, the State also loses the tax equivalent payments the privatised entity used to pay whilst under State ownership and the NTER. These tax equivalent payments then become actual federal tax payments under the Federal tax system once the business is privatised. There has been discussion about whether to allow States to continue to receive these tax payments from privatised entities. This is discussed further in section 5.1.2.2: Privatisation and the loss of tax payments to the State. In addition to losing the tax equivalent payments, the State also loses the dividend payments it used to receive, once it privatises its businesses.

In addition to raising funds for the State, a further argument for the privatisation of State-owned businesses is to promote innovation and investment. Kressides (cited in Nepal and Foster), argues that privatisations improve innovation and investment in the electricity networks sector.[337] Also, a result of privatisation is that businesses are free to structure their borrowing and financing any way they choose and are not held to public sector restrictions on borrowings.[338] Public sector constraints on borrowings are covered in the debt neutrality discussion in section 5.1.1. However, a potential

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[334] OECD, *Privatisation in the 21st Century: Recent experiences of OECD countries: Report on good practices,* (2009) 5.
[335] Reserve Bank of Australia, 'Privatisation in Australia' (1997) *Reserve Bank of Australia Bulletin* 1.
[336] Nepal, Rabindra and John Foster, 'Electricity networks privatisation in Australia: An overview of the debate' (2015) *School of Economics: University of Queensland* 5.
[337] Kressides, 2004 cited in Nepal, Rabindra and John Foster, 'Electricity networks privatisation in Australia: An overview of the debate' (2015) *School of Economics: University of Queensland* 19.
[338] OECD, *Privatisation, competition and regulation*, (2000) 29.

disadvantage from privatisation is that the private sector will forgo objectives which are deemed to be socially valuable with the aim of maximising profits.[339]

In addition, State-owned corporations are subject to different objectives set by their owner State or Territory government. Company law as it currently stands does not have any provisions which can stop the government setting these objectives for their corporatised businesses.[340] These objectives were discussed in section 2.11.2.

The National Tax Equivalent Regime plays a key role in the privatisation of State-owned businesses. By requiring the State-owned business to be subject to a tax equivalent regime, NTER entities are required to abide by the ATO's rules to keep accurate and complete tax records. This involves detailed tax asset registers and, in addition to the ATO's record-keeping requirements, the accounting standards require the calculation of a tax provision and deferred tax assets or liabilities for the purposes of the Financial Statements. In so doing, the process of privatisation is improved, and is simpler and more transparent, as all the data needed for the tax due diligence required by the private sector as part of the sale process, is available and complete.

This section will examine privatisation from the Australian context and will draw on research undertaken as to the effectiveness of privatisation overseas. It will consider the type of assets suitable for privatisation, privatisation and the regulatory regime, and privatisation effects on efficiency. It will also look more specifically at privatisation in the electricity sector, as this is a focus of this thesis. Lastly, this section will examine a case study of privatisation in Australia.

5.1.2.1 Which assets should be privatised

While a government might choose to go down the path of privatisation, not all its businesses are suitable for privatisation. Infrastructure Australia produced a report which considered which infrastructure assets are suitable for privatisation. It allocated them into the following categories:

- "Those which have competitive markets and where the remaining publicly owned assets are suitable candidates for transfer to the private sector;

[339] Holmstrom and Milgrom, 1991, cited in Nepal, Rabindra and John Foster, 'Electricity networks privatisation in Australia: An overview of the debate' (2015) *School of Economics: University of Queensland* 5.
[340] OECD, *Privatisation, competition and regulation*, above n 338, 26.

- Those which are not competitive or have significant non-competitive segments, but in which appropriate regulatory structures currently apply, making them suitable candidates for transfer to the private sector;
- Those which are not competitive or have significant non-competitive segments and where the regulatory framework is not yet suitably developed to allow privatisation, but where this can be achieved with structural and/or regulatory changes; and
- Those which are unsuitable for transfer to the private sector, either because of significant structural or regulatory impediments, or sectors which are unlikely to yield upfront revenue from privatisation because they do not have sufficient non-Government earnings and/or they carry a very large community service obligation component."[341]

In order to prepare for privatisation, the government needs to take certain steps. Prior to privatisation, restructuring of government business needs to take place. Key to the success of privatisation is the separation of commercial and non-commercial objectives within the State-owned corporation.[342] Further, within a natural monopoly segment, it is important to separate the monopoly parts of the business from those parts which can be competitive.[343] For example, the electricity sector in Australia has been successfully separated into network, distribution and retail segments. Some of these components are natural monopolies, while others are able to be competitive. This is covered further in section 5.2.2.2.

5.1.2.2 Privatisation and the loss of tax payments to the State

Once the government privatises its assets, two things occur. Firstly, it ceases to receive dividends from the privatised businesses. Secondly, it also ceases to receive the tax equivalent payments made under the NTER. This is because the entity now being privatised is no longer subject to a tax equivalent regime, and instead becomes subject to Federal income tax. Tax payments, if any, are no longer made to the State, and are instead made to the Commonwealth.

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[341] Infrastructure Australia, *Australia's public infrastructure: Part of the answer to removing the infrastructure deficit* (Australian Government, October 2012) 17.
[342] OECD, *Privatisation, competition and regulation*, above n 338, 25.
[343] Ibid 37.

The Senate issued "Privatisation of State and Territory assets and new infrastructure". As part of this inquiry, submissions were sought from interested parties. The Water Services Association of Australia requested that, on privatisation, States and Territories should be compensated for the loss of dividends and tax equivalent payments that resulted from the privatisation of State-owned assets.[344]

Although notional tax payments under the NTER are lost, the Productivity Commission held that

> "dividend imputation and productivity gains from privatisation could offset the loss of notional income tax payments. Specifically, if dividend imputation is complete and the purchaser of the enterprise can obtain full compensation of company tax through franking credits, a State Government would not lose from privatisation."[345]

However, tax payments typically reduce, at least in the initial years, after privatisation. This could be because of stamp duty relating to the transaction, or because of more aggressive tax treatments and structuring taken by the private sector. This is expanded further in section 6.5.2.

5.1.2.3 Privatisation and efficiency

There has been much debate and many studies around whether privatisation has resulted in increased efficiency and whether privatisation has resulted in an increase in prices (refer to section 5.2.2.2.1: The increase in electricity prices and privatisation for further discussion about whether the privatisation of much of the electricity industry has been the cause for the increase in electricity prices and bills). In the electricity industry, in particular, it has been found that privatisation has had no effect on electricity prices. The increase has largely been driven by aging assets which need to be replaced. The AER reported that "its regulatory determinations from 2009 to 2011 reflected increasing capital needs to replace aging assets, meet

[344] The Senate: Economics References Committee. *Privatisation of state and territory assets and new infrastructure*, (2015) 9.
[345] Productivity Commission, *Public Infrastructure*, above n 163, 263.

higher reliability standards and respond to forecasts made at the time of rising peak demand."[346]

Notwithstanding this, the AER reports that privately-owned electricity companies in the distribution sector "generally appear more productive" than their State-owned counterparts.[347] On the other hand, the Australia Institute reports that the increase in electricity prices could be due to the decrease in productivity experienced in the electricity sector since privatisation. It argues that whilst productivity has increased throughout the economy by 33.6%, it has instead decreased by 24.9% in the electricity sector.[348]

Privatisation is generally believed to result in more efficiency. Infrastructure Australia argues that a transfer of privately owned infrastructure assets to the private sector "can often result in more efficient management of the infrastructure, remove conflicts of interest where the government is both owner and regulator and transfer responsibility for future investment in upgrades and expansions to the private sector."[349] It should be noted that there is no conflict of interest where the government is both owner and regulator. Price regulators, although owned by the government, provide an independent regulatory function and are not under any influence by any levels of government. The role of the price regulator is outlined in section 6.1.

Infrastructure Australia goes on to state that efficiency gains can be made by privatising assets in the form of:

- productivity efficiency gains: where infrastructure services are provided to consumers at a lower cost;
- allocative efficiency gains: where the infrastructure assets are put to their most efficient use; and

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[346] ABC News, 'Fact check: Does privatisation increase electricity bills?' *ABC News* (online), 3 March 2016 <https://www.abc.net.au/news/2015-03-25/fact-check-does-privatisation-increase-electricity-prices3f/6329316>
[347] Ibid.
[348] Richardson, David, 'Electricity and privatisation: What happened to those promises?' (2013) 22 The Australia Institute, 1.
[349] Infrastructure Australia, above n 341, 4.

- dynamic efficiency gains: where there is long-term innovation, sound investment and delivery of efficient services.[350]

It is argued that although State-owned corporations are generally less efficient than their privately owned counterparts, where these businesses are operating in a natural monopoly industry, they are able to continue operating as there is no competition to challenge their position in the market.[351] So where, in a contested market, a less efficient operator would have been out of business by the presence of a more efficient business, in a monopoly market, these businesses are able to continue their operations due to a lack of competition from more competitive players. However, this paper argues that efficiency is determined by the price regulator in allowing for what it considers to be efficient expenditure in its prices. This is examined in chapter 6.

Two reports indicate that State-owned corporations are inefficient in comparison to their privately-owned counterparts. "A Productivity Commission report in 2013 found that some network businesses were inefficient, reliability standards were too high and management of peak demand was weak."[352] In addition, the "New South Wales Commission of Audit also concluded that publicly owned New South Wales electricity businesses are inefficient in comparison with those privately owned."[353] However, studies carried out by IPART and the McKell Institute have found that electricity companies owned by the State are either more efficient or as efficient as their privately owned counterparts.[354] The IPART and McKell Institute studies demonstrate that privatisation may not have resulted in efficiency.

The literature appears to demonstrate an inconsistency in opinion about whether privatisation has resulted in increased efficiency. One of the factors that has an influence on the efficiency of entities could be price regulation, because the price regulator makes no distinction between private and public, and therefore, both types

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[350] Ibid 11.
[351] Productivity Commission, *Electricity networks regulatory frameworks: Productivity Commission inquiry report*, Report No 62 (2013) 12.
[352] ABC News, 'Does privatisation increase electricity bills?', above n 346.
[353] Infrastructure Australia, above n 341, 12.
[354] Lynne Chester, 'Myths, not facts, muddy the electricity privatisation debate', *The Conversation* (online), 18 March 2015 <http://theconversation.com/myths-not-facts-muddy-the-electricity-privatisation-debate-38524>.

of entities can be expected to be measured and held accountable using the same benchmarks. This will be discussed in the next section.

5.1.2.4 Privatisation and the regulatory regime

In monopoly industries, the effectiveness of privatisation in achieving efficiency gains, and whether these are passed onto the consumer, depends very much on the regulatory regime. An effective regulatory regime needs to be in place prior to the privatisation of a State-owned enterprise.

International studies have found that privatisation will only result in improvements in efficiency if it is accompanied by an effective regulatory framework.[355] This is because an effective regulatory framework is needed in order to ensure that any efficiency gains resulting from privatisation are passed on to consumers through lower prices. Without an effective regulatory regime, efficiency gains are at risk of being retained by the private sector.

The Productivity Commission believes that the current incentive-based regulation regime is best suited to the private sector and that there is no longer a need for State-owned electricity network businesses, since incentive-based regulation is best targeted towards privately owned businesses whose main targets are to minimise costs and maximise profits.[356] If State-owned network businesses are not privatised, the Productivity Commission believes that there needs to be a change to the governance arrangements, including board members being appointed on merit, a requirement for the public disclosure of all ministerial directions, and the removal of non-commercial objectives.[357]

However, the OECD has found that regulators often underestimate the profit and cost-cutting motives of newly privatised businesses.[358] Also, The Australia Institute argues that the private sector will pay more for assets in a monopoly market as there is potential to earn more from these assets due to the lack of competition in the market. The result of paying above market value also comes with additional borrowings which also need to be funded by increased prices.[359] A number of

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[355] Nepal and Foster, above n 336, 27.
[356] Productivity Commission, *Electricity networks regulatory frameworks: Productivity Commission inquiry report*, above n 351, 24.
[357] Ibid 25.
[358] OECD, *Privatisation, competition and regulation*, above n 338, 39.
[359] Richardson, above n 348, 10.

regulators (for example, IPART and the AER) do not factor in any above market prices paid for assets – prices are set on the value of assets alone, not the prices paid for them. However, this could be an area for further research to determine whether any other price regulators allow for higher prices resulting from an above market price paid for monopoly assets. In relation to the additional borrowings and resultant additional interest expense, the price regulator sets a debt to equity ratio for each of its regulated businesses. Any borrowings above this amount are to be borne at the regulated entity's own expense.

5.1.2.5 Privatisation in the electricity industry

The Productivity Commission investigated the electricity network sector and found that "state-owned network businesses have conflicting objectives, which reduce their efficiency and undermine the effectiveness of incentive regulation. Their privately-owned counterparts are better at efficiently meeting the long-term interests of their customers."[360] The Productivity Commission went on to recommend that all State-owned electricity network businesses should be privatised.[361]

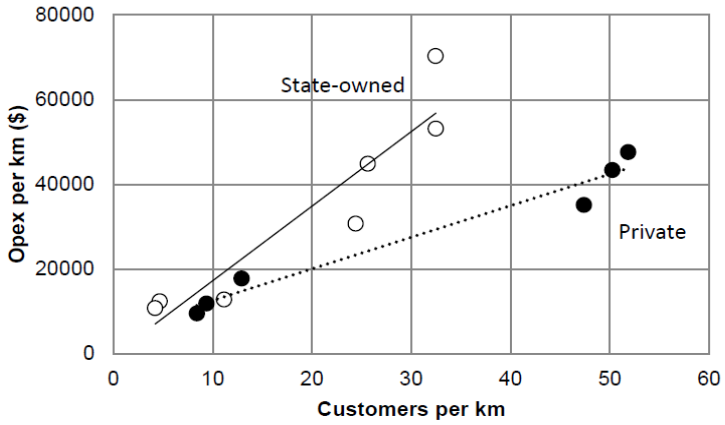
The Productivity Commission compared the operating expenses for State-owned and privately-owned electricity network businesses in Australia. It found that the State-owned corporations in the electricity network sector were less efficient than their privately-owned counterparts, with the cost of production being higher in the State-owned sector than the privately-owned sector. The graph below is an extract from the

[360] Productivity Commission, *Electricity networks regulatory frameworks: Productivity Commission inquiry report*, above n 351, 3.
[361] Ibid.

Productivity Commission report.[362]

Figure 7 **Operating expenses for state-owned and private businesses**

$ per kilometre of line



This table shows that privately owned entities in the electricity network out-perform their State-owned counterparts and are able to deliver electricity at a lower operating cost than the State-owned sector for all numbers of customers surveyed.

Given the above, it could reasonably follow that the private sector electricity networks would then pay more tax than their State-owned counterparts due to the availability of fewer tax deductions (resulting from more efficient, and therefore lower, operating expenses). However, the ATO also performed a comparison of tax paid between publicly owned and privately owned corporations and found that the publicly-owned corporations also paid more tax than their privately owned counterparts.[363] (This is discussed further in section 6.4.4) This outcome indicates a potential problem in the NTER which could restrict how State-owned corporations are able to minimise their tax or could reinforce the view that State-owned

[362] Productivity Commission, *Electricity networks regulatory frameworks: Productivity Commission inquiry report*, above n 351, 25.
[363] 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>

corporations are more conservative (or, for these purposes, less efficient) than their privately owned counterparts, including in the management of their tax affairs.[364]

In the privatisation of the electricity networks in Australia, Chester states that employees were disadvantaged, whereas investors, owners and creditors were advantaged by the privatisations.[365] Further, Nepal and Foster found that "the extent of gains to consumers from networks privatisation depends on the toughness of the regulator and the effectiveness of the underlying network regulation regime in a given regulatory institutional framework."[366]

When electricity network assets are initially privatised, electricity prices experience a rise. This rise can be minimised by effective price regulation. The long-term gains of privatisation to the consumer are dependent on effective price regulation to ensure the gains are passed onto the consumer.[367]

Whilst there could be questions about whether the private sector would forgo service standards in the interest of greater profits and therefore greater returns to shareholders, the Productivity Commission states that there is no evidence that productivity, quality, reliability or cost performance standards are any lower in the private sector than they are in the public sector.[368]

5.1.2.6 Overseas experiences with privatisation

A number of countries embarked on privatisation much earlier than Australia. This section looks at overseas experiences of privatisation, where privatisation provided improvements, and where it failed.

In Argentina, Columbia and Chile, privatisation came with additional expense to the government because contracts needed to be constantly updated and renegotiated. In addition, the government was required to provide additional funds at public expense. Also, US privatised uranium enrichment company U.S. Enrichment Corporation

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[364] 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; Australian Taxation Office, 'ATO Note', *Indicative comparative analysis of the AER electricity distribution tax allowance and tax payable* (10 April 2018).
[365] Chester, 2007 cited in Nepal, Rabindra and John Foster, 'Electricity networks privatisation in Australia: An overview of the debate' (2015) *School of Economics: University of Queensland* 11.
[366] Nepal and Foster, above n 336, 11.
[367] Ibid 19.
[368] Productivity Commission, *Electricity networks regulatory frameworks: Productivity Commission inquiry report*, above n 351, 25.

needed a public bail-out. Stiglitz and Rosengard state that one of the reasons for the failure of privatisation is due to the abuse of monopoly power.[369]

A study of the performance of privatised businesses in Egypt found that there was a significant improvement in performance when a before and after privatisation comparison is made. However, when non-privatised businesses in the same industry were also compared, there too was an improvement in performance. Therefore, either privatisation improves the performance in an industry or the privatisation had nothing to do with the improvement in performance, and that improvement could have come about as a result of other factors.[370] The OECD has found that it is not privatisation which is the catalyst for improved performance, but rather, the introduction of competition into a market.[371]

In addition, privatisation in the UK water industry has not resulted in the efficiencies expected. This is discussed further in section 5.2.2.1: The water industry.

5.1.2.7 Division 58 ITAA97

This section will briefly look at Division 58 ITAA97 which applies to newly privatised depreciating assets which were owned by a tax-exempt entity. For the purposes of Division 58, NTER entities are classified as tax-exempt entities as they are not Federal taxpayers. Division 58 caps the opening value of assets upon entry to the Federal tax regime.

The options available to the purchaser of privatised assets are to value the opening written down value for tax purposes at either:

- the *notional written-down value* (NWDV) of the asset at the time it transfers to the private sector; or
- the *undeducted pre-existing audited book value* at the time it transfers to the private sector.

[369] Stiglitz and Rosengard, above n 269, 208.
[370] Omran cited Cagla Okten and K. Peren Arin, 'The effects of privatization on efficiency: How does privatization work?' (2006) 34(9) *World Development* 1537
[371] OECD, *Privatisation, competition and regulation*, above n 338, 35.

The application of this division limits privatised assets' opening value to less than market value. Future tax depreciation is then determined using the values prescribed under the application of this division.

5.1.2.8 Conclusion

This section has briefly examined privatisation as an alternative for competitive neutrality and has illustrated that privatisation, has had mixed success. It is an area for further research to determine why it has succeeded in some instances and has not been as successful in others. With further research, this could possibly be improved for the future. However, it should be noted again that privatisation is only one of the options available for achieving competitive neutrality, and it has been found to be not as important in producing an improvement in results as the introduction of competition.[372] Further, a key success factor in the privatisation of State-owned businesses is the integrity of the regulatory system underpinning the way business is done and prices are set in the privatised sector.

5.1.3 Privatisation of Ausgrid and Transgrid: Case study

The most recent privatisations in Australia have been undertaken via a sale and lease-back transaction, usually using a finance lease with a 99-year lease term. Assets being privatised are transferred to the Crown, and those assets are then leased to the winning bidder, often a consortium, in exchange for a 99-year lease. At the end of the lease term, these assets transfer to the private sector.

Two privatisations undertaken using this type of transaction were the privatisations of Ausgrid and TransGrid. This section will examine the privatisation of these two companies because they are both in the electricity sector, their privatisation attracted a lot of media attention, and because the ATO applied a paragraph of the NTER Manual that allowed the sales to be treated in a tax-neutral manner, meaning that no tax was paid by the owner NTER entities on the sale of these assets. Calculations of ratios will be performed to determine the effect of treating these sales as tax-neutral, and the effect this had on the overall results to these companies, and to the State. It will further be shown how the privatisation resulted in an outcome that makes it difficult to determine how much tax the companies are now paying, and why it

[372] Ibid 35.

would be difficult for States to argue for the receipt of the Federal tax these privatised companies now pay.

Transgrid

Transgrid operates and manages the high voltage transmission network in NSW and the ACT.[373] Transgrid was privatised via a 100% lease for 99 years in 2015 for a total of $10.273 billion.[374] It was purchased by a consortium comprised of Spark Infrastructure, Hastings, Caisse de depot et placement du Quebec (CDPQ), and Tawreed Investments Limited.[375] Total proceeds of $9.758 billion were remitted directly to the Crown and were treated as a distribution to the Restart NSW Fund.[376] On completion of the transaction, Transgrid was converted into the Electricity Transmission Ministerial Holding Corporation (ETMHC).[377]

The breakdown of proceeds was as follows:[378]

	$'000
Cash proceeds received by former TransGrid SOC	61,513
Purchase price adjustment paid to ETMHC post 16 Dec	15,137
Stamp duty	438,000
Cash proceeds remitted directly to the Crown	9,758,368
Total proceeds	10,273,018

Cash proceeds remitted directly to the Crown	9,758,368
Repayment of NSW TCorp borrowings	(3,420,880)
Payment of FY 14/15 2nd dividend instalment	(147,303)
Total net cash proceeds	6,190,185

[373] Transgrid, *About Us* <https://www.transgrid.com.au/AboutUs>
[374] New South Wales Parliament, *Privatisation in NSW: a timeline and key sources*, (2017) 9.
[375] Transgrid, *Welcoming our New Owners* <https://www.transgrid.com.au/news-views/news/2015/Pages/Welcoming-our-new-owners.aspx>
[376] New South Wales Government, *2015-16 Crown Related Entities' Annual Reports*, (2016) 132.
[377] Ibid 105.
[378] Calculated based on figures provided in New South Wales Government, *2015-16 Crown Related Entities' Annual Reports*, (2016) 132.

As part of the privatisation, the ATO issued a private binding ruling that held the long-term lease transaction was tax neutral under the NTER. This private ruling held that the gain on the long-term lease of the TransGrid network, the loss on the early settlement of debt, and other costs related to the transaction were to be non-assessable and non-deductible for tax purposes.[379] Paragraph 103A of the NTER Manual states that in relation to government-imposed restructures and privatisations:

> "Such an imposed renegotiation, restructure or privatisation will be treated in a tax neutral manner for NTER purposes. (For example, on an imposed transfer of CGT assets, there will be no CGT consequences for the transferor and the transferee will inherit the CGT cost bases of the transferor.)"[380] (This is also discussed in section 4.1.2).

Paragraph 103 states that:

> "This includes a renegotiation or a restructure involving the transfer of assets for no consideration from an NTER entity to another entity of its State or Territory government that does not have commercial returns as a primary objective and is not an NTER entity."[381]

Had TransGrid not been part of the NTER, any gains or losses on the sale of this business would have been assessable. A private business making such a disposal would not have been allowed a non-assessable, non-deductible tax treatment. Following the privatisation, the Electricity Transmission Ministerial Holding Corporation (ETMHC) was established to act as the lessor of the network assets.[382] ETMHC was granted a tax-exempt status as part of the privatisation when the TransGrid SOC was privatised and the assets moved to the Ministerial Holding Corporation.[383]

The 2015-16 Related Crown Entity Annual Reports contained the details of the disposal of TransGrid SOC. In the table below, the first column is an extract of the TransGrid discontinued operations section of the Crown Related Entities' 2015-16

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[379] New South Wales Government, *2015-16 Crown Related Entities' Annual Reports*, (2016) 133.
[380] Australian Taxation Office, *Manual for the National Tax Equivalent Regime (Version 10),* above n 2, 24.
[381] Ibid 23.
[382] New South Wales Government, *2015-16 Crown Related Entities' Annual Reports*, (2016) 105.
[383] Ibid 123.

Annual Reports. It can be noted that as a result of the tax ruling mentioned above, there is a non-assessable gain on lease and sale transaction and related costs of $991.183 million. The second column removes these non-assessable, non-deductible amounts and treats the entire transaction as taxable, as would be the case for the private sector.

	Crown Entity return	**Amended**
	$,000	**$,000**
	Pg 130	
Financial Performance of Discontinued Operations		
Revenue	418,556.0	418,556.0
Expenses excluding finance costs	(191,573.0)	(191,573.0)
Finance costs	(76,387.0)	(76,387.0)
(Loss)/gain on disposal of property, plant and equipment	0.0	0.0
Results from operating activities	150,596.0	150,596.0
Loss on early settlement of debt portfolio	(301,845.0)	(301,845.0)
Gain on disposal of discontinued operation	3,635,210.0	3,635,210.0
Total loss on early settlement & gain on disposal of discontinued operations	3,333,365.0	3,333,365.0
Profit from discontinued operations before tax	3,483,961.0	3,483,961.0
Income tax equivalent benefit/(expense)	284,288.0	(715,474.3)
Profit after tax for the period from discontinued	3,768,249.0	2,768,486.7
	Pg 135	
Profit/(loss) before income tax expense	3,483,961.0	3,483,961.0
Tax exempt profit/(loss) from 17 December 2015 onwards	(28,599.0)	
	3,455,362.0	3,483,961.0
Income tax expense/(benefit) calculated at statutory income tax rate of 30%	1,036,608.6	1,045,188.3
Non-assessable gain on lease and sale transaction and related	(991,183.0)	
Expenditure not allowed for income tax purposes	(1,376.0)	(1,376.0)
Origination and reversal of temporary differences recognised in relation to prior years	(330,043.0)	(330,043.0)
Adjustments in respect of current income tax of previous years	1,705.0	1,705.0
Income tax expense/(benefit) recognised in profit or loss of discontinued operations	(284,288.4)	715,474.3

As can be seen from the above table, assessing the non-assessable gain results in the change of the tax position from an income tax benefit of $284.2 million to an income tax expense of $715.47 million. This, in turn, changes the profit after tax from $3,768.249 million to $2,768.487 million, a decrease of 26.53%.

The following will look at the impact of allowing such tax treatment on the financial ratios.

Return on assets

Return on assets = Net profit after tax / Total assets

For the purposes of this exercise, the return on assets ratio will be calculated using the net profit after tax of the discontinued operations divided by the total assets disposed of.

The 2015-16 Crown Related Entities' Annual Report outlines the assets de-recognised under the 99-year finance lease, and the assets disposed of through the sale.[384] The total assets derecognised under the 99-year finance lease and disposed of through sale total $6,447,533.[385]

The return on assets resulting from treating the transaction in a tax-neutral manner is:

= $3,768,249 / $6,447,533

= 58.44%

The return on assets resulting from removing the non-assessable gain of $991.183 million and the tax-exempt loss of $28,599 million is:

= $2,768,486.7 / $6,447,533

= 42.94%

The removal of the tax-neutral status resulted in a reduction of the return on assets from 58.44% to 42.94%. By granting a tax-neutral ruling, the result overstates the return on assets.

[384] Ibid 131.
[385] Ibid.

Return on equity

Return on equity = Net profit after tax / Total equity

This ratio will seek to compare the net profit after tax of the discontinued operations with the total equity prior to the privatisation. It aims only to illustrate the difference in the ratio as a result of treating this transaction in a tax-neutral manner.

The total equity in the financial statements immediately prior to privatisation was $2,092,931.[386]

The return on equity resulting from the transaction is:

= $3,768,249.0 / $2,092,931

= 180.05%

Had the transaction not been treated in a tax-neutral manner, the return on equity would have been:

= $2,768,486.7 / $2,092,931

= 132.28%

Again, the treatment of the transaction as a tax-neutral transaction with gains and losses treated as non-assessable and non-deductible overstated the return on equity. It gave the appearance of a much greater return on equity than would have been the case for a privately-owned entity.

Ausgrid

Ausgrid was formerly part of EnergyAustralia. EnergyAustralia was restructured and assets which comprised the grid were broken away from the main company and formed into a separate company which was named Ausgrid. Ausgrid was privatised by way of a 99-year lease which transferred 50.4% to the private sector for $16.2 billion on 1 December 2016.[387] The remainder of Ausgrid is still held by the NSW Government. The privatised portion is held by AustralianSuper and IFM Investors.[388]

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[386] TransGrid, *TransGrid Annual Report 2015*, (2015) 76.

[387] New South Wales Parliament, *Privatisation in NSW: a timeline and key sources*, above n 374.

[388] Ausgrid, *About Us* <https://www.ausgrid.com.au/Common/About-us.aspx#.W245DjMnaMw>

Ausgrid now operates as a partnership between the private sector and the public sector. Total proceeds of $15.7 billion were remitted directly to the Crown Entity and were also used as a distribution for the Restart NSW Fund.[389]

The breakdown of proceeds was as follows:[390]

	$'000
Cash proceeds received by former Ausgrid SOC	61,400
Purchase price adjustment paid to ADMHC post 16 Dec	37,400
Stamp duty	489,000
Cash proceeds remitted directly to the Crown	15,700,300
Total proceeds	16,288,100

Cash proceeds remitted directly to the Crown	15,700,300
Repayment of NSW TCorp borrowings	(10,168,100)
Payment of FY 16 dividend	(63,500)
Payment of Government Guarantee Fee (GGF)	(223,100)
Total net cash distribution	5,245,600
Promissory note received from NSW Govt	3,852,100
Net distribution reflected in statement of changes in equity	9,097,700

Similar to TransGrid, above, Ausgrid SOC also received a private binding ruling from the ATO which treated the privatisation in a tax neutral manner under the NTER, where the gain on the lease, the loss on the early settlement of debt, and other expenses related to the privatisation were held to be non-assessable and non-deductible for tax purposes.[391] Similar to TransGrid above, this ruling would have been sought in relation to paragraph 103 of the NTER Manual.

[389] New South Wales Government, *2016-17 Crown Related Entities' Annual Reports*, (2017) 185.
[390] Calculated based on figures provided in New South Wales Government, *2016-17 Crown Related Entities' Annual Reports*, (2017) 184-85.
[391] New South Wales Government, *2016-17 Crown Related Entities' Annual Reports*, (2017) 185.

Following the privatisation, the Alpha Distribution Ministerial Holding Corporation (ADMHC) was established to act as the lessor of the network assets.[392] ADMHC was granted a tax-exempt status as part of the privatisation when the Ausgrid SOC was privatised, and the assets moved to the Ministerial Holding Corporation.[393]

Similar to TransGrid, above, had Ausgrid not been a State-owned corporation subject to tax under the NTER, the option of treating such a divestment in a tax neutral manner, where all gains and losses are non-assessable or non-deductible for tax purposes, would not have been an option. This section will outline the outcome that such treatment had on the financial ratios. It will also estimate the gains and losses and tax which would have been assessed had the transaction not been treated in a tax neutral manner.

Ausgrid SOC prepared financial statements to the day before it was privatised on 1 December 2016. The Ausgrid website contains the Ausgrid SOC financial statements for the period 1 July 2016 – 30 November 2016. It also contains the financial statements for the Ausgrid Partnership for the period 20 October 2016 to 30 June 2017. The Crown Related Entities' 2016-17 Annual Reports contain details of the disposal transaction.[394] The data relating to the disposal overlap between the final Ausgrid SOC financial statements and the Crown Related Entities' 2016-17 Annual Reports. This section will use the two reports to piece together the details of the transaction. It will further move to look at the difference tax would have made to the transaction.

In the table below, the first column is an extract of the Ausgrid discontinued operations section of the Crown Related Entities' 2016-17 Annual Reports. It can be noted that as a result of the tax ruling mentioned above, there is a non-assessable gain on lease and sale transaction and related of $1,312.5 million, and a non-deductible realised loss on retirement of long-term debt of $200.3 million. This represents a total net non-assessable gain of $1,112.2 million. The second column removes these non-assessable, non-deductible amounts and treats the entire transaction as taxable, as would be the case for the private sector.

[392] Ibid 153.
[393] Ibid 172.
[394] Ibid 184.

	Crown Entity return	Amended
	$M	$M
	Pg 183	
Financial Performance of Discontinued Operations		
Revenue	1,158.0	1,158.0
Expenses excluding finance costs	(640.6)	(640.6)
Finance costs	(200.8)	(200.8)
(Loss)/gain on disposal of property, plant and equipment	(10.5)	(10.5)
Results from operating activities	306.1	306.1
Loss on early settlement of debt portfolio	(667.7)	(667.7)
Gain on disposal of discontinued operation	4,375.0	4,375.0
Total loss on early settlement & gain on disposal of discontinued operations	3,707.3	3,707.3
Profit from discontinued operations before tax	4,013.4	4,013.4
Income tax equivalent benefit/(expense)	1,014.8	(97.4)
Profit after tax for the period from discontinued	5,028.2	3,916.0
	Pg 187	
Profit/(loss) before tax	4,013.4	4,013.4
Income tax using the domestic corporation tax rate of 30%	1,204.0	1,204.0
Non-assessable gain on lease and sale transaction and related	(1,312.5)	
Non-deductible realised losses on retirement of long term debt	200.3	
Other non-deductible expenses	0.5	0.5
Non-assessable income on the sale of property	1.5	1.5
Over provision of tax in prior years	(0.1)	(0.1)
Reclassification of superannuation to continuing operations	(1.6)	(1.6)
Origination and reversal of temporary differences recognised in relation to prior years	(1,106.9)	(1,106.9)
Income tax expense/(benefit) recognised in profit or loss of discontinued operations	(1,014.8)	97.4

As can be seen from the above table, the removal of the non-assessable gain and non-deductible loss results in a change in the tax position from an income tax benefit of $1,014.8 million to an income tax expense of $97.4 million. This, in turn, changes the profit after tax from $5,028.2 million to $3,916.0 million, a decrease of 22.12%.

The following will compare a few key financial ratios and how they varied when treating the transaction as a tax-neutral transaction, and as a taxable transaction.

Return on assets

Return on assets = Net profit after tax / Total assets

For the purposes of this exercise, the return on assets ratio will be calculated using the net profit after tax of the discontinued operations divided by the total assets disposed of.

The 2016-17 Crown Related Entities' Annual Report outlines the assets de-recognised under the 99-year finance lease, and the assets disposed of through the sale.[395] The total assets derecognised under the 99-year finance lease and disposed of through sale total $16,072.9.[396]

The return on assets resulting from treating the transaction in a tax-neutral manner is:

= $5.028.2 / $16,072.9

= 31.28%

The return on assets resulting from removing the non-assessable gain on lease and sale transaction and related of $1,312.5 million and non-deductible realised loss on retirement of long-term debt of $200.3 million is:

= $3,916 / $16,072.9

= 24.36%

The removal of the tax-neutral status resulted in a reduction of the return on assets from 31.28% to 24.36%. By granting a tax-neutral ruling, the result overstates the return on assets.

Return on equity

Return on equity = Net profit after tax / Total equity

[395] Ibid 183-84.
[396] Ibid.

This ratio will seek to compare the net profit after tax of the discontinued operations with the total equity prior to the privatisation. It aims only to illustrate the difference in the ratio as a result of treating this transaction in a tax-neutral manner.

The total equity in the financial statements immediately prior to privatisation was $3,679.4 million.[397]

The return on equity resulting from the transaction is:

= $5,028.2 / $3,679.4

= 136.66%

Had the transaction not been treated in a tax-neutral manner, the return on equity would have been:

= $3,916.0 / $3,679.4

= 106.43%

Again, the treatment of the transaction as a tax-neutral transaction with gains and losses treated as non-assessable and non-deductible overstated the return on equity. It gave the appearance of a much greater return on equity than would have been the case for a privately-owned entity.

Conclusion

The privatisation of TransGrid and Ausgrid saw tax rulings issued which treated the transaction as a tax neutral transaction, with gains and losses being non-assessable and non-deductible for tax purposes. This treatment would not have been available to a privately-owned entity on the disposal of one of its businesses. In addition, this treatment is inconsistent with the treatment of the disposal of the Sydney Desalination Plant, the disposal of which was assessable under the NTER (although Sydney Water did not seek to have this transaction treated in a tax neutral manner for NTER purposes). This illustrates that this paragraph of the NTER manual can be used in such a way as to give a government-owned entity a tax advantage that is not

[397] Ausgrid, *Ausgrid and its Controlled Entity: Consolidated financial statements for the 5 month period ended 30 November 2016*, (2016) 3.

available to the private sector, but also, that it can be applied inconsistently to NTER entities. Although the transfers of Ausgrid and Transgrid were to a State-owned entity that does not have commercial returns as a primary objective and is not in the NTER, the entities transferring the assets (in this case Ausgrid and Transgrid) are not exempt from having commercial returns as their objective.

The result of this favourable tax treatment resulted in large income tax benefits where, in fact, without these rulings, both entities would have experienced an income tax expense. The size of the benefit received was substantial too, being $991.183 million for TransGrid and $1,112.2 million for Ausgrid.

5.2 Why tax was the policy used to achieve competitive neutrality in this case

Tax was used alongside a number of other tools to achieve competitive neutrality. With the introduction of the Hilmer Report recommendations, it was decided that a number of the tools to achieve competitive neutrality would be used. So rather than tax being the only method used to achieve competitive neutrality, it formed a small piece of the larger puzzle. The Hilmer Report recommended the use of corporatisation, privatisation, reforming any advantages or disadvantages that State-owned businesses might have over their privately-owned counterparts, and pricing directions (through the form of price regulation).[398] All of these recommendations have been put in place, to some degree.

Indeed, the OECD recommends tax neutrality as just one of a number of tools to achieve competitive neutrality and recommends that governments use a number of these tools together to achieve a more even playing field.

The OECD recommends:

- "Streamlining the operational form of government business
- Identifying the direct costs of any given function
- Achieving a commercial rate of return
- Accounting for public service obligations
- Tax neutrality

[398] National Competition Council, above n 6, 300-302.

- Regulatory neutrality
- Debt neutrality and outright subsidies
- Public procurement."[399]

When considering how to achieve competitive neutrality, the Hilmer Report recommended that competitive neutrality is achieved in four different ways:

- Privatisation
- Corporatisation
- Through the reform of specific advantages and disadvantages; and
- Through pricing directions.[400]

Issues of financing and tax neutrality were briefly mentioned under Corporation and *Reform of Specific advantages and disadvantages*. While this is more sparse and less thought-out than the OECD recommendations, this could be due to the Hilmer Report pre-dating the OECD recommendations by about 20 years.

A report subsequently submitted by Australia to the OECD outlining the measures taken to achieve competitive neutrality noted that the Australian competitive neutrality policy mainly focused on tax neutrality, debt neutrality, regulatory neutrality, and achieving commercial rate of return requirements (*Roundtable on Competitive Neutrality in Competition Enforcement – Note by Australia*).

The Harper Review stated that competitive neutrality should focus on corporatisation, privatisation and full cost-reflective pricing. In addition, the main measures taken to achieve competitive neutrality were as mentioned above in Australia's submission to the OECD (that is, tax neutrality, debt neutrality, regulatory neutrality, and achieving commercial rate of return requirements).

5.2.1 Monopolies and competition policy

"Monopoly pricing" occurs where an entity has the ability to restrict output or charge higher prices as a result of there being no other competition in the market. There are two scenarios where monopoly pricing can occur.

[399] OECD, *Competitive neutrality: Maintaining a level playing field between public and private* business, above n 66.
[400] National Competition Council, above n 6, 300-302.

The first is where an entity exists in a natural or legislated monopoly. The government has attempted to remedy this by regulating prices. However, "economic efficiency has seldom been the sole or even principal criterion in regulating prices, with governments often choosing to regulate to favour categories of consumers or to achieve other social or political objectives. Price regulation of this kind may come at a cost to economic efficiency."[401] There is further argument that allowing a monopoly to charge high prices without putting in place pricing regulation will encourage competitors to find a way to enter into that market.[402]

In addition, regulation does have its disadvantages. Costs of administration can be quite high. A lot of government investment is required to make regulation work. Also, regulatory schemes can result in market distortions as private companies attempt to maximise their profits within regulatory guidelines.[403]

The second takes place in unregulated uncontestable markets. It is important to understand the industry and whether barriers to entry are high in order to determine whether monopolistic pricing is at play or pricing is merely due to a competitive return on capital.[404]

Where a monopoly is unregulated and privately owned, the organisation can take advantage by being in a position of having no competition by increasing prices and reducing quality, resulting in large profits.[405]

The Hilmer Report only recommends regulation or price control as a last resort if there are no other options. Price regulation does not solve the problem of there being a lack of competition in the industry in question and, as such, should only be used if there are no better alternatives or other options.[406]

Although monopolies by nature have no competition, it is believed that the mere threat of competition can result in improved efficiency.[407] This improved efficiency as a result of a threat of competition is the reason why monopolies have been

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[401] Ibid 270.
[402] Ibid 271.
[403] Stiglitz and Rosengard, above n 269, 207.
[404] National Competition Council, above n 6, 271.
[405] Sanford V. Berg, 'Best practices in regulating state-owned and municipal water utilities' (2013), *United Nations* 9.
[406] National Competition Council, above n 6, 271.
[407] Collins, above n 36.

included in competitive neutrality measures and are subject to tax equivalent payments. There may be no room in the market for actual competition due to the nature of the industry; however, just having legislation that does not prevent any competition and leaves it open for potential competition is enough to achieve competition goals.[408] As such, the threat of potential competition, no matter how unlikely, should lead to improved efficiency and lower prices.

> "The NCP reforms have placed downward pressure on the cost of infrastructure services and increased choice across the economy. Twenty years ago, infrastructure markets were characterised by vertically integrated, government-owned monopolies that were not responsive to changes in consumer tastes or needs. This has largely changed through competition policy. While most infrastructure markets have been substantially reformed, the Panel has heard numerous examples that suggest progress has been patchy, the degree of reform differs substantially among sectors and much more needs to be done to provide greater choice and better service levels for consumers and businesses.[409]
>
> The introduction of competitive neutrality and the application of the CCA to government businesses encouraged private businesses to invest and compete alongside government-owned businesses. E.g., there are now many privately-owned electricity generators competing alongside the remaining government-owned generators. Private operators have also entered the market in rail, with most freight services now privately owned and operated.[410]
>
> In contrast, there has been little private investment in urban water supply, except for desalination plants. These plants are reliant on government contracts and are shielded from demand risk."[411]

This section highlighted the importance of separating out non-monopoly components of industries, and creating market conditions conducive to competition.

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[408] OECD, *State owned enterprises and the principle of competitive neutrality*, above n 12, 327.
[409] Commonwealth of Australia, *Competition Policy Review Draft Report*, above n 71, 117.
[410] Ibid.
[411] Ibid.

5.2.2 The electricity and water industries

This section briefly examines the electricity and water industries in Australia. The discussion will then branch out to a more detailed study of the water industry (section 5.2.2.1) and the electricity industry (section 5.2.2.2).

Comparisons were made between the OECD average and Australia's results of productivity. These comparisons focused on capital and labour productivity for a number of sectors of the economy for the period between 1970 and 1985.[412] The comparisons lead to the conclusion that the most unproductive sector of the economy was that of Australia's public utilities (electricity, gas and water). However, when these results were compared for the period between 1985 and 1991, it was found that the highest rate of growth in productivity came from these public utilities. Borthwick came to the conclusion that these sectors were likely to experience even more productivity gains from the introduction of the Hilmer reforms.[413]

5.2.2.1 The water industry

The water industry in Australia operates as a monopoly and is State-owned. There is currently little competition in the water industry. However, water competition legislation is gradually being introduced to allow private competition to enter the water market.

The water industry in Australia has not seen the same level of structural reform and vertical separation as has taken place in the electricity sector (discussed further below in section 5.2.2.2). A more commercial focus was introduced in the water industry in 1994 with the signing of an agreement by the Council of Australian Governments (COAG) which called for reforms to the pricing regimes in place at that time. This COAG agreement was further updated by National Water Initiative, which was signed by Australian governments in 2004. This agreement required water prices to be set by independent pricing bodies.[414] As a result, there has been a move to a commercial cost recovery framework, whereby price regulators take into account efficient expenditure and set prices which allow for recovery of these efficient costs. However, the water sector has not seen the same level of privatisation which has

[412] David Borthwick, 'The true consumer interest in utilities reform', *Passing on the Benefits: Consumers and the reform of Australia's utilities*, TPC, March 1994, pp. 21-29, cited in Robert Troedson, above n 97, 25.
[413] Troedson, above n 97, 4.
[414] Infrastructure Australia, above n 341, 22.

taken place in the electricity sector. (The electricity sector is discussed further in section 5.2.2.2, below). However, there are a number of private water businesses in the rural water sector which supplies water to irrigators in New South Wales and South Australia.[415]

The water sector is currently divided into the following segments:

- bulk water supply and treatment: "bulk water assets include dams and reservoir storages for water supply, desalination plants and water recycling plants."
- water distribution and retailing: "the water pipeline networks and retailing services provided to end users."
- Wastewater: "assets associated with collecting, treating and disposing of wastewater in urban areas. This would include wastewater pipeline networks and associated treatment plants."[416]

Water authorities are typically price takers. The effect of a price reduction on the rate of return can have no influence on productivity in the water industry. Any price reduction can simply be financed by under-pricing environment costs or bringing forward any future benefits.[417]

Further, as a result of corporatisation, non-commercial activities which were once the responsibility of the water entity have been shifted to other government departments. This shift, coupled with replacement of contract labour, has distorted any labour productivity measures.[418] This means that traditional methods of assessing labour productivity have become incorrect. In addition, the cost of providing water services may be too high for some residents to afford.[419]

As discussed in section 3.2.1.1: Criticisms of Corporatisation, political influence plays a part in the running of utilities. Berg argues that inefficiencies in the water industry can be caused by excessive political influence; such influence can result in

[415] Ibid 22.
[416] Ibid 22-24.
[417] Sheil, above n 242, 13.
[418] Ibid.
[419] Berg, above n 405.

the promise of low prices which then leave the utility with not enough money to fund essential capital works.[420]

As it currently stands, the State-owned water corporations operate under the relevant SOC Act of their State; each water corporation also operates under its own legislation (for example, *The Sydney Water Act 1994, The Hunter Water Act 1991,* and so on), and the *Water Act 2007.*

Australia's water industry will now be compared to the UK, where all its water utilities have been privatised and are run by private equity groups.[421] At the time of privatisation, it was hoped that the result would be greater efficiency and an improvement in the water network at much lower prices than would have otherwise been the case, had the network been operated by a publicly owned corporation.[422] However, the result has been that the private owners have focused on maximising shareholder and senior executive wealth at the expense of the network.[423] Thames Water did the bare minimum to comply with the regulator's requirements and no more than that. Rather than managing the company to prepare for drought or large capital expenditure, the company borrowed enormous amounts of money to increase the wealth of the shareholders and senior executives.[424] This borrowing to fund increased wealth for shareholders and senior executives has resulted in Thames Water then needing to seek grants from the government to carry out essential infrastructure works.

The current system of State-owned monopolies in the water industry appears to be the better one when considering the above examples. As a State-owned monopoly, the owner State or Territory government is able to draw both a tax and a dividend from its water utility and should not need to finance the water utility as result of providing excess private sector shareholder returns.

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[420] Ibid.
[421] Will Hutton, 'Thames Water – a private equity plaything that takes us for fools', *The Guardian* (online) 11 November 2012 < http://www.theguardian.com/commentisfree/2012/nov/11/will-hutton-thames-water-private-equity-plaything>; Michael White, 'Tax and pricing scams that make regulators look silly: Jail the rascals', *The Guardian* (online), 14 November 2012 < http://www.theguardian.com/politics/blog/2012/nov/13/tax-pricing-scams-regulators-silly>.
[422] Ibid.
[423] Michael White, 'Tax and pricing scams that make regulators look silly: Jail the rascals', *The Guardian* (online), 14 November 2012 < http://www.theguardian.com/politics/blog/2012/nov/13/tax-pricing-scams-regulators-silly>.
[424] Hutton, above n 421.

5.2.2.2 The electricity industry

In Australia, the national electricity market is divided into four segments:

- Generation involves the creation of electricity through a number of methods, including the burning of fossil fuels, and the use of wind or solar power;
- Transmission relates to the method of transferring this electricity through the use of high voltage power lines to power stations;
- Distribution which is concerned with the delivery of low voltage electricity to consumers through the use of power lines and poles; and
- Retail which deals with the metered sale of electricity to customers.[425]

The electricity industry is split into network and distribution segments. The network deals with the production of electricity while the distribution is the retail branch and deals with the transportation of electricity to homes and businesses.

A government body, the National Energy Market (NEM) was created in 1996 to facilitate the trading of electricity between NSW, Victoria, Queensland and the ACT.[426] The NEM operates as a wholesale electricity market which allows electricity generators to sell electricity to electricity retailers who then sell the electricity to customers.[427]

The electricity industry is regulated by the Australian Energy Regulator (AER). The AER was created under the NEM to set prices for the electricity network, monitor the electricity market, and support the ACCC.[428] The AER sets prices for the transmission and distribution sectors, whereas the Australian Energy Market Operator (AEMO) sets the prices for the generation sector. In NSW, Victoria, and South Australia, the electricity retail sector is not price regulated, whereas all other States have their own government regulators who set the retail price component.[429]

As such, part of the setting of prices is regulated across most of the country, unlike the water industry in which each State has its own pricing regulator.

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[425] ABC News, 'Does privatisation increase electricity bills?', above n 346.
[426] Ibid.
[427] Australian Energy Market Operator, *Fact Sheet: The National Electricity Market* (n.d.) 3 https://www.aemo.com.au/-/media/Files/Electricity/NEM/National-Electricity-Market-Fact-Sheet.pdf
[428] ABC News, 'Does privatisation increase electricity bills?', above n 346.
[429] Chester, above n 354.

The South West Interconnected System (SWIS) was created in Western Australia when the state owned Western Power Corporation was split into Verve Energy (the electricity generation sector of the electricity industry in Western Australia), Western Power (the transmission and distribution arm), Synergy (the retail side of the electricity sector) and Horizon Power (which is the regional electricity supplier).[430] The separation of Western Power Corporation into separate state-owned corporations by division has enabled the creation of a wholesale electricity market in that region, and a general move towards more competition in the electricity sector in Western Australia.[431] Although there has been progress in the introduction of the SWIS, the electricity sector in Western Australia still remains less competitive as a whole than the NEM.[432]

Retail competition was introduced into NSW and Victoria, enabling consumers to choose their own retailer. As a result of increased competition, prices fell, and efficiency increased in the industry.[433]

There are differences of opinion as to whether competition has improved efficiency. Prof John Quiggin has found that the privatisation of the electricity sector has largely failed. He has found that the privatisation of the electricity sector has delivered no benefits to the consumers, and has instead resulted in high price rises. The rate of return of 10% used by privately owned electricity companies is too high when considering the low level of risk involved in the industry. Additionally, the cost of capital of 10% used by privately owned corporations is much higher than the 3% cost of capital used by State-owned electricity companies. Prof Quiggin went on to argue that the public ownership of critical infrastructure is the best option.[434]

Although Prof Quiggin argues that the cost of capital used by privately owned corporations is higher than that used by companies owned by the State, this is incorrect to an extent. The alternative view is that the rate of return for electricity network businesses is determined by the AER, and the AER does not distinguish

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[430] Infrastructure Australia, above n 341, 18.
[431] Ibid.
[432] Ibid 19.
[433] Abbott, above n 270, 96.
[434] John Quiggin, 'Electricity privatisation in Australia: A record of failure' (2014) *John Quiggin Opinion and Consulting* <http://www.etu.org.au/system/files/ETU%20Electricity%20Privatisation%20Report.pdf>

between privatised and non-privatised entities when deciding this rate. In current times, rates for both private and public companies are high, and both take into account investment and asset replacement.[435] To support this argument, a report by Ernst and Young in 2013, and a further study by Dr Lynne Chester, an energy researcher at the University of Sydney, have both found that the increase in electricity prices has been less in privatised states (Victoria and South Australia) than states in which electricity is still government owned (at that time – New South Wales and Queensland).[436]

Further studies have found that privatisation has neither increased nor decreased electricity prices.[437] However, several of the companies in the distribution sector of the electricity industry appear to spend more than they should.[438] Most of the companies in the electricity distribution sector are still government-owned (refer to the table in section 5.3). The question of whether privatisation resulted in an increase in electricity prices and bills is discussed further in the next section.

5.2.2.2.1 The increase in electricity prices and privatisation

Although the initial introduction of the NCP saw a drop in electricity prices of 19% (refer to section 2.9.1), subsequent years have seen a dramatic increase in electricity prices Australia-wide. This increase coincided with the privatisation of a number of electricity companies and assets. Naturally, the question was asked about whether the privatisation of the electricity industry had led to the increase in prices.

The Australian Energy Market Commission (AEMC), whose role it is to set the rules for the retail electricity segment and undertake work for the Council of Australian Governments (COAG),[439] reported that the electricity price could be separated into three separate components:

- the wholesale generation and retail component – that is, the 'competitive' portion;

[435] Chester, above n 354.
[436] ABC News, 'Does privatisation increase electricity bills?', above n 346.
[437] Lynne Chester in ABC News, 'Does privatisation increase electricity bills?', above n 346.
[438] Liam Wagner, a lecturer in economics at Griffith University in ABC News, 'Does privatisation increase electricity bills?', above n 346.
[439] ABC News, 'Does privatisation increase electricity bills?', above n 346.

- the costs related to transmission and distribution – that is, the 'network' portion; and
- costs related to the government's environment policies.[440]

However, a typical residential electricity bill across the NEM was comprised of:

- "Network costs (48%)
- Wholesale costs (22%)
- Environmental costs (7%)
- Retail and other costs (16%)
- Retail margins (8%)"[441]

The largest component of costs on an electricity bill is the transmission and distribution components, and these have both been trending upwards regardless of whether the companies have been privatised or kept in government hands.[442]

It has been found that the main cause of the drastic increase in electricity prices has been higher network charges, which have increased by greater than 90% in the five years to 2012-13. This increase is largely due to a high rate of return set by the AER for things such as proposed investment and replacing aging assets. These high rates of return apply regardless of ownership.[443] Hence, the cost of the "poles and wires" is the largest item on the consumer's electricity bill.[444]

In addition, it has been found that a key factor in the price of electricity has been how the electricity is created. Electricity produced from the burning of coal is generally cheaper than electricity produced from gas or wind. Thus, where Victoria relies on electricity produced from coal, it follows that their electricity will be cheaper than that in South Australia, which relies on more renewable methods for electricity generation.[445]

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[440] AEMC report mentioned under "Privatisation and retail prices" in ABC News, 'Does privatisation increase electricity bills?' above n 346.
[441] ACCC, *Electricity report details affordability, competition issues,* 16 October 2017 <https://www.accc.gov.au/media-release/electricity-report-details-affordability-competition-issues>
[442] ABC News, 'Does privatisation increase electricity bills?' above n 346.
[443] Chester, above n 354.
[444] Ibid.
[445] Mr Wood. ABC News, 'Does privatisation increase electricity bills?' above n 346.

In 2017, Ken Baldwin[446] completed a review for The Conversation, about whether renewable energy is now cheaper than coal for electricity generation. He found that, as at 2017, the cost of generating electricity through the use of wind power was $60-70/MWh, while the cost of generating an MWh of power using coal was less than $40. However, these figures are based on the use of existing assets. Ken Baldwin goes on to explain that the projected cost of building new assets would price coal at $75/MWh; whereas it is $60-70/MWh for wind.[447]

As discussed in the previous section, Dr Lynne Chester has found that privatisation has not had any effect on the price of electricity. In addition, both the AER and the Australian Bureau of Statistics (ABS) have found in separate studies that there has been no correlation or link between privatisation and the rise in electricity prices and bills.[448] The price rise has been across both privatised and State-owned corporations.

Based on research already completed, it can be concluded that although electricity prices have been increasing in all States, privatisation has had little effect on this increase. The increase has mainly been due to higher rates of return in the network sector of the electricity industry. This is largely due to levels of investment required in order to maintain the infrastructure needed to deliver a constant and steady supply of electricity.[449]

5.2.3 Making a single payment to Treasury

As discussed earlier, 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, it will not be discussed in great detail.

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[446] Ken Baldwin, 'Fact check Q&A: Is coal still cheaper than renewables as an energy source?', *The Conversation* (online), 14 August 2017 <http://theconversation.com/factcheck-qanda-is-coal-still-cheaper-than-renewables-as-an-energy-source-81263>

[447] Ibid.

[448] ABS 6401.0 and AER Annual Report cited in ABC News, 'Does privatisation increase electricity bills?' above n 346.

[449] Note that this section, and the research by Ken Baldwin, have not taken into account the effect of the introduction of a carbon tax, or a price on emissions. This is outside the scope of this study.

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. This will be illustrated in a case study in section 5.2.4.

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.[450] 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.[451]

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 against a privately owned organisation. This comparison will be made in the case studies.

5.2.4 The effect of removing tax and instead paying a larger dividend to the owner State or Territory Treasury: Case study

This section seeks to numerically quantify the outcome of abolishing tax neutrality and the payment of tax equivalents and instead increasing the dividend returned by each NTER entity to their owner State or Territory Treasury. The data presented in this case study relates to the financial year ended 30 June 2017. The theory behind this was discussed above in section 5.2.3.

5.2.4.1 Financial ratios

The financial ratios used in this case study are those which are impacted by a change in dividend or taxes. The suitability of the ratios was taken from the AER review of

[450] Burton, above n 280, 109.
[451] Ibid.

Profitability Measures for Electricity and Gas Network Businesses.[452] A review of the ratios is outlined below. Some businesses calculate these ratios using the average, for example, average total assets, or average equity. Since this case study provides only a comparison of the impact of the removal of tax, only closing values have been used.

Return on assets

The return on assets formula used in this case study is:

Net profit after tax / Total assets

This ratio provides a measure of profitability, and companies aim to have a high return on assets ratio. However, the outcome of this ratio will depend on how capital intensive the business is. Generally, the more capital intensive a business, the lower this ratio. Since this thesis is focused on the infrastructure sector (water and electricity), it is to be expected that the return on assets will be much lower compared to other less capital-intensive businesses.

This ratio was used because it is expected that the removal of the tax (and so using just the net profit number), and the removal of any tax assets in the balance sheet, will alter the ratio.

Return on equity

The return on equity is calculated using the following formula:

Net profit after tax / Total equity

This ratio is a measure of profit and efficiency. It is also commonly referred to as "return on net worth".

This ratio was used in this case study because it is expected that the removal of tax expense and the removal of tax assets and liabilities in the balance sheet (which would have a flow-through effect to equity) will alter the ratio.

Debt to equity

[452] Australian Energy Regulator, *Profitability measures for electricity and gas network businesses: Draft position paper*, April 2018.

There are a number of different ways of calculating this ratio. Some entities use the total liabilities, whereas others use long-term debt. For the purpose of this case study, there are two ratios which have been utilised. The formulas are as follows:

Total liabilities / Total equity (to be referred to as "liabilities to equity")

Total liabilities / Total assets (to be referred to as liabilities to assets")

These formulas are being used because this will enable the comparison of total liabilities to total assets, and separately, to total equity, once any tax assets and liabilities have been removed and equity adjusted accordingly.

Net profit margin

The net profit margin is calculated using the formula:

Net profit after tax / Total revenue

This ratio represents a percentage measure of revenue remaining after all expenses (including tax – however, some businesses calculate the ratio as net profit before tax) have been deducted from total revenue. It is a profitability ratio, and is an indicator of how efficiently a business can convert revenue into profit.

This ratio was used in this case study to examine what the effect of removing the tax expense has on the ratio.

Earnings per share

Earnings per share is calculated using the formula:

Net profit after tax / Number of shares issued

This ratio is not commonly used for businesses that are not traded, and is not a good measure of profitability, as the ratio is impacted by the number of shares issued.[453] This will be very clearly illustrated in this case study, where some treasuries have issued only one or two shares in the corporation being studied, whereas others have issued many shares.

[453] McGrathNicol, *Review of measures of financial performance that could be applied to the Electricity and Gas businesses the AER regulates: Final Report*, (15 June 2017) 33.

This ratio was used in this case study in an attempt to quantify the impact of the removal of tax on the amount of earnings per share.

Dividend payout ratio

The dividend payout ratio is calculated using the formula:

Dividends / Net profit after tax

The dividend payout ratio is an indicator of how much a company is returning to shareholders relative to the net profit after tax earned in that year.

For the purpose of this case study, the dividend amount used is the dividends paid in the Cash Flow Statement, not the dividends relating to that financial year (it can be expected that the company will declare dividends from the 2017 financial results, which are then paid in the 2018 financial year).

This ratio was used in this case study to measure the impact of replacing the tax equivalent with an additional dividend.

Tax compared to total tax and dividend

This ratio is calculated as follows:

Tax paid / (Total dividend + Tax paid)

This ratio is not a recognised financial ratio in the financial literature. This ratio is one that is used for the purpose of this study to demonstrate what percentage of payments being received by the owner State or Territory Treasury relates to taxes.

5.2.4.2 Tables of information

The section provides the tables of information used in this case study. A number of State-owned NTER organisations in the water and electricity industries were used. This study attempted to use at least one NTER entity from each state. Due to electricity privatisations, there have been fewer electricity companies used in this case study. Where relevant, the consolidated figures have been used, because the entire consolidated group is owned by the State or Territory Treasury.

The first two tables, Table 5.2.4A and Table 5.2.4B relate to data extracted from the 2017 Financial Statement or 2017 Annual Report of the companies used in this case study.

TABLE 5.2.4A

	Melbourne Water VIC	SA Water SA	Sun Water QLD	Sydney Water NSW	TasWater TAS	Water Corporation WA
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS						
	$'000	$'000	$'000	$'000	$'000	$M
Cash Flow Statement	Pg 86	Pg 63	Pg 46	Pg 96	Pg 50	Pg 60
Tax refund received				(397)		
Tax Paid	192,529	83,493	31,918	209,030	9,036	316
Dividend Paid	28,300	193,037	159,009	389,232	19,457	483
Total dividend and tax paid	220,829	276,530	190,927	597,865	28,493	799
Income Statement	Pg 83	Pg 60	Pg 43	Pg 93	Pg 48	Pg 57
Total income	1,791,363	1,369,531	287,927	2,659,531	315,483	2,549
Total expenses	(1,553,410)	(1,181,005)	(236,874)	(2,024,032)	(274,625)	(1,629)
Net profit	237,953	188,526	51,053	635,499	40,858	920
Tax expense	(87,520)	(54,171)	(15,005)	(188,177)	(12,266)	(275)
Net profit after tax	150,433	134,355	36,048	447,322	28,592	645
Balance Sheet	Pg 84	Pg 61	Pg 44	Pg 94	Pg 49	Pg 58
Total assets	14,882,083	14,194,721	996,551	18,077,854	2,153,440	17,153
Total liabilities	9,611,974	8,775,930	541,539	10,764,548	568,397	6,696
Total equity (also Net assets)	5,270,109	5,418,791	455,012	7,313,306	1,585,043	10,457
Current tax asset	0	5,659	0	16,508	0	0
Current tax liability	7,066	0	0	0	737	26
Deferred tax asset	0	45,460	11,114	0	39,703	0
Deferred tax liability	1,239,675	1,673,790	0	996,967	0	246
Total	(1,246,741)	(1,622,671)	11,114	(980,459)	38,966	(272)
			Pg 66	Pg 141	Pg 49	
Number of shares issued			2	3.161854b	8,972,507	
Ratios						
Return on assets	1.01%	0.95%	3.62%	2.47%	1.33%	3.76%
Return on equity	2.85%	2.48%	7.92%	6.12%	1.80%	6.17%
Liabilities to equity	182.39%	161.95%	119.02%	147.19%	35.86%	64.03%
Liabilities to assets	64.59%	61.83%	54.34%	59.55%	26.39%	39.04%
Net profit margin	8.40%	9.81%	12.52%	16.82%	9.06%	25.30%
Earnings per share	#DIV/0!	#DIV/0!	$18,024.00	$ 0.00	$ 0.00	#DIV/0!
Dividend payout ratio	18.81%	143.68%	441.10%	87.01%	68.05%	74.88%
Tax compared to total tax + divide	87.18%	30.19%	16.72%	34.90%	31.71%	39.55%
Net tax assets/(liabilities) / Net a	-23.66%	-29.95%	2.44%	-13.41%	2.46%	-2.60%

TABLE 5.2.4B

	Power and Water NT	Energy Queensland QLD	Essential Energy NSW/Sth QLD	Synergy WA	Tasnetworks TAS
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS					
	$'000	$M	$M	$'000	$'000
Cash Flow Statement	Pg 69	Pg 59	Pg 69	Pg 34	Pg 52
Tax refund received					
Tax Paid	18,940	632	24	30,704	46,596
Dividend Paid	0	0	28	0	72,628
Total dividend and tax paid	18,940	632	52	30,704	119,224
Income Statement	Pg 67	Pg 55	Pg 66	Pg 30	Pg 48
Total income	712,565	5,265	1,534	3,087,984	552,212
Total expenses	(755,512)	(4,007)	(1,462)	(3,096,124)	(418,125)
Net profit	(42,947)	1,258	72	(8,140)	134,087
Tax expense	(737)	(377)	(22)	(4,484)	(40,160)
Net profit after tax	(43,684)	881	50	(12,624)	93,927
Balance Sheet	Pg 67	Pg 57	Pg 67	Pg 32	Pg 50
Total assets	3,110,037	26,008	8,399	2,624,151	3,265,038
Total liabilities	1,735,687	22,437	6,041	1,574,390	2,320,951
Total equity (also Net assets)	1,374,350	3,571	2,359	1,049,761	944,087
Current tax asset	0	92	0	0	0
Current tax liability	26,959	0	10	8,995	6,069
Deferred tax asset	47,516	0	0	46,137	0
Deferred tax liability	73,502	3,520	222	0	226,196
Total	(52,945)	(3,428)	(232)	37,142	(232,265)
	Pg 100	Pg 99	Pg 77		Pg 80
Number of shares issued	1	100	2		2
Ratios					
Return on assets	-1.40%	3.39%	0.60%	-0.48%	2.88%
Return on equity	-3.18%	24.67%	2.12%	-1.20%	9.95%
Liabilities to equity	126.29%	628.31%	256.08%	149.98%	245.84%
Liabilities to assets	55.81%	86.27%	71.92%	60.00%	71.08%
Net profit margin	-6.13%	16.73%	3.26%	-0.41%	17.01%
Earnings per share	-$ 43,684.00	$ 8.81	$ 25.00	#DIV/0!	$ 46,963.50
Dividend payout ratio	0.00%	0.00%	56.20%	0.00%	77.32%
Tax compared to total tax + divider	100.00%	100.00%	45.75%	100.00%	39.08%
Net tax assets/(liabilities) / Net ass	-3.85%	-95.98%	-9.83%	3.54%	-24.60%

The next two tables, Table 5.2.4C and Table 5.2.4D are extrapolated from Tables 5.2.4A and 5.2.4B. These tables remove the effect of taxation from the Income Statement and Balance Sheet, and adjust Equity accordingly. In addition, the tax and dividend amounts from the Cash Flow Statement are consolidated into a single amount to represent a larger dividend to be paid to the NTER entity's owner State or Territory Treasury.

TABLE 5.2.4C

	Melbourne Water VIC	SA Water SA	Sun Water QLD	Sydney Water NSW	TasWater TAS	Water Corporation WA
B: IF NO TAX WAS PAID AND IT WAS ALL PAID AS A DIVIDEND INSTEAD						
	$'000	$'000	$'000	$'000	$'000	$M
Cash Flow Statement	Pg 86		Pg 46	Pg 96	Pg 50	Pg 60
Tax Paid						
Dividend Paid	220,829	276,530	190,927	597,865	28,493	799
Total dividend and tax paid	220,829	276,530	190,927	597,865	28,493	799
Income Statement	Pg 83	Pg 60	Pg 43	Pg 93	Pg 48	Pg 57
Total income	1,791,363	1,369,531	287,927	2,659,531	315,483	2,549
Total expenses	(1,553,410)	(1,181,005)	(236,874)	(2,024,032)	(274,625)	(1,629)
Net profit	237,953	188,526	51,053	635,499	40,858	920
Tax expense						
Net profit after tax	237,953	188,526	51,053	635,499	40,858	920
Balance Sheet	Pg 84	Pg 61	Pg 44	Pg 94	Pg 49	Pg 58
Total assets	14,882,083	14,194,721	996,551	18,077,854	2,153,440	17,153
Total liabilities	8,277,713	7,099,088	537,648	9,595,912	595,097	6,149
Adjusted Equity						
Equity per financial statements	5,270,109	5,418,791	455,012	7,313,306	1,585,043	10,457
Addback: current tax liability	7,066	0	0	0	737	26
Addback: deferred tax liability	1,239,675	1,673,790	0	996,967	0	246
Addback: equity adjustment for tax expense	87,520	54,171	15,005	188,177	12,266	275
Less: current tax asset	0	(5,659)	0	(16,508)	0	0
Less: deferred tax asset	0	(45,460)	(11,114)	0	(39,703)	0
Total adjusted equity	6,604,370	7,095,633	458,903	8,481,942	1,558,343	11,004
Number of shares issued			2	Pg 141 3.161854b	8,972,507	
Ratios						
Return on assets	1.60%	1.33%	5.12%	3.52%	1.90%	5.36%
Return on equity	3.60%	2.66%	11.13%	7.49%	2.62%	8.36%
Liabilities to equity	125.34%	100.05%	117.16%	113.13%	38.19%	55.88%
Liabilities to assets	55.62%	50.01%	53.95%	53.08%	27.63%	35.85%
Net profit margin	13.28%	13.77%	17.73%	23.90%	12.95%	36.09%
Earnings per share	#DIV/0!	#DIV/0!	$25,526.50	$ 0.00	$ 0.00	#DIV/0!
Dividend payout ratio	92.80%	146.68%	373.98%	94.08%	69.74%	86.85%

TABLE 5.2.4D

	Power and Water NT	Energy Queensland QLD	Essential Energy NSW/Sth QLD	Synergy WA	Tasnetworks TAS
B: IF NO TAX WAS PAID AND IT WAS ALL PAID AS A DIVIDEND INSTEAD					
	$'000	$M	$M	$'000	$'000
Cash Flow Statement	Pg 69	Pg 59	Pg 69	Pg 34	Pg 52
Tax Paid					
Dividend Paid	18,940	632	52	30,704	119,224
Total dividend and tax paid	18,940	632	52	30,704	119,224
Income Statement	Pg 67	Pg 55	Pg 66	Pg 30	Pg 48
Total income	712,565	5,265	1,534	3,087,984	552,212
Total expenses	(755,512)	(4,007)	(1,462)	(3,096,124)	(418,125)
Net profit	(42,947)	1,258	72	(8,140)	134,087
Tax expense					
Net profit after tax	(42,947)	1,258	72	(8,140)	134,087
Balance Sheet	Pg 67	Pg 57	Pg 67	Pg 32	Pg 50
Total assets	3,110,037	26,008	8,399	2,624,151	3,265,038
Total liabilities	1,682,005	18,632	5,787	1,607,048	2,048,526
Adjusted Equity					
Equity per financial statements	1,374,350	3,571	2,359	1,049,761	944,087
Addback: current tax liability	26,959	0	10	8,995	6,069
Addback: deferred tax liability	73,502	3,520	222	0	226,196
Addback: equity adjustment for tax expe	737	377	22	4,484	40,160
Less: current tax asset	0	(92)	0	0	0
Less: deferred tax asset	(47,516)	0	0	(46,137)	0
Total adjusted equity	1,428,032	7,376	2,612	1,017,103	1,216,512
	Pg 100	Pg 99	Pg 77		Pg 80
Number of shares issued	1	100	2		2
Ratios					
Return on assets	-1.38%	4.84%	0.85%	-0.31%	4.11%
Return on equity	-3.01%	17.06%	2.74%	-0.80%	11.02%
Liabilities to equity	117.78%	252.62%	221.54%	158.00%	168.39%
Liabilities to assets	54.08%	71.64%	68.90%	61.24%	62.74%
Net profit margin	-6.03%	23.89%	4.66%	-0.26%	24.28%
Earnings per share	-$42,947.00	$ 12.58	$ 35.75	#DIV/0!	$ 67,043.50
Dividend payout ratio	-44.10%	50.24%	72.45%	-377.20%	88.92%

The final two tables, Table 5.2.4E and Table 5.2.4F represent the impact on the financial ratios of removing tax from the financial statements and instead replacing it with a single, but larger, dividend payment to treasury. The change in ratios below was calculated as the difference between the ratios after and before tax was removed, divided by the actual financial results and is expressed as a percentage. To specify as a formula:

$$C = (B - A) / A$$

TABLE 5.2.4E

	Melbourne Water VIC	SA Water SA	Sun Water QLD	Sydney Water NSW	TasWater TAS	Water Corporation WA
C: Change in ratios as a result of only having a dividend payment, and no tax						
Return on assets	58.18%	40.32%	41.63%	42.07%	42.90%	42.64%
Return on equity	26.22%	7.16%	40.42%	22.49%	45.35%	35.55%
Liabilities to equity	-31.28%	-38.22%	-1.56%	-23.14%	6.49%	-12.73%
Liabilities to assets	-13.88%	-19.11%	-0.72%	-10.86%	4.70%	-8.17%
Net profit margin	58.18%	40.32%	41.63%	42.07%	42.90%	42.64%
Earnings per share	#DIV/0!	#DIV/0!	41.63%	42.90%	42.90%	#DIV/0!
Dividend payout ratio	393.31%	2.09%	-15.22%	8.12%	2.48%	15.98%
Increase in equity %	25.32%	30.94%	0.86%	15.98%	-1.68%	5.23%
Balance sheet						
Change in assets	0	0	0	0	0	0
Change in liabilities	(1,334,261)	(1,676,842)	(3,891)	(1,168,636)	26,700	(547)
Change in equity	1,334,261	1,676,842	3,891	1,168,636	(26,700)	547

TABLE 5.2.4F

	Power and Water NT	Energy Queensland QLD	Essential Energy NSW/Sth QLD	Synergy WA	Tasnetworks TAS
C: Change in ratios as a result of only having a dividend payment, and no tax					
Return on assets	-1.69%	42.79%	43.00%	-35.52%	42.76%
Return on equity	-5.38%	-30.86%	29.13%	-33.45%	10.79%
Liabilities to equity	-6.74%	-59.79%	-13.49%	5.35%	-31.50%
Liabilities to assets	-3.09%	-16.96%	-4.20%	2.07%	-11.74%
Net profit margin	-1.69%	42.79%	43.00%	-35.52%	42.76%
Earnings per share	-1.69%	42.79%	43.00%	#DIV/0!	42.76%
Dividend payout ratio	#DIV/0!	#DIV/0!	28.91%	#DIV/0!	14.99%
Increase in equity %	3.91%	106.54%	10.74%	-3.11%	28.86%
Balance sheet					
Change in assets	-	-	-	-	-
Change in liabilities	(53,682)	(3,805)	(253)	32,658	(272,425)
Change in equity	53,682	3,805	253	(32,658)	272,425

The following section will examine what the above tables mean for each corporation and overall.

5.2.4.3 Analysis

This section of the case study provides a brief overview of the operations of each company and an analysis of the impact that removal of tax equivalents would have on the financial ratios.

Melbourne Water Corporation

Melbourne Water supplies the Melbourne region with water and sewerage services. It manages the catchments, treats and supplies water, removes and treats sewerage and manages the waterways and drainage systems in Port Phillip and Westernport.[454] Melbourne Water is a statutory authority which is owned by the Victorian Government.[455] The number of shares held by the Victorian Government in

[454] Melbourne Water, *Who we are* <https://www.melbournewater.com.au/about-us/who-we-are>.
[455] Melbourne Water, *Who we are: Behind the scenes at Melbourne Water* <https://www.melbournewater.com.au/about-us/who-we-are>.

Melbourne Water was not easily accessible, and so has been excluded for the purpose of this case study.

Melbourne Water is also an NTER entity which pays its tax equivalents to the Victorian Government. Melbourne Water has no subsidiaries and is a stand-alone entity.[456]

During the year ended 30 June 2017, Melbourne Water made a net profit after tax of $150.433m. It paid both a tax and a dividend to the Victorian Government. Of the receipts by the Victorian Government, tax made up the larger portion of tax and dividend, accounting for 87.18% of total tax and dividend payments. It had a large tax liability in its balance sheet of over $1.2b, which accounted for 23.66% of net assets.

Because total tax liabilities comprised 23.66% of the total net assets, removal of these and tax expense in the Profit and Loss Statement, resulted in an increase to equity of over $1.3b, or 25.32%. The Net Profit Margin (and Return on Assets) increased by 58.18% as a result of the removal of the tax expense from the Profit and Loss Statement. In addition, the Dividend Payout Ratio increased from 18.81% to 92.80%, an increase of 393.31%. This result is to be expected since tax made up such a large portion of the total payment to the Victorian Government – moving the tax paid to dividend would then result in a large percentage increase in dividend. This is a material distortion that would result from the removal of any system of tax neutrality.

In addition, when adjusted total liabilities are compared to adjusted total equity and total assets, falls in the ratios of 31.28% and 13.88% are witnessed. This illustrates a shift from liabilities to equity, which demonstrates a better financial position than would actually be the case if taxes, and resulting tax liabilities, were included.

South Australian Water Corporation

South Australian Water Corporation is a statutory corporation which is owned by the South Australian Government and is included in the portfolio of the Minister for

[456] Melbourne Water, *Melbourne Water Annual Report 2016-17*, (2017).

Water and the River Murray.[457] It provides water and sewerage services to 1.6 million people in the South Australian region.[458] The number of shares held by the South Australian Government, or Minister, was not reported, and so has been excluded for the purpose of this case study.

South Australian Water Corporation holds a 50% interest in SA Water/Lofty Ranges Power.[459] For the purposes of this study, the total consolidated figures have been used, as it is the total consolidated group which is ultimately owned by the South Australian Government.

For the year ended 30 June 2017, South Australian Water Corporation made a net profit after tax of $134.355m and paid both a tax and a dividend to the South Australian Government. However, in contrast to Melbourne Water Corporation, above, South Australian Water Corporation made a large dividend payment, compared to total tax payments. Tax paid during the year accounted for only 30.19% of total tax and dividend payments received by the South Australian Government. Total tax liabilities compared to total assets was 29.95%.

Removing the effect of taxation from the Balance Sheet reduced the liabilities by $1.67b, and resulted in a corresponding increase in Equity of $1.67b. This saw a drop in total liabilities compared to equity, and total assets of 38.22% and 19.11% respectively. However, unlike Melbourne Water, which saw a massive increase in the dividend payout ratio of 393.31%, the dividend payout ratio of South Australian Water increased by only 2.09%. This is because the dividend paid by South Australian Water in the 2017 financial year was much larger than the tax paid, and so including the tax as an additional dividend would not make such a large difference. However, the Return on Assets and Net Profit Margin increased by 40.32%.

SunWater Corporation

SunWater Corporation provides bulk water to Queensland. It owns the dams, weirs and barrages to store this water, and the pumping stations, pipelines and drains to

[457] South Australian Water, *2016-17 South Australian Water Corporation Annual Report for the year ending 30 June 2017*, (2017) 7.
[458] Ibid.
[459] Ibid 111.

deliver the water.[460] SunWater Corporation has three subsidiaries: North West Queensland Water Pipeline Pty Ltd; Eungella Water Pipeline Pty Ltd; and Burnett Water Pty Ltd. SunWater holds 100% equity in all three subsidiaries.[461]

SunWater was established under the *Government Owned Corporations Act 1993* (QLD); and has two issued shares to its two shareholding Ministers: the Minister for Trade and Investment; and the Minister for Energy, Biofuels and Water Supply.[462]

For the 2017 financial year, SunWater made a net profit after tax of $36m. Similarly to South Australian Water, it had a much larger dividend than tax payment. The percentage of tax paid compared to total tax and dividends was 16.72%. However, it differed from Melbourne Water and South Australian Water, in that it had a deferred tax asset rather than a deferred tax liability. Its deferred tax asset of $11.114m accounted for only 2.44% of total net assets. From the note reporting the Movement in Deferred Tax Balances note, the net total deferred tax asset balance is mainly as a result of the deferred tax asset recognised for provisions. There does not appear to have been a tax loss which was carried forward from prior years.[463]

The removal of tax from the financial results for the year ended 30 June 2017 results in only a minor change to equity of 0.86%, or $3.891m. This is because the deferred tax assets did not make up a large component of the net assets. A large change can be witnessed in the decline of the dividend payout ratio, which fell by 15.22%. This is because the tax paid in the Cash Flow Statement is less than the tax expense in the Income Statement.

Sydney Water Corporation

Sydney Water was incorporated under the *Sydney Water Act 1994* and is the largest water and wastewater service provider in Australia. Sydney Water services almost five million people across the Sydney, Blue Mountains and Illawarra regions.[464] Sydney Water is a stand-alone entity and has no subsidiaries. It is owned by the Treasurer and Minister for Industrial Relations; and the Minister for Finance,

[460] SunWater, *2016-17 Annual Report*, (2017) 2.
[461] Ibid 69.
[462] Ibid 2.
[463] Ibid 52.
[464] Sydney Water, *2016-17 Annual Report*, (2017) 6.

Services and Property.[465] Sydney Water ultimately pays its tax and dividends to the NSW State Government.

During the financial year ended 30 June 2017, Sydney Water made a net profit after tax of $447.322m and paid both tax and dividends to NSW Treasury. The tax paid of $209.030m comprised 34.94% of total tax and dividend payments. Total net tax assets and liabilities formed 13.41% of total net assets.

Removing tax from the Income Statement and Balance Sheet, and moving all the tax payments to be made as an additional dividend payment results in an increase in the Return on Assets (and Net Profit Margin and Earnings per Share) of 42.07%. The liabilities to equity and liabilities to assets falls from 147.19% and 59.55% respectively to 113.13% and 53.08% respectively. This would give a falsely better outcome if tax were to be removed and does not paint an accurate picture of the financial position of the organisation. However, because Sydney Water has issued many shares, earnings per share is negligible.

TasWater Corporation

TasWater provides water and sewerage services to customers in Tasmania. It was formed in 2013 by the merger of three water authorities: Ben Lomond Water, Cradle Mountain Water and Southern Water, and services provider Onestream. TasWater is owned by 29 councils in Tasmania. These 29 councils receive their share of dividends, tax equivalent payments, and the government guarantee fee.[466] TasWater was founded under the *Water and Sewerage Corporation Act 2012*.

TasWater is a standalone entity and has no subsidiaries. It is subject to tax under the National Tax Equivalent Regime, although it pays its tax back to its owner local councils rather than the State Treasury.

For the financial year ended 30 June 2017, TasWater made a net profit after tax of $28.592m. The dividend paid to the owner local councils was much larger than the tax paid, with tax paid accounting for only 31.71% of the total tax and dividends paid. TasWater had a deferred tax asset in its balance sheet of $39.7m, of which

[465] Ibid 141.
[466] TasWater, *2016-17 Annual Report*, (2017) 3.

$10.424m related to tax losses brought into TasWater from the merger of the three abovementioned water authorities.[467]

The removal of tax had a similar effect as Sydney Water on the Return on Assets, Net Profit Margin and Earnings per Share ratios, in that they fell by 42.90%. However, unlike Sydney Water, which saw the Return on Equity ratio rise by 22.49%, the Return on Equity ratio for TasWater rose by 45.35%. This is because the removal of tax increased Sydney Water's equity by 15.98%, whereas it decreased TasWater's equity by 1.68%. Similarly, where Sydney Water saw a fall in both measures of debt to equity (liabilities to equity, and liabilities to assets), TasWater saw small increases in both (6.49% for total liabilities compared to equity, and 4.70% for total liabilities compared to total assets). There was only a small change in the dividend payout ratio of 2.48%, which is to be expected since the tax payments made were small compared to the total tax and dividend payments during the year.

Water Corporation (WA)

Water Corporation supplies water, wastewater, drainage and bulk irrigation services in Western Australia. It is owned by the West Australian Government and is governed under two principal acts: *Water Corporations Act 1995* and *Water Services Act 2012* and is regulated by the Economic Regulation Authority (ERA). The State Government determines the prices of regulation services through the State Budget process.[468]

Water Corporation made a profit after tax of $645m during the year ended 30 June 2017. It paid both tax and dividends to the West Australian Government, where tax comprised 39.55% of the total $799m paid. The total tax liabilities were relatively small at (2.60%) of the total net assets.

Removing tax from the financial results again has an outcome of an increase in the return on assets and net profit margin ratios in the vicinity of 42%, similar to a number of the entities studied in this case study. The return on equity had an increase of 35.55% from 6.17% to 8.36%. In addition, the debt to equity ratios decreased by 12.73% (liabilities to equity) and 8.17% (liabilities to assets) respectively (from

[467] Ibid 60.
[468] Water Corporation, *2017 Annual Report*, (2017) 2.

64.03% and 39.04% to 55.88% and 35.85% respectively). This indicates a favourable result from removing tax and increasing the dividend payment.

Power and Water Corporation (NT)

Power and Water Corporation operates in the electricity network and water and sewerage segments in the Northern Territory. It owns and operates the dams, parts of the electricity network, and five generation plants. In addition, it retails water and wastewater, gas, and electricity.[469] Power and Water Corporation is a parent entity of two subsidiaries: Indigenous Essential Services Pty Limited and BGP Tenure Holdings Pty Limited.[470] Power and Water Corporation has issued one share which is ultimately owned by the Northern Territory Government.[471]

For the year ended 30 June 2017, Power and Water Corporation made a net loss after tax of $43.684m and made no dividend payments to the Northern Territory Government. However, the Northern Territory Government received tax equivalent payments of $18.94m. Therefore, tax accounted for 100% of the total tax and dividend payments to the Northern Territory Government. The net tax liability in the balance sheet of $52.945m accounts for (3.85%) of the net assets in the balance sheet.

The inclusion of tax as a dividend instead demonstrated the smallest change in ratios of all the companies examined in this case study. This is because the tax expense in the Income Statement was very small in comparison to the pre-tax profit, at only 1.72%. Also, the total net tax liability when compared to the total net assets was small at (3.85%). All the ratios declined, with the largest decline being the liabilities to equity. This ratio declined by 6.74% from 126.29% to 117.78%. This decline is actually favourable as it indicates that total liabilities have declined (as a result of the removal of the total tax liability).

[469] Power and Water Corporation, *PowerWater Annual Report 2016-17*, (2017) 10.
[470] Ibid 90.
[471] Ibid.

Energy Queensland Limited

Energy Queensland Limited was formed in 2016 by the merger of Ergon and Energex groups. Energy Queensland operates electricity network, retail and energy services.[472]

The Energy Queensland Limited consolidated group is comprised of the Energex Group, which has Energex as its head company, and four subsidiaries; and the Ergon Energy Group, which has Ergon Energy as its head company and two subsidiaries.[473]

Energy Queensland Limited is owned by the Queensland Government and has two shareholding ministers.[474] The shareholding ministers are the Treasurer and Minister for Trade and Investment; and the Minister for Main Roads, Road Safety and Ports and Minister for Energy, Biofuels and Water Supply.[475]

During the year ended 30 June 2017, Energy Queensland made large tax payments of $632m, but no dividend payments to the Queensland Government. It has a net profit after tax of $881m, a tax receivable of $92m, and a deferred tax liability of $3,520m. The most notable ratios were the liabilities to equity of 628.31% and resulted from the total net tax liability being (95.98%) of equity. This indicates that the net deferred tax liability is very large when compared to total equity and that liabilities on the balance sheet are also very large.

It then follows that the removal of all tax items in the financial statements results in an increase in equity of 106.54%. Further, the liabilities to equity fell by the largest results in this case study – a fall of 59.79%. This fall is favourable, as it represents overall less debt and greater equity. The removal of tax would present an inaccurate and far too favourable a view of the company. In addition, there was another increase in the vicinity of 42% to the return on assets, net profit margin and earnings per share ratios.

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[472] Energy Queensland, *Annual Report 2016-17*, (2017) 2.
[473] Energy Queensland, *Energy Queensland Limited: Annual financial statements for the year ended 30 June 2017*, (2017) 102.
[474] Energy Queensland, *Annual Report 2016-17*, (2017) 36.
[475] Energy Queensland, *Energy Queensland Limited: Annual financial statements for the year ended 30 June 2017*, (2017) 108.

There was a decline in the return on equity from 24.67% to 17.06%, a decline of 30.86%. This is as a result of the large increase in equity (an increase of $3.8b, or 106.54%) once tax was removed from the balance sheet.

Essential Energy

Essential Energy builds, owns and operates one of Australia's largest electricity networks. Essential Energy services 95% of NSW and parts of Southern Queensland.[476] Essential Energy was founded under the *Energy Services Corporations Act 1995 (NSW)* and is a State-owned corporation owned by the NSW Government.[477] It has issued two $1 ordinary shares, one to each of its two shareholders: the Treasurer; and the Minister for Finance, Services and Property.[478]

Essential Energy owned one-third of Networks NSW Pty Limited until 29 January 2016. The company had no transactions, and so did not make a material difference to the financial statements presented by Essential Energy for the year ended 30 June 2017.[479]

For the year ended 30 June 2017, Essential Energy made both tax and dividend payments to the NSW Government, with tax paid of $23.70m accounting for 45.75% of total tax and dividend payments back to the NSW Government. In addition, Essential Energy had a net profit after tax of $50m; and a net tax liability in its balance sheet of $231.9m, which accounted for (9.83%) of the total net assets.

The removal of tax from the financial statements, and shifting tax payments to additional dividend payments results in an increase to equity of $253.4m (a 10.74% increase). Again, the return on assets, net profit margin and earnings per share ratios increased by 43% (although only from 0.60% to 0.85%, so not a large or material amount overall). The dividend payout ratio increases from 56.20% to 72.45% (an increase of 28.91%) on the moving of tax to be an additional dividend. This is the second largest increase in this ratio of all the companies included in this case study.

[476] Essential Energy, *Essential Energy Annual Report 2016-17*, (2017) 4.
[477] Ibid 48.
[478] Ibid 77.
[479] Ibid 70.

Synergy

Synergy is the leading energy generator and retailer in Western Australia.[480] Synergy is an electricity generator and a retailer of both electricity and gas. It also trades in wholesale electricity and gas under ringfenced arrangements. Synergy participates in the Wholesale Electricity Market in Western Australia.[481] Synergy is owned by the West Australian Government and reports to the Minister for Energy.[482] Synergy is comprised of a head (parent) entity and three subsidiaries:

- Vinalco Energy Pty Ltd
- South West Hub Pty Ltd
- South West Solar Development Holdings Pty Ltd (was 50% prior to 2017, but the remaining 50% was acquired on 30 June 2017).[483]

The amounts reported in this case study are the total consolidated figures because the entire group is owned by the West Australian Government.

For the year ended 30 June 2017, Synergy made a net loss after tax of $12.624m, although it also had a tax expense. Synergy paid tax but made no dividend payments during the 2017 financial year. The balance sheet contains a net tax asset of $37.142m, of which a $21 thousand carried forward tax loss was created and is being carried forward to future years.

The removal of tax resulted in a 3.11% decrease in equity (because the balance sheet held a deferred tax asset, the removal resulted in a reduction in net assets, and so also a reduction in the total equity). Although the return on assets, return on equity, and net profit margin ratios decreased by 35%, these ratios were less than one percent, so it was a very small decrease overall. Similar to TasWater, Synergy saw an increase in both the debt to equity ratios (liabilities to equity, and liabilities to assets). This is because both companies had net tax assets in their balance sheets, removal of which resulted in an unfavourable outcome in these formulas.

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[480] Synergy, *2017 Annual Report 2017 (for the Electricity Generation and Retail Corporation trading as Synergy)*, (2017) 2
[481] Synergy, *what we do* <https://www.synergy.net.au/About-us/Who-we-are/What-we-do>.
[482] Synergy, *2017 Annual Report 2017 (for the Electricity Generation and Retail Corporation trading as Synergy)*, (2017) 2.
[483] Ibid 77.

TasNetworks

Tasmanian Networks Pty Ltd, trading as TasNetworks, owns the Tasmanian transmission and distribution network. It also provides telecommunications network services. TasNetworks is owned by the State of Tasmania.[484]

TasNetworks is a consolidated group, consisting of Tasmanian Networks Pty Ltd as the parent entity, and two subsidiaries: Auroracom Pty Ltd and Ezikey Group Pty Ltd.[485]

During the year ended 30 June 2017, TasNetworks paid both tax and dividends to the Tasmanian Government, with the tax paid of $46.596m accounting for 39.08% of the total tax and dividends paid. TasNetworks made a profit after tax of $93.927m and had net tax liabilities in the balance sheet of $232.265m, a total of (24.60%) of the net assets.

The removal of tax from the financial results causes an increase in equity of $272.425m, or 28.86%. An increase of 42.76% is also witnessed in the return on assets, net profit margin, and earnings per share ratios.

5.2.4.4 Conclusion

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%.

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[484] TasNetworks, *Annual Report 2016-17*, (2017) 8.
[485] Ibid.

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 liabilities to 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-owned corporations are not permitted to borrow from any private institutions; they are required to borrow from their own State or Territory Treasury Corporation (this is discussed further in section 5.1.1: Debt neutrality). In addition, an entity which does not have to pay tax is able to charge lower prices than one which is liable to tax.

5.3 Comparison of NTER entities with their privately-owned counterparts: Case study

Government-owned entities do not appear to have the same incentive to minimise tax as their privately-owned counterparts. CME[486] argues that this is because privately-owned entities have an interest in minimising tax and thereby maximising post-tax profits, leading to increased dividends to shareholders. However, where the government-owned entity pays both its tax equivalents and dividends to its owner State Treasury, it is maintained that the incentive to minimise taxes does not exist.[487] This section seeks to test that theory by comparing an NTER entity with a similar privately-owned entity in the same industry.

As discussed earlier in section 5.2.2.2, the electricity industry in Australia is split into four segments: generation, transmission, distribution and retail. Ownership across these four segments is a mix of either private or public ownership. A summary of the ownership type is provided below.

Majority ownership of electricity market components in Australia[488]

Component	Generation	Transmission	Distribution	Retail
SA	Private	Private	Private	Private
VIC	Private	Private	Private	Private
Qld	Public	Public	Public	Private#
NSW	Private	Public	Public	Private
WA	Public	Public	Public	Public
TAS	Public	Public	Public	Public
NT	Public	Public	Public	Public
ACT	Private*	Private*	Private*	Private*

[486] 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.
[487] Ibid.
[488] ABC News, 'Does privatisation increase electricity bills?', above n 346.

*ACT Government and AGL joint venture

Also includes a state-owned enterprise (Ergon Energy).

Sources: Australian Energy Regulator; WA Department of Finance; NT Department of Treasury and Finance

To summarise:

- "Victoria and South Australia have sold all their electricity businesses, while only some have been sold in Queensland and NSW.
- The generators have been sold in NSW and the retail businesses have been sold in Queensland and NSW.
- Everywhere else in Australia, they are still state-owned assets."[489]

This section will compare a number of companies in the electricity industry, some of which are publicly-owned and others which are privately-owned. Many of the privately-owned electricity companies are structured as partnerships or consortiums, meaning that there are no publicly available annual reports or financial statements. The privately-owned companies selected for the purpose of this study are those for which annual reports are publicly available and, in most cases, are listed on the Australian Stock Exchange. This section aims to examine how they are structured for tax purposes, whether they pay tax, dividend return to shareholders, and are subject to price regulation. In doing this, it is hoped that any differences between public and private ownership will be brought to light.

These case studies are examined over a period of five years, and then the results averaged over that time. This is because there are timing differences between when payments, such as tax and dividends, are paid, and the period they relate to. It is hoped that in providing a five-year average for each company researched, these variances will be largely smoothed out over that timeframe. Figures reported in this case study have been reported on a consolidated basis, as many of the consolidated

[489] Chester, above n 354.

entities have businesses in the same sectors and would prove too difficult to attempt to separate out the data into segments.

This case study will analyse the following privately-owned companies: AGL Limited, Origin Energy, and Ausnet. The government owned companies studied include Synergy Limited, Ergon, Energex, Energy Queensland, Tasnetworks, Aurora Energy, and Essential Energy. All are operators in the electricity and gas industries.

As they all operate in the same industries, this enables a good comparison between public sector and private sector operations in the same market.

In addition to the ratios outlined in section 5.2.4.1, the following ratios will also be utilised in this analysis:

Tax paid as a percentage of net profit

The formula used to determine the tax paid as a percentage of net profit is:

Tax paid / Net profit before tax

This aims to determine, over the five-year time-frame examined, whether tax paid when compared to net profit is close to the statutory tax rate of 30%, and also, whether the tax paid differs according to ownership. It is expected that the tax paid will not be close to the 30% statutory rate when compared to net profit because there are many differences between net accounting profit and taxable income. These will be outlined in a future section. However, the comparison to be made in this case study is whether the rate varies greatly according to ownership.

Total borrowings as a percentage of total assets

The formula used to determine this ratio is:

Total borrowings / Total assets

This ratio aims to determine how many of the total assets held by the company are financed by borrowings. A comparison of the private sector and public sector borrowings will be performed to determine if the rate of borrowings is similar between the private and public sectors.

Interest paid as a percentage of total income

The formula used to calculate this ratio is:

Interest paid / Total revenue

This formula aims to determine the total ratio of interest payments to revenue earned. Averaging this ratio over five years should eliminate any timing issues. A comparison between the private and public sector should determine whether the sector has a similar result regardless of ownership, or whether there is a difference that is related to ownership type.

Interest paid as a percentage of total borrowings

The formula used to calculate the ratio is as follows:

Interest paid / Total borrowings

This ratio will give a very high-level interest rate on total borrowings. Comparing the interest rate for public companies and private companies will enable a comparison of whether the borrowing options offered by State and Territory Treasury corporations are similar to those available to the private sector.

Net tax paid compared to total revenue

The formula used to calculate this ratio is as follows:

Total net tax paid (from the cash flow statement) / Total revenue

This ratio will determine how much tax was paid per dollar of revenue earned. It aims to compare whether the private sector pays more tax per dollar earned than the government-owned entities.

Total dividends compared to total equity

The formula used to calculate the total dividends compared to total equity is:

Total dividends paid (from cash flow statement) / Total equity

This formula aims to calculated how much was returned to shareholders as a percentage of their total equity. This formula is being used to determine whether, if it was found privately owned corporations paid less tax compared to their state-owned counterparts, this resulted in more dividends being paid out to their shareholders.

The interest amounts utilised in this case study include any applicable government guarantee fees. Government guarantee fees are levied by State and Territory governments on their State-owned corporations. This fee is imposed to ensure competitive neutrality between the private and public sectors.[490]

Total expenses compared to total income

The formula used to calculate this ratio is as follows:

Total expenses / Total income

This ratio aims to give a high-level indicator of the cost of earning each dollar of revenue. Explained simply, it is a very high-level measure of efficiency, where the higher the percentage, the greater the cost of earning each dollar of revenue.

5.3.1 Privately owned companies studied

Many of the privatised entities in the electricity industry are operating through a consortium, meaning that there was no publicly available annual reports or financial statements. Therefore, the following case study utilises only a small number of players in the industry, although they were companies with influence in the industry. However, despite the small number of participants studied in this case study, a larger case study is examined in section 6.5. The findings of the larger case study are consistent with the findings in this case study.

5.3.1.1 AGL

Australian Gas Light Company was formed in Sydney in 1837 and is one of the largest companies listed on the Australian Stock Exchange.

AGL Energy provides gas and electricity to over 3.6 million customers across Australia. It is Australia's largest electricity generator and the largest ASX-listed investor in renewable energy.[491]

[490] New South Wales Treasury, *Government Guarantee Fee Policy for Government Businesses: Policy and Guidelines Paper*, (2014).

[491] AGL, *Who we are: Our company* <https://www.agl.com.au/about-agl/who-we-are/our-company>

AGL Energy has 47 subsidiaries, of which a number have subsidiaries of their own.[492] The consolidated group contains a number of partnerships, and three foreign (two New Zealand and one Netherlands) companies.

Only part of AGL's activities are price regulated. The electricity retail arm is generally not regulated because there are a number of players in the market, and it is competitive enough to not require price regulation.

[492] AGL, *Annual Report* 2017, (2017) 44-45.

The following table outlines the key results and averages of the five years to 2017.

	Year ended 30 June 2013[493]	Year ended 30 June 2014[494]	Year ended 30 June 2015[495]	Year ended 30 June 2016[496]	Year ended 30 June 2017[497]	5-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$M	$M	$M	$M	$M	$M	$M
Cash Flow Statement	Pg 84	Pg 76	Pg 79	Pg 67	Pg 7		
Interest paid	257	217	216	186	188	1,064	213
						-	-
Tax refund received	-	-	-	-	-	-	-
Tax Paid	71	191	147	166	292	867	173
Dividend Paid	214	269	344	446	517	1,790	358
Total dividend and tax paid	285	460	491	612	809	2,657	531
Income Statement	Pg 80	Pg 72	Pg 75	Pg 63	Pg 3		
Total income	9,742	9,568	10,705	11,201	12,603	53,819	10,764
Total expenses	9,278	8,808	10,368	11,675	11,839	51,968	10,394
Net profit	464	760	337	474	764	1,851	370
Tax expense	75	190	119	67	225	542	108
Net profit after tax	389	570	218	407	539	1,309	262
Balance Sheet	Pg 82	Pg 74	Pg 77	Pg 65	Pg 5		
Total borrowings	3,109	3,714	3,882	3,108	3,346	17,159	3,432
Total assets	13,366	13,975	15,833	14,604	14,458	72,236	14,447
Total liabilities	6,027	6,387	7,018	6,678	6,884	32,994	6,599
Total equity (also Net assets)	7,339	7,588	8,815	7,926	7,574	39,242	7,848
Current tax asset	-	-	-	-	-	-	-
Current tax liability	155	49	86	102	13	405	81
Deferred tax asset	729	631	682	953	792	3,787	757
Deferred tax liability	99	50	-	-	-	149	30
Total	475	532	596	851	779	3,233	647

[493] AGL, *2013 Annual Report*, (2013).
[494] AGL, *Annual Report 2014*, (2014).
[495] AGL, *Annual Report 2015*, (2015).
[496] AGL, *Annual Report 2016*, (2016).
[497] AGL, *Annual Report* 2017, (2017).

B: RATIOS							
Return on assets	2.91%	4.08%	1.38%	-2.79%	3.73%	1.81%	1.81%
Return on equity	5.30%	7.51%	2.47%	-5.13%	7.12%	3.33%	3.33%
Liabilities to equity	82.12%	84.17%	79.61%	84.25%	90.89%	84.08%	84.08%
Liabilities to assets	45.09%	45.70%	44.33%	45.73%	47.61%	45.68%	45.68%
Net profit margin	3.99%	5.96%	2.04%	-3.63%	4.28%	2.43%	2.43%
Dividend payout ratio	55.03%	47.19%	157.80%	-109.58%	95.92%	136.77%	136.77%
Tax compared to total tax + dividend	24.95%	41.52%	29.94%	27.12%	36.09%	32.63%	32.63%
Net tax assets/(liabilities) / Net assets	6.47%	7.01%	6.76%	10.74%	10.29%	8.24%	8.24%
Tax paid as a percentage of net profit	15.32%	25.13%	43.62%	-35.02%	38.22%	46.84%	46.84%
Total borrowings as a percentage of total assets	23.26%	26.58%	24.52%	21.28%	23.143%	23.75%	23.75%
Interest paid as a percentage of total income	2.64%	2.27%	2.02%	1.66%	1.49%	1.98%	1.98%
Interest paid as a percentage of total borrowings	8.27%	5.84%	5.56%	5.98%	5.62%	6.20%	6.20%
Total tax and dividends compared to total equity	3.88%	6.06%	5.57%	7.72%	10.68%	6.77%	6.77%
Total dividends compared to total equity	2.91%	3.55%	3.90%	5.63%	6.83%	4.56%	4.56%
Net tax paid compared to total revenue	0.73%	2.00%	1.37%	1.48%	2.32%	1.61%	1.61%
Total income compared to total expenses	95.24%	92.06%	96.85%	104.23%	93.94%	96.56%	96.56%

Key points worthy of note are that AGL has a large asset value of $14,447.16m (five-year average), but an average net deferred tax asset of $646.64m, which is unusual for companies in this industry. Usually, infrastructure companies with large asset bases have deferred tax liabilities because, for tax purposes, assets are valued at their historical cost and are often depreciated more rapidly than for accounting purposes. Also, assets can be revalued for accounting purposes, which also increases the difference between the tax carrying value and the accounting carrying value. Total borrowings as a percentage of total assets is 23.75%, which is lower than the other privately-owned corporations studied, and also below the average for state-owned corporations (however, not the lowest result surveyed). AGL's average interest paid as a percentage of total borrowings is 6.20%, which is higher than both other privately-owned companies surveyed, but again, less than the average for the government-owned sector. With the exception of 2016, when AGL made a loss, the company has made strong profits in the other years. Overall, AGL made tax payments in every year studied, suggesting that although AGL made an accounting loss in 2016, it might have still have made a taxable gain for that year. In addition, AGL had the lowest liabilities to equity of all the companies surveyed, at 84.08%

and the highest net tax paid as a percentage of profit of the private companies at 46.84%.

5.3.1.2 Origin Energy

Origin Energy was formed in February 2000. It is one of the largest energy retailers in Australia, with 4.2 million gas, electricity and LPG customers across Australia.[498] It is also involved in developing renewable energy. Origin Energy is involved in retailing, exploration, production and generation.[499] It is in both the electricity and gas markets. As an Australian-owned private company, it is listed on the Australian Stock Exchange. Origin Energy is a very large consolidated group with 17 direct subsidiaries which have many more subsidiaries of their own, some being foreign companies.

The following table contains key financial data and ratios for the financial years ended 30 June 2013 to 30 June 2017.

	Year ended 30 June 2013[500]	Year ended 30 June 2014[501]	Year ended 30 June 2015[502]	Year ended 30 June 2016[503]	Year ended 30 June 2017[504]	5-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$M	$M	$M	$M	$M	$M	$M
Cash Flow Statement	Pg 70	Pg 68	Pg 72	Pg 72	Pg 87		
Interest paid	448	463	547	611	540	2,609	522
						-	-
Tax refund received	-	-	-	-	-	-	-
Tax Paid	275	17	109	52	53	506	101
Dividend Paid	546	550	553	452	-	2,101	420
Total dividend and tax paid	821	567	662	504	53	2,607	521
Income Statement	Pg 67	Pg 64	Pg 68	Pg 68	Pg 83		
Total income	14,900	14,951	11,747	11,956	13,833	67,387	13,477
Total expenses	- 14,397	- 14,204	- 12,281	- 12,693	- 15,908	- 69,483	- 13,897
Net profit	503	747	- 534	- 737	- 2,075	- 2,096	- 419

[498] Origin Energy, *Annual Report 2017*, (2017) 13.
[499] Origin Energy, What we do <https://www.originenergy.com.au/about/who-we-are/what-we-do.html>.
[500] Origin Energy, *Annual Report 2013*, (2013).
[501] Origin Energy, *Annual Report 2014*, (2014).
[502] Origin Energy, *Annual Report 2015*, (2015).
[503] Origin Energy, *Annual Report 2016*, (2016).
[504] Origin Energy, *Annual Report 2017*, (2017).

Tax expense	-42	-109	85	133	26	93	19
Net profit after tax	461	638	-449	-604	-2,049	-2,003	-401
Balance Sheet	Pg 68	Pg 66	Pg 70	Pg 70	Pg 85		
Total borrowings	7,116	9,362	11,877	9,616	8,515	46,486	9,297
Total assets	29,586	31,139	33,367	28,898	25,199	148,189	29,638
Total liabilities	14,792	16,010	19,208	14,368	13,781	78,159	15,632
Total equity (also Net assets)	14,794	15,129	14,159	14,530	11,418	70,030	14,006
Current tax asset	174	-	79	59	-	312	62
Current tax liability	-21	-41	-4	-6	-52	-124	-25
Deferred tax asset	-	-	-	-	35	35	7
Deferred tax liability	-1,136	-883	-147	-110	-	-2,276	-455
Total	-983	-924	-72	-57	-17	-2,053	-411
B: RATIOS							
Return on assets	1.56%	2.05%	-1.35%	-2.09%	-8.13%	-1.35%	-1.35%
Return on equity	3.12%	4.22%	-3.17%	-4.16%	-17.95%	-2.86%	-2.86%
Liabilities to equity	99.99%	105.82%	135.66%	98.89%	120.70%	111.61%	111.61%
Liabilities to assets	50.00%	51.41%	57.57%	49.72%	54.69%	52.74%	52.74%
Net profit margin	3.09%	4.27%	-3.82%	-5.05%	-14.81%	-2.97%	-2.97%
Dividend payout ratio	118.44%	86.21%	-123.16%	-74.83%	0.00%	-104.89%	-104.89%
Tax compared to total tax + dividend	33.50%	3.00%	16.47%	10.32%	100.00%	19.41%	19.41%
Net tax assets/(liabilities) / Net assets	6.64%	6.11%	0.51%	0.39%	0.15%	2.93%	2.93%
Tax paid as a percentage of net profit	54.67%	2.28%	-20.41%	-7.06%	-2.55%	-24.14%	-24.14%
Total borrowings as a percentage of total assets	24.05%	30.07%	35.60%	33.28%	33.791%	31.37%	31.37%
Interest paid as a percentage of total income	3.01%	3.10%	4.66%	5.11%	3.90%	3.87%	3.87%
Interest paid as a percentage of total borrowings	6.30%	4.95%	4.61%	6.35%	6.34%	5.61%	5.61%
Total tax and dividends compared to total equity	5.55%	3.75%	4.68%	3.47%	0.46%	3.72%	3.72%
Total dividends compared to total equity	3.69%	3.64%	3.91%	3.11%	0.00%	3.00%	3.00%
Net tax paid compared to total revenue	1.85%	0.11%	0.93%	0.43%	0.38%	0.75%	0.75%
Total income compared to total expenses	96.62%	95.00%	104.55%	106.16%	115.00%	103.11%	103.11%

Origin Energy has the largest asset base of all companies studied for this research, with total assets of $29,637.8m, and also the largest total equity of $14,006m (five-year average). It also earned more income than any other company in this study.

However, it was the only company in this study that had a five-year average net loss. Although making small losses in 2015 and 2016, the average net loss result is as a result of a large $2bn loss in 2017. This loss resulted from an impairment of $3.1b.[505] Origin Energy had a tax benefit (rather than tax expense) recognised in its Income Statement. However, because impairments are not recognised as a tax deduction, Origin Energy made tax payments for all the years surveyed. Origin Energy did not pay a dividend in 2017. Origin Energy had the lowest net tax liability over total equity ratio of all the companies surveyed, at 2.93%.

5.3.1.3 Ausnet

Ausnet owns and operates the electricity transmission network, an electricity distribution network, and a gas distribution network in Victoria. Ausnet is listed on the Australian Securities Exchange and is 49% publicly owned, while 31.1% is owned by Singapore Power, and 19.9% is owned by the State Grid of China.[506] Ausnet is regulated by the Australian Energy Regulator (AER). Ausnet is a large consolidated group with 21 subsidiaries, some of which were not incorporated in Australia. Ausnet operates on 31 March financial year-ends.

The following table contains key financial data and ratios for the 2013-2017 financial years.

	Year ended 31 March 2013[507]	Year ended 31 March 2014[508]	Year ended 31 March 2015[509]	Year ended 31 March 2016[510]	Year ended 31 March 2017[511]	5-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$M	$M	$M	$M	$M	$M	$M
Cash Flow Statement	Pg 74	Pg 74	Pg 62	Pg 68	Pg 70		
Interest paid	357	361	326	297	285	1,626	325
						-	-
Tax refund received	-	-	-	-	-	-	-
Tax Paid	41	35	55	142	49	322	64
Dividend Paid	253	279	285	295	308	1,419	284
Total dividend and tax paid	294	315	339	436	357	1,741	348

[505] Origin Energy, *2017 Annual Report*, (2017) 5.
[506] Ausnet, About us <https://www.ausnetservices.com.au/en/Misc-Pages/Links/About-Us>.
[507] Ausnet, *Statutory Annual Report 2014*, (2014).
[508] Ibid.
[509] Ausnet, *Statutory Annual Report 2015*, (2015).
[510] Ausnet, *Annual Report 2016*, (2016).
[511] Ausnet, *Annual Report 2017*, (2017).

Income Statement	Pg 68	Pg 68	Pg 57	Pg 63	Pg 65		
Total income	1,639	1,799	1,834	1,919	1,882	9,073	1,815
Total expenses	1,324	1,494	1,480	1,461	1,518	7,277	1,455
Net profit	315	305	354	458	363	1,796	359
Tax expense	42	127	332	31	108	578	116
Net profit after tax	273	178	23	489	255	1,219	244
Balance Sheet	Pg 70	Pg 70	Pg 59	Pg 65	Pg 67		
Total borrowings	5,277	6,069	7,216	6,898	6,665	32,126	6,425
Total assets	10,082	10,612	12,063	11,676	11,757	56,190	11,238
Total liabilities	6,645	7,168	8,815	8,118	8,058	38,804	7,761
Total equity (also Net assets)	3,437	3,445	3,249	3,558	3,698	17,387	3,477
Current tax asset	-	-	-	-	26	26	5
Current tax liability	10	70	139	3	-	222	44
Deferred tax asset	75	17	-	-	-	92	18
Deferred tax liability	294	305	472	466	586	2,123	425
Total	229	357	611	469	561	2,226	445
B: RATIOS							
Return on assets	2.71%	1.68%	0.19%	4.19%	2.17%	2.17%	2.17%
Return on equity	7.95%	5.18%	0.70%	13.75%	6.90%	7.01%	7.01%
Liabilities to equity	193.33%	208.09%	271.32%	228.18%	217.88%	223.18%	223.18%
Liabilities to assets	65.91%	67.54%	73.07%	69.53%	68.54%	69.06%	69.06%
Net profit margin	16.68%	9.91%	1.23%	25.50%	13.56%	13.43%	13.43%
Dividend payout ratio	92.43%	156.53%	1259.73%	60.19%	120.66%	116.42%	116.42%
Tax compared to total tax + dividend	13.90%	11.26%	16.07%	32.49%	13.83%	18.49%	18.49%
Net tax assets/(liabilities) / Net assets	6.65%	10.37%	18.80%	13.19%	15.16%	12.80%	12.80%
Tax paid as a percentage of net profit	12.94%	11.59%	15.38%	30.95%	13.60%	17.92%	17.92%
Total borrowings as a percentage of total assets	52.34%	57.19%	59.82%	59.08%	56.695%	57.17%	57.17%
Interest paid as a percentage of total income	21.77%	20.03%	17.79%	15.47%	15.16%	17.92%	17.92%
Interest paid as a percentage of total borrowings	6.76%	5.94%	4.52%	4.30%	4.28%	5.06%	5.06%
Total tax and dividends compared to total equity	8.54%	9.13%	10.44%	12.26%	9.66%	10.01%	10.01%
Total dividends compared to total equity	7.35%	8.10%	8.76%	8.28%	8.32%	8.16%	8.16%
Net tax paid compared to total revenue	2.49%	1.97%	2.97%	7.38%	2.63%	3.55%	3.55%

Total income compared to total expenses	80.77%	83.03%	80.68%	76.14%	80.69%	80.20%	80.20%

Ausnet had the lowest total assets of the three privately owned corporations surveyed, with average total assets of $11,238.06m, but the highest average percentage of total borrowings compared to total assets at 57.17%. However, although borrowings were so high compared to total assets, total interest paid as a percentage of total assets was the lowest of the privately owned, and amongst the lowest overall, at 5.06%. This could be due to Ausnet's borrowings coming from a variety of different sources from a number of countries. Ausnet's borrowings include medium-term and senior notes, bank debt facilities, floating rate notes and hybrid securities. Countries from which these financial instruments are held include the US, Singapore, Switzerland, Japan, Hong Kong, Norway, Great Britain and Euro currency.[512]

Ausnet made a net profit for all years studied, and paid tax in every year, although there was a sharp spike in tax paid in 2016. This was due to a settlement in relation to a tax dispute with the ATO.[513] The ATO dispute related to the deductibility of payments made under s 163AA of the *Electricity Industry Act 1993 (Vic)*. The payments were required to be made to the State out of company profits, but after the calculation of taxable income. These payments were required to be made as an owner of an electricity transmission license. Ausnet had been claiming these payments as deductible under s 8-1 of ITAA 1997, but the Court held that these were capital payments and not deductible.[514] This resulted in additional tax payable of $54m and interest of $37m, being a total of $91m owed to the ATO.[515] As a result of the outcome of this dispute with the ATO, Ausnet adjusted its Balance Sheet, which included a reduction in its deferred tax liabilities of $292.9m, the cancellation of tax losses (which led to an increase in the deferred tax liabilities of $153m) and the reversal of a derivative financial instrument of $4.9m.[516]

[512] Ausnet, *Annual Report 2017*, (2017) 91.
[513] Ausnet, *Annual Report 2016*, (2016) 68.
[514] *Ausnet Transmission Group Pty Ltd v Commissioner of Taxation* (2015) HCA 25.
[515] Ausnet, *Australian Taxation Office (ATO) Dispute – s 163AA* (5 August 2015).
[516] Ausnet, *Tax Transparency Report 2017*, (2017).

Dividends paid were fairly consistent over the five years surveyed, and the average dividend payout ratio over the five years was 116.42%. The tax expense for the year ended 31 March 2015 was abnormally high at 93.62% of net profit before tax. This was in anticipation of the settlement of the dispute with the ATO.[517]

5.3.2 State-owned companies studied

5.3.2.1 Synergy

The Electricity Generation and Retail Corporation, trading as Synergy, was established in 1883 when the Perth Gas Company was formed and acquired the assets of City of Perth Gas Co.[518] It is a "wholly-owned public sector entity, controlled by the State Government of Western Australia."[519] Synergy is a not-for-profit entity which was incorporated under the Electricity Corporations Act 2005.[520] "Synergy is neither an agent of the state, and in accordance with schedule 1 of the Public Sector Management Act 1994 nor is it a public sector organisation." It is a government trading enterprise which is not listed on the ASX.[521]

Synergy is the leading energy generator and retailer in Western Australia.[522] Synergy is an electricity generator and a retailer of both electricity and gas. It also trades in wholesale electricity and gas under ringfenced arrangements. Synergy participates in the Wholesale Electricity Market in Western Australia.[523]

Synergy generates electricity through the following methods:

- It operates large power stations in Collie, Kwinana, Cockburn and Pinjar;
- It operates small power stations in Mungarra and West Kalgoorlie, and has a joint venture at Worsley Alumina refinery near Collie; and
- It generates electricity from renewable sources via wind farms at Albany, Esperance, Kalbarri and Mumbida, a solar farm near Geraldton and wind-diesel systems in Bremer Bay, Coral Bay, Denham and Hopetoun.[524]

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[517] Ausnet, *Statutory Annual Report 2015*, (2015) 31.
[518] Synergy, Where we've been <https://www.synergy.net.au/About-us/Vision-and-values/Where-weve-been?tid=Wherewevebeen:help_advice:Wherewevebeen>.
[519] Synergy, *2017 Annual Report*, (2017) 85.
[520] Ibid 35.
[521] Ibid 16.
[522] Ibid 2
[523] Synergy, What we do <https://www.synergy.net.au/About-us/Who-we-are/What-we-do>.
[524] Ibid.

As Western Australia's largest energy retailer, Synergy supplies electricity and gas to one million residential, business and industrial customers.[525]

Synergy is comprised of a head (parent) entity and three subsidiaries:

- Vinalco Energy Pty Ltd
- South West Hub Pty Ltd
- South West Solar Development Holdings Pty Ltd (was 50% prior to 2017, but the remaining 50% was acquired on 30 June 2017).[526]

The following table reports on the group results for the five years to 30 June 2017.

	Year ended 30 June 2013[527]	Year ended 30 June 2014[528]	Year ended 30 June 2015[529]	Year ended 30 June 2016[530]	Year ended 30 June 2017[531]	5-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Cash Flow Statement	Pg 56	Pg 56	Pg 55	Pg 37	Pg 34		
Interest paid	75,250	107,984	36,082	10,910	8,892	239,118	47,824
Tax refund received	-		-	- 40,710	-	- - 40,710	- - 8,142
Tax Paid	13,946	173,192	44,111	-	30,704	261,953	52,391
Dividend Paid	39,800	37,600	83,567	70,331	-	231,298	46,260
Total dividend and tax paid	53,746	210,792	127,678	29,621	30,704	452,541	90,508
Income Statement	Pg 53	Pg 53	Pg 52	Pg 34	Pg 30		
Total income	1,606,676	2,781,881	3,240,566	3,121,922	3,087,984	13,839,029	2,767,806
Total expenses	- 1,493,186	- 2,653,057	- 3,161,216	- 3,081,240	- 3,096,124	- 13,484,823	- 2,696,965
Net profit	113,490	128,824	79,350	40,682	- 8,140	354,206	70,841
Tax expense	- 54,596	- 45,454	- 22,203	- 6,996	- 4,484	- 133,733	- 26,747
Net profit after tax	58,894	83,370	57,147	33,686	- 12,624	220,473	44,095
Balance Sheet	Pg 54	Pg 54	Pg 53	Pg 35	Pg 32		
Total borrowings	790,208	141,086	292,183	249,808	193,984	1,667,269	333,454

[525] Ibid.
[526] Synergy, *2017 Annual Report*, (2017) 77.
[527] Synergy, *Annual Report: 1 July 2012 – 30 June 2013*, (2013).
[528] Synergy, *Annual Report: 1 July 2013 – 30 June 2014*, (2014).
[529] Synergy, *Annual Report 2015*, (2015).
[530] Synergy, *Annual Report 2016*, (2016).
[531] Synergy, *2017 Annual Report*, (2017).

Total assets	2,825,274	3,345,525	2,910,985	2,823,878	2,624,151	14,529,813	2,905,963
Total liabilities	2,094,723	2,218,894	1,810,992	1,763,903	1,574,390	9,462,902	1,892,580
Total equity (also Net assets)	730,551	1,126,631	1,099,993	1,059,975	1,049,761	5,066,911	1,013,382
Current tax asset	-	31,591	67,902	-		99,493	19,899
Current tax liability	38,172	-	-	11,931	8,995	59,098	11,820
Deferred tax asset	-	7,348	-	24,042	46,137	77,527	15,505
Deferred tax liability	42,507	-	8,085	-		50,592	10,118
Total	80,679	38,939	59,817	12,111	37,142	67,330	13,466
B: RATIOS							
Return on assets	2.08%	2.49%	1.96%	1.19%	-0.48%	1.52%	1.52%
Return on equity	8.06%	7.40%	5.20%	3.18%	-1.20%	4.35%	4.35%
Liabilities to equity	286.73%	196.95%	164.64%	166.41%	149.98%	186.76%	186.76%
Liabilities to assets	74.14%	66.32%	62.21%	62.46%	60.00%	65.13%	65.13%
Net profit margin	3.67%	3.00%	1.76%	1.08%	-0.41%	1.59%	1.59%
Dividend payout ratio	67.58%	45.10%	146.23%	208.78%	0.00%	104.91%	104.91%
Tax compared to total tax + dividend	25.95%	82.16%	34.55%	-137.44%	100.00%	48.89%	48.89%
Net tax assets/(liabilities) / Net assets	11.04%	3.46%	5.44%	1.14%	3.54%	1.33%	1.33%
Tax paid as a percentage of net profit	12.29%	134.44%	55.59%	0.00%	-377.20%	73.95%	73.95%
Total borrowings as a percentage of total assets	27.97%	4.22%	10.04%	8.85%	7.392%	11.47%	11.47%
Interest paid as a percentage of total income	4.68%	3.88%	1.11%	0.35%	0.29%	1.73%	1.73%
Interest paid as a percentage of total borrowings	9.52%	76.54%	12.35%	4.37%	4.58%	14.34%	14.34%
Total tax and dividends compared to total equity	7.36%	18.71%	11.61%	2.79%	2.92%	8.93%	8.93%
Total dividends compared to total equity	5.45%	3.34%	7.60%	6.64%	0.00%	4.56%	4.56%
Net tax paid compared to total revenue	0.87%	6.23%	1.36%	-1.30%	0.99%	1.60%	1.60%
Total income compared to total expenses	92.94%	95.37%	97.55%	98.70%	100.26%	97.44%	97.44%

With the exception of 2017, Synergy reported net profits for all years studied, and an overall average net profit after tax of $44,094.6m over the five years studied. The loss in 2017 was due to the change to a long-term gas supply contract.[532]Synergy was the only company of the State-owned corporations studied to return a net tax asset in the balance sheet. The only year (of those studied) that had a net tax liability was

[532] Ibid 6.

2013. As discussed in AGL, it is unusual for an infrastructure and asset-intensive company to return an overall tax asset.

Total interest paid over total borrowings returned abnormal results, with the average being 14.34% and 76.54% for the year ended 30 June 2014. This result was excluded from the average government calculations.

Synergy also had the highest tax paid as a percentage of net profit before tax of all companies studied, at 73.95%. This does not take into account the tax refund received in 2016. When the tax refund is included, this percentage falls to 62.46%, which is still the largest and fairly substantial when compared to all the other companies studied. However, tax paid in comparison to total income was amongst the lowest, at 1.60%. In addition, Synergy had the lowest Net Profit Margin (being net profit after tax compared to total revenue) of 1.59%. This result suggests extreme inefficiency and expenses that are way too high compared to revenue. It also had the lowest return on assets of 1.52%.

5.3.2.2 Essential Energy

Essential Energy was founded on 1 March 2011 and is the "poles and wires" company that delivers electricity to 95% of regional, rural and remote NSW and parts of southern Queensland.[533] It is owned by the New South Wales Government and was incorporated under the *State Owned Corporations Act 1989*.[534] Essential Energy had a one-third ownership in its subsidiary, Networks NSW Pty Limited, until 29 January 2016. At that date, Networks NSW became wholly owned. However, it had no transactions, and total assets and liabilities were immaterial. This subsidiary was subsequently de-registered on 3 August 2016.[535]

Essential Energy currently has issued two fully paid $1 ordinary shares owned by the Treasurer and the Minister for Finance, Services, and Property on behalf of the NSW Government.[536] As a monopoly, its prices are regulated by the Australian Energy Regulator (AER).

[533] Essential Energy, What we do <https://www.essentialenergy.com.au/about-us/corporate-profile>.
[534] Essential Energy, *Annual Report 2016-17*, (2017) 70.
[535] Ibid.
[536] Ibid 77.

The table below shows the key results (as extracted from the financial statements and annual reports) and ratios for Essential Energy over the five-year period to 30 June 2017.

	Year ended 30 June 2013[537]	Year ended 30 June 2014[538]	Year ended 30 June 2015[539]	Year ended 30 June 2016[540]	Year ended 30 June 2017[541]	5-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$M	$M	$M	$M	$M	$M	$M
Cash Flow Statement	Pg 36	Pg 38	Pg 40	Pg 41	Pg 69		
Interest paid	355	330	336	333	340	1,694	339
						-	-
Tax refund received	-	-	-	-	-	-	-
Tax Paid	132	219	125	35	24	534	107
Dividend Paid	67	241	134	59	28	529	106
Total dividend and tax paid	199	460	259	94	52	1,063	213
Income Statement	Pg 33	Pg 35	Pg 37	Pg 38	Pg 66		
Total income	2,164	1,965	2,054	1,552	1,534	9,269	1,854
Total expenses	- 1,665	- 1,615	- 1,672	- 1,560	- 1,462	- 7,975	- 1,595
Net profit	499	350	381	- 8	72	1,294	259
Tax expense	- 149	- 55	- 115	7	- 22	- 333	- 67
Net profit after tax	350	295	266	- 1	50	961	192
Balance Sheet	Pg 34	Pg 36	Pg 38	Pg 39	Pg 67		
Total borrowings	4,336	4,697	4,798	5,045	5,229	24,104	4,821
Total assets	7,780	8,037	8,228	8,283	8,399	40,727	8,145
Total liabilities	5,833	5,919	5,846	5,995	6,041	29,634	5,927
Total equity (also Net assets)	1,947	2,118	2,382	2,288	2,359	11,093	2,219
Current tax asset						-	-
Current tax liability	- 96	- 5	- 25	- 3	- 10	- 138	- 28
Deferred tax asset						-	-
Deferred tax liability	- 332	- 263	- 258	- 210	- 222	- 1,287	- 257

[537] Essential Energy, *Annual Report 2012-13*, (2013).
[538] Essential Energy, *Annual Report 2013-14*, (2014).
[539] Essential Energy, *Annual Report 2014-15*, (2015).
[540] Essential Energy, *Annual Report 2015-16*, (2016).
[541] Essential Energy, *Annual Report 2016-17*, (2017).

Total	-429	-268	-283	-213	-232	-1,425	-285
B: RATIOS							
Return on assets	4.50%	3.68%	3.24%	-0.01%	0.60%	2.36%	2.36%
Return on equity	17.98%	13.95%	11.18%	-0.05%	2.12%	8.66%	8.66%
Liabilities to equity	299.65%	279.54%	245.42%	262.00%	256.08%	267.13%	267.13%
Liabilities to assets	74.98%	73.65%	71.05%	72.38%	71.92%	72.76%	72.76%
Net profit margin	16.18%	15.03%	12.97%	-0.08%	3.26%	10.36%	10.36%
Dividend payout ratio	19.22%	81.52%	50.28%	-4891.67%	56.20%	55.05%	55.05%
Tax compared to total tax + dividend	66.16%	47.61%	48.20%	37.42%	45.75%	50.24%	50.24%
Net tax assets/(liabilities) / Net assets	22.01%	12.67%	11.88%	9.32%	9.83%	12.84%	12.84%
Tax paid as a percentage of net profit	26.36%	62.51%	32.69%	-438.75%	33.15%	41.26%	41.26%
Total borrowings as a percentage of total assets	55.73%	58.44%	58.32%	60.90%	62.253%	59.18%	59.18%
Interest paid as a percentage of total income	16.42%	16.78%	16.36%	21.45%	22.17%	18.28%	18.28%
Interest paid as a percentage of total borrowings	8.20%	7.02%	7.00%	6.60%	6.50%	7.03%	7.03%
Total tax and dividends compared to total equity	10.22%	21.70%	10.85%	4.10%	2.20%	9.58%	9.58%
Total dividends compared to total equity	3.46%	11.37%	5.62%	2.57%	1.19%	4.77%	4.77%
Net tax paid compared to total revenue	6.08%	11.13%	6.07%	2.26%	1.55%	5.76%	5.76%
Total income compared to total expenses	76.93%	82.19%	81.44%	100.52%	95.34%	86.04%	86.04%

Essential Energy paid taxes and dividends in each of the years surveyed. With the exception of 2016, it also made net profits in all years surveyed.

Overall, Essential Energy had net tax liabilities which formed an average of 12.84% of its net assets, which was far below the State-owned average of 40.73%. Total dividends paid over the five-year period compared to equity was an average of 4.77%, which was also below the State-owned average of 12.49%.

Tax paid as a percentage of total revenue was 5.76%, which was slightly higher than the State-owned average of 4.61%.

5.3.2.3 Aurora Energy

Aurora Energy is an electricity and gas retailer which operates in Tasmania. It was established in 1998 and is owned by the Tasmanian Government. It was established under the *Electricity Companies Act 1997* (Tas).

Aurora Energy is a stand-alone entity and has no subsidiaries. It has issued 112,700,004 shares[542] to its two shareholders: the Minister for Energy and the Treasurer of Tasmania.[543]

Aurora Energy used to have a distribution segment. As a result of the reform of the electricity supply industry in Tasmania, the electricity distribution segment of Aurora Energy's business was transferred to TasNetworks from 1 July 2014 (see the next section below). However, Aurora continued trading as a gas and electricity retailer throughout Tasmania.

Financial data for the 2013-2017 years were able to be extracted from publicly available annual reports and financial statements. These results were then collated and averaged over the five-year period to produce the following table and ratios:

	Year ended 30 June 2013[544]	Year ended 30 June 2014[545]	Year ended 30 June 2015[546]	Year ended 30 June 2016[547]	Year ended 30 June 2017[548]	5-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Cash Flow Statement	Pg 80	Pg 33	Pg 38	Pg 53	Pg 54		
Interest paid	66,488	50,332	121	-	2	116,943	23,389
						-	-
Tax refund received	-	-	-	-	-	-	-
Tax Paid	3,386	29,881	32,932	14,481	9,720	90,400	18,080
Dividend Paid	16,000	25,000	-	27,600	27,000	95,600	19,120
Total dividend and tax paid	19,386	54,881	32,932	42,081	36,720	186,000	37,200
Income Statement	Pg 77	Pg 30	Pg 35	Pg 50	Pg 51		
Total income	1,575,566	1,202,971	948,951	866,282	903,050	5,496,820	1,099,364
Total expenses	- 1,491,070	- 1,137,890	- 903,967	- 823,156	- 875,215	- 5,231,298	- 1,046,260
Net profit	84,496	65,081	44,984	43,126	27,835	265,522	53,104
Tax expense	- 25,381	- 1,090	- 13,497	- 12,940	- 8,353	- 61,261	- 12,252
Net profit after tax	59,115	63,991	31,487	30,186	19,482	204,261	40,852

[542] Aurora Energy, *Annual Report 2017*, (2017) 83.
[543] Ibid 30.
[544] Aurora Energy, *Annual Report 2012-13*, (2013).
[545] Aurora Energy, *Annual Report 2013-14*, (2014).
[546] Aurora Energy, *2015 Annual Report*, (2015).
[547] Aurora Energy, *Annual Report 2016*, (2016).
[548] Aurora Energy, *Annual Report 2017*, (2017).

Balance Sheet	Pg 78	Pg 31	Pg 36	Pg 51	Pg 52		
Total borrowings	749,813	762,570	-	-		1,512,383	302,477
Total assets	1,816,196	1,884,945	269,391	345,106	349,697	4,665,335	933,067
Total liabilities	1,261,278	1,321,929	186,065	236,421	241,694	3,247,387	649,477
Total equity (also Net assets)	554,918	563,016	83,326	108,685	108,003	1,417,948	283,590
Current tax asset	-	-	-	-		-	-
Current tax liability	- 19,957	- 22,294	- 2,566	- 1,392	- 1,118	- 47,327	- 9,465
Deferred tax asset	46,053	59,484	7,471	10,108	10,198	133,314	26,663
Deferred tax liability	- 159,942	- 143,062	- 9,503	- 21,534	- 23,460	- 357,501	- 71,500
Total	- 133,846	- 105,872	- 4,598	- 12,818	- 14,380	- 271,514	- 54,303
B: RATIOS							
Return on assets	3.25%	3.39%	11.69%	8.75%	5.57%	4.38%	4.38%
Return on equity	10.65%	11.37%	37.79%	27.77%	18.04%	14.41%	14.41%
Liabilities to equity	227.29%	234.79%	223.30%	217.53%	223.78%	229.02%	229.02%
Liabilities to assets	69.45%	70.13%	69.07%	68.51%	69.12%	69.61%	69.61%
Net profit margin	3.75%	5.32%	3.32%	3.48%	2.16%	3.72%	3.72%
Dividend payout ratio	27.07%	39.07%	0.00%	91.43%	138.59%	46.80%	46.80%
Tax compared to total tax + dividend	17.47%	54.45%	100.00%	34.41%	26.47%	48.60%	48.60%
Net tax assets/(liabilities) / Net assets	24.12%	18.80%	5.52%	11.79%	13.31%	19.15%	19.15%
Tax paid as a percentage of net profit	4.01%	45.91%	73.21%	33.58%	34.92%	34.05%	34.05%
Total borrowings as a percentage of total assets	41.28%	40.46%	0.00%	0.00%	0.000%	32.42%	32.42%
Interest paid as a percentage of total income	4.22%	4.18%	0.01%	0.00%	0.00%	2.13%	2.13%
Interest paid as a percentage of total borrowings	8.87%	6.60%	#DIV/0!	#DIV/0!	#DIV/0!	7.73%	7.73%
Total tax and dividends compared to total equity	3.49%	9.75%	39.52%	38.72%	34.00%	13.12%	13.12%
Total dividends compared to total equity	2.88%	4.44%	0.00%	25.39%	25.00%	6.74%	6.74%
Net tax paid compared to total revenue	0.21%	2.48%	3.47%	1.67%	1.08%	1.64%	1.64%
Total income compared to total expenses	94.64%	94.59%	95.26%	95.02%	96.92%	95.17%	95.17%

Aurora Energy made net profits and paid taxes for all years studied. It paid dividends for all years except 2015. Total assets dropped off sharply in 2015 and in the following years, which was to be expected as a result of the distribution business being transferred to TasNetworks. A key result worthy of note is that Aurora Energy

no longer has any borrowings. Initially, in the 2013 and 2014 years, it had borrowings of $749.813m and $762.570m respectively, but as part of the restructure it was left with no borrowings at all for the 2015, 2016 and 2017 financial years. This resulted in a very low average interest paid as a percentage of total income over the five years of 2.13% and, as expected, total borrowings as a percentage of total assets was nil in the years following the transfer of the distribution business. However, even though there was not a high interest expense, total expenses expressed as a percentage of total income were still amongst the highest surveyed at 95.17%. Following on from this, net tax paid compared to total revenue was amongst the lowest at 1.64%.

Although a significant portion of its business was transferred to TasNetworks, the resulting transfer of debt meant that the total debt to equity ratios (liabilities to equity, and liabilities to assets), remained fairly consistent over the five years.

5.3.2.4 TasNetworks

TasNetworks is the electricity transmission and distribution network, and telecommunications network company in Tasmania. It was formed on 1 July 2014 from a merger between Aurora Energy's distribution network (the electricity poles and wires) and Transend Networks (the electricity towers and lines). TasNetworks is owned by the Tasmanian Government.[549] TasNetworks has two fully paid $1 ordinary shares which are held in trust for the Crown in Right of the State of Tasmania. These shares have been issued to the Treasurer and the Minister for Energy.[550] TasNetworks has two non-trading subsidiaries: Ezikey Group Pty Ltd and Auroracom Pty Ltd.[551]

Transend provided electricity transmission and telecommunications (providing telecommunications services only to those in the electricity supply industry) to Tasmania until 30 June 2014.[552] It was owned by the Tasmanian Government and had four issued fully paid ordinary shares with no par value. These shares were held in trust for the Crown in Right of the State of Tasmania.[553]

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[549] TasNetworks, About TasNetworks <https://www.tasnetworks.com.au/about-us/corporate-profile/about-tasnetworks/>.
[550] TasNetworks, *Annual Report 2016-17*, (2017) 70.
[551] Ibid 28.
[552] Transend, *Annual Report 2014*, (2014) 3.
[553] Ibid 70.

In May 2012, the Tasmanian Government reformed the electricity supply industry which resulted in a merger of the transmission services of Transend Networks and the electricity distribution business of Aurora Energy. All the business activities of Transend were transferred to TasNetworks from 1 July 2014.[554]

For the purposes of this case study, the Annual Reports of Transend Networks Pty Ltd were used for the 2013 and 2014 financial years; and the Annual Reports of TasNetworks Pty Ltd were used for the 2015, 2016 and 2017 financial years. This data has been summarised in the table below:

	Year ended 30 June 2013[555]	Year ended 30 June 2014[556]	Year ended 30 June 2015[557]	Year ended 30 June 2016[558]	Year ended 30 June 2017[559]	5-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Cash Flow Statement	Pg 34	Pg 46	Pg 64	Pg 60	Pg 52		
Interest paid	39,705	40,650	72,393	104,308	78,049	335,105	67,021
						-	-
Tax refund received	-	-	-	-	-	-	-
Tax Paid	32,482	31,187	79,089	55,612	46,596	244,966	48,993
Dividend Paid	25,900	28,686	61,000	63,200	72,628	251,414	50,283
Total dividend and tax paid	58,382	59,873	140,089	118,812	119,224	496,380	99,276
Income Statement	Pg 31	Pg 42	Pg 60	Pg 56	Pg 48		
Total income	241,471	234,644	583,613	597,778	552,212	2,209,718	441,944
Total expenses	- 173,142	- 181,296	- 422,217	- 457,254	- 418,125	- 1,652,034	- 330,407
Net profit	68,329	53,348	161,396	140,524	134,087	557,684	111,537
Tax expense	- 20,519	- 16,024	- 48,465	- 42,142	- 40,160	- 167,310	- 33,462
Net profit after tax	47,810	37,324	112,931	98,382	93,927	390,374	78,075
Balance Sheet	Pg 32	Pg 44	Pg 62	Pg 58	Pg 50		
Total borrowings	631,197	664,349	1,643,718	1,749,302	1,785,762	6,474,328	1,294,866
Total assets	1,710,446	1,754,096	3,174,731	3,198,236	3,265,038	13,102,547	2,620,509
Total liabilities	988,624	1,045,189	2,158,681	2,278,153	2,320,951	8,791,598	1,758,320

[554] Ibid 3.
[555] Transend, *Annual Report 2013*, (2013).
[556] Transend, *Annual Report 2014*, (2014).
[557] Tasmanian Networks Pty Ltd, *Annual Report 2014-15*, (2015).
[558] Tasmanian Networks Pty Ltd, *Annual Report 2015-16*, (2016).
[559] TasNetworks, *Annual Report 2016-17*, (2017).

Total equity (also Net assets)	721,822	708,907	1,016,050	920,083	944,087	4,310,949	862,190
Current tax asset	-		11,951	2,086	-	14,037	2,807
Current tax liability	8,974	3,700	-	-	6,069	18,743	3,749
Deferred tax asset	-	-	-	-	-	-	-
Deferred tax liability	209,987	208,116	237,302	218,208	226,196	1,099,809	219,962
Total	218,961	211,816	225,351	216,122	232,265	1,104,515	220,903
B: RATIOS							
Return on assets	2.80%	2.13%	3.56%	3.08%	2.88%	2.98%	2.98%
Return on equity	6.62%	5.27%	11.11%	10.69%	9.95%	9.06%	9.06%
Liabilities to equity	136.96%	147.44%	212.46%	247.60%	245.84%	203.94%	203.94%
Liabilities to assets	57.80%	59.59%	68.00%	71.23%	71.08%	67.10%	67.10%
Net profit margin	19.80%	15.91%	19.35%	16.46%	17.01%	17.67%	17.67%
Dividend payout ratio	54.17%	76.86%	54.02%	64.24%	77.32%	64.40%	64.40%
Tax compared to total tax + dividend	55.64%	52.09%	56.46%	46.81%	39.08%	49.35%	49.35%
Net tax assets/(liabilities) / Net assets	30.33%	29.88%	22.18%	23.49%	24.60%	25.62%	25.62%
Tax paid as a percentage of net profit	47.54%	58.46%	49.00%	39.57%	34.75%	43.93%	43.93%
Total borrowings as a percentage of total assets	36.90%	37.87%	51.78%	54.70%	54.693%	49.41%	49.41%
Interest paid as a percentage of total income	16.44%	17.32%	12.40%	17.45%	14.13%	15.17%	15.17%
Interest paid as a percentage of total borrowings	6.29%	6.12%	4.40%	5.96%	4.37%	5.18%	5.18%
Total tax and dividends compared to total equity	8.09%	8.45%	13.79%	12.91%	12.63%	11.51%	11.51%
Total dividends compared to total equity	3.59%	4.05%	6.00%	6.87%	7.69%	5.83%	5.83%
Net tax paid compared to total revenue	13.45%	13.29%	13.55%	9.30%	8.44%	11.09%	11.09%
Total income compared to total expenses	71.70%	77.26%	72.35%	76.49%	75.72%	74.76%	74.76%

Differently to what happened to Aurora Energy above, total borrowings and total assets increased sharply in 2015 as a result of the merger of Transend Networks and the electricity distribution business of Aurora Energy. However, unlike Aurora Energy, the liabilities to equity and liabilities to assets ratios both rose sharply in the initial year of the merger. Borrowings as a percentage of total assets also increased immediately after the merger.

As expected in such a situation, both taxes and dividends paid increased following the merger, and both taxes and dividends were paid in every year. TasNetworks also experienced net profits in all years surveyed.

Tax paid compared to total revenue was the highest for any of the companies studied, at 11.09%. This could be in part due to the fact that total expenses as a percentage of total revenue were the lowest for all companies studied, at 74.76%, albeit interest paid as a percentage of total income was amongst the highest at 15.17%.

5.3.2.5 Ergon, Energex and Energy Queensland

Ergon

Ergon Energy both builds and maintains the electricity distribution network, and also acts as a retailer to residential and business customers in Queensland.[560] It services regional Queensland. Ergon Energy is a state-owned corporation, owned by the Queensland Government. In June 2016 it was merged with Energex and now sits beneath the Energy Queensland umbrella. However, the brand continues.

Ergon Energy currently holds 100% ownership of two subsidiaries: Ergon Energy Queensland Pty Ltd and Ergon Energy Telecommunications Pty Ltd. Both are Australian companies.[561]

For the purposes of this study, the three years to 30 June 2015 were studied, and the averages over those three years calculated as follows:

	Year ended 30 June 2013	Year ended 30 June 2014	Year ended 30 June 2015	3-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$'000	$M	$M	$'000	$'000
Cash Flow Statement	Pg 11	Pg 11	Pg 11		
Interest paid	365	369	337	1,071	357
Tax refund received	-	-	-	-	-
Tax Paid	-	-	51	51	17
Dividend Paid	256	326	392	974	325
Total dividend and tax paid	256	326	443	1,025	342

[560] Ergon Energy, Understanding our business <https://www.ergon.com.au/about-us/who-we-are/understanding-our-business>.
[561] Energy Queensland Limited, *Annual Financial Statements for the year ended 30 June 2017*, (2017) 102.

Income Statement	Pg 7	Pg 7	Pg 7		
Total income	3,004	2,440	2,627	8,071	2,690
Total expenses	2,409	2,019	1,636	- 6,064	2,021
Net profit	595	421	991	2,007	669
Tax expense	172	126	295	593	198
Net profit after tax	423	295	696	1,414	471
Balance Sheet	Pg 9	Pg 9	Pg 9		
Total borrowings	5,004	5,141	5,300	15,445	5,148
					-
Total assets	11,461	10,931	11,485	33,877	11,292
Total liabilities	7,746	7,862	9,669	25,277	8,426
Total equity (also Net assets)	3,715	3,069	1,816	8,600	2,867
Current tax asset	-	-	-	-	-
Current tax liability	-	7	134	141	47
Deferred tax asset	-	-	-	-	-
Deferred tax liability	1,750	1,625	1,687	- 5,062	1,687
Total	1,750	1,632	1,821	- 5,203	1,734
B: RATIOS					
Return on assets	3.69%	2.70%	6.06%	4.17%	4.17%
Return on equity	11.39%	9.61%	38.33%	16.44%	16.44%
Liabilities to equity	208.51%	256.17%	532.43%	293.92%	293.92%
Liabilities to assets	67.59%	71.92%	84.19%	74.61%	74.61%
Net profit margin	14.08%	12.09%	26.49%	17.52%	17.52%
Dividend payout ratio	60.52%	110.51%	56.32%	68.88%	68.88%
Tax compared to total tax + dividend	0.00%	0.00%	11.51%	4.98%	4.98%
Net tax assets/(liabilities) / Net assets	47.11%	53.18%	100.28%	60.50%	60.50%
Tax paid as a percentage of net profit	0.00%	0.00%	5.15%	2.54%	3%
Total borrowings as a percentage of total assets	43.66%	47.03%	46.15%	45.591%	0.46
Interest paid as a percentage of total income	12.15%	15.12%	12.83%	13.27%	13.27%
Interest paid as a percentage of total borrowings	7.29%	7.18%	6.36%	6.93%	6.93%
Total tax and dividends compared to total equity	6.89%	10.62%	24.39%	11.92%	0.12
Total dividends compared to total equity	6.89%	10.62%	21.59%	11.33%	0.11
Net tax paid compared to total revenue	0.00%	0.00%	1.94%	0.63%	0.01

Total income compared to total expenses	80.19%	82.75%	62.28%	75.13%	0.75

Of note is that Ergon did not pay any tax in the financial years ended 30 June 2013 and 30 June 2014. This is due to tax losses that were available from earlier years.[562] The utilisation of these carried forward losses against tax payable for those years resulted in the average tax paid as a percentage of revenue being lower than it otherwise would have been, had there been no losses available. This gave Ergon the lowest net tax paid compared to total revenue of all the companies studied, at 0.63%. Despite this, Ergon made a net profit after tax for all years surveyed and had a tax expense (as opposed to tax benefit) for those years.

Dividend payments were high, at an average of 11.33% of total equity, the second highest of all companies surveyed, and represented 95.02% of total tax and dividend payments made to the Queensland Government.

Energex

Energex builds, operates and maintains the electricity distribution network in South East Queensland.[563] Energex is a state-owned corporation which is owned by the Queensland Government. In June 2016 it was merged with Ergon and is now a subsidiary of Energy Queensland. However, it has kept its brand and still continues to trade as Energex.

Energex currently holds 100% ownership of four subsidiaries of its own:

- Energy Impact Pty Ltd
- Metering Dynamics Business Support Pty Ltd
- Vamsdorf Pty Ltd
- VH Operations Pty Ltd[564]

All these subsidiaries are Australian companies.

[562] Ergon Energy, *Annual Financial Statements for the year ended 30 June 2014*, (2014) 20.
[563] Energex, Our profile <https://www.energex.com.au/about-us/company-information/who-we-are/our-profile>
[564] Energy Queensland, *Annual Financial Statements for the year ended 30 June 2017*, (2017) 102.

For the purposes of this study, the three years to 30 June 2015 were studied, and the averages over those three years calculated as follows:

	Year ended 30 June 2013[565]	Year ended 30 June 2014[566]	Year ended 30 June 2015[567]	3-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$M	$M	$M	$M	$M
Cash Flow Statement	Pg 17	Pg 15	Pg 15		
Interest paid	389	419	350	1,158	386
				-	-
Tax refund received	-	-	-	-	-
Tax Paid	15	35	121	171	57
Dividend Paid		294	406	700	233
Total dividend and tax paid	15	329	527	871	290
Income Statement	Pg 13	Pg 11	Pg 11		
Total income	2,274	2,248	2,575	7,097	2,366
Total expenses	- 1,772	- 1,871	- 1,842	- 5,485	- 1,828
Net profit	502	377	733	1,612	537
Tax expense	- 151	- 111	- 221	- 483	- 161
Net profit after tax	351	266	512	1,129	376
Balance Sheet	Pg 13, 2015 restated amts	Pg 13	Pg 13		
Total borrowings	6,001	6,465	6,811	19,277	6,426
Total assets	11,359	12,388	12,475	36,222	12,074
Total liabilities	8,414	9,195	10,402	28,011	9,337
Total equity (also Net assets)	2,945	3,193	2,073	8,211	2,737
Current tax asset	-	-	-	-	-
Current tax liability	- 10	- 64	- 184	- 258	- 86
Deferred tax asset	-	-	-	-	-
Deferred tax liability	- 1,707	- 1,895	- 1,727	- 5,329	- 1,776
Total	- 1,717	- 1,959	- 1,911	- 5,587	- 1,862

[565] Energex, *Annual Performance Report 2012/13*, (2013).
[566] Energex, *Annual Report 2013/14*, (2014).
[567] Energex, *Annual Report 2014/15*, (2015).

B: RATIOS					
Return on assets	3.09%	2.15%	4.10%	3.12%	3.12%
Return on equity	11.92%	8.33%	24.70%	13.75%	13.75%
Liabilities to equity	285.70%	287.97%	501.78%	341.14%	341.14%
Liabilities to assets	74.07%	74.23%	83.38%	77.33%	77.33%
Net profit margin	15.44%	11.83%	19.88%	15.91%	15.91%
Dividend payout ratio	0.00%	110.53%	79.30%	62.00%	62.00%
Tax compared to total tax + dividend	100.00%	10.64%	22.96%	19.63%	19.63%
Net tax assets/(liabilities) / Net assets	58.30%	61.35%	92.19%	68.04%	68.04%
Tax paid as a percentage of net profit	2.99%	9.28%	16.51%	10.61%	11%
Total borrowings as a percentage of total assets	52.83%	52.19%	54.60%	53.219%	0.53
Interest paid as a percentage of total income	17.11%	18.64%	13.59%	16.32%	16.32%
Interest paid as a percentage of total borrowings	6.48%	6.48%	5.14%	6.01%	6.01%
Total tax and dividends compared to total equity	0.51%	10.30%	25.42%	10.61%	0.11
Total dividends compared to total equity	0.00%	9.21%	19.59%	8.53%	0.09
Net tax paid compared to total revenue	0.66%	1.56%	4.70%	2.41%	0.02
Total income compared to total expenses	77.92%	83.23%	71.53%	77.29%	0.77

Of note is that Energex did not pay a dividend in 2013 and had a very low tax payment for that year. There were tax losses in the group in 2012 which could explain the low tax payment. Energex earned a net profit after tax in all years studied and had a total net tax liability that averaged $1,862.33m.

Interest paid as a percentage of total income was in the higher range of companies studied at 16.32%, while average interest rate on borrowings was 6.01% which was lower than the State-owned average of 6.29%, but higher than the privately-owned average of 5.62%.

Energy Queensland

Energy Queensland was formed in June 2016 through a merger of Ergon Energy and Energex. Energy Queensland combines the two electricity distributors, a retail arm (Ergon Energy Retail), and a new energy services business.[568] These changes to the energy sector were undertaken with the intention of introducing efficiencies and keeping prices for customers low. Energy Queensland Limited is a consolidated

[568] Energy Queensland, About us <https://www.energyq.com.au/about-us>.

group which controls Energex Limited (which has four subsidiaries of its own), Ergon Energy Corporation Limited (which has two subsidiaries of its own), and SPARQ Solutions Pty Ltd.[569]

Financial data for the years ended 30 June 2015, 2016 and 2017 were able to be extracted from publicly available annual reports and financial statements. These results were then collated and averaged over the three-year period to produce the following table and ratios:

	Year ended 30 June 2015[570]	Year ended 30 June 2016[571]	Year ended 30 June 2017[572]	3-year total	Average
A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	$M	$M	$M	$M	$M
Cash Flow Statement	Pg 14	Pg 14	Pg 59		
Interest paid	688	697	791	2,176	725
Tax refund received	-	-	-	-	-
Tax Paid	173	609	632	1,414	471
Dividend Paid	798	4,147	-	4,945	1,648
Total dividend and tax paid	971	4,756	632	6,359	2,120
Income Statement	Pg 10	Pg 10	Pg 55		
Total income	5,158	5,029	5,265	15,452	5,151
Total expenses	- 3,434	- 3,671	- 4,007	- 11,112	- 3,704
Net profit	1,724	1,358	1,258	4,340	1,447
Tax expense	- 516	- 416	- 377	- 1,309	- 436
Net profit after tax	1,208	942	881	3,031	1,010
Balance Sheet	Pg 12	Pg 12	Pg 57		
Total borrowings	12,112	16,287	16,267	44,666	14,889
Total assets	23,956	24,177	26,008	74,141	24,714
Total liabilities	20,070	20,812	22,437	63,319	21,106
Total equity (also Net assets)	3,886	3,365	3,571	10,822	3,607
Current tax asset	-	-	-	-	-

[569] Energy Queensland, *Annual Financial Statements for the year ended 30 June 2017*, (2017) 102.
[570] Energy Queensland, *Annual Financial Statements for the year ended 30 June 2016*, (2016).
[571] Ibid.
[572] Energy Queensland, *Annual Financial Statements for the year ended 30 June 2017*, (2017).

Current tax liability	- 318	- 144	-	- 462	- 154
Deferred tax asset	-	-	-	-	-
Deferred tax liability	- 3,414	- 3,453	- 3,520	- 10,387	- 3,462
Total	- 3,732	- 3,597	- 3,520	- 10,849	- 3,616
B: RATIOS					
Return on assets	5.04%	3.90%	3.39%	4.09%	4.09%
Return on equity	31.09%	27.99%	24.67%	28.01%	28.01%
Liabilities to equity	516.47%	618.48%	628.31%	585.10%	585.10%
Liabilities to assets	83.78%	86.08%	86.27%	85.40%	85.40%
Net profit margin	23.42%	18.73%	16.73%	19.62%	19.62%
Dividend payout ratio	66.06%	440.23%	0.00%	163.15%	163.15%
Tax compared to total tax + dividend	17.82%	12.80%	100.00%	22.24%	22.24%
Net tax assets/(liabilities) / Net assets	96.04%	106.89%	98.57%	100.25%	100.25%
Tax paid as a percentage of net profit	10.03%	44.85%	50.24%	32.58%	33%
Total borrowings as a percentage of total assets	50.56%	67.37%	62.55%	60.245%	0.60
Interest paid as a percentage of total income	13.34%	13.86%	15.02%	14.08%	14.08%
Interest paid as a percentage of total borrowings	5.68%	4.28%	4.86%	4.87%	4.87%
Total tax and dividends compared to total equity	24.99%	141.34%	17.70%	58.76%	0.59
Total dividends compared to total equity	20.54%	123.24%	0.00%	45.69%	0.46
Net tax paid compared to total revenue	3.35%	12.11%	12.00%	9.15%	0.09
Total income compared to total expenses	66.58%	73.00%	76.11%	71.91%	0.72

The results show that, although Energy Queensland did not pay a dividend in the 2017 financial year, the dividend paid in the 2016 financial year was so large ($4,147m) that it had the highest average dividend payout ratio of any company studied at 163.15%. It also made the largest average dividend payment compared to total equity of any of the companies studied at 45.69%.

Energy Queensland had the largest total assets balance of the State-owned corporations of $24.714b and was second only to Origin in the companies surveyed. However, it had much higher liabilities than Origin, resulting in a lower equity of $3.6b compared to Origin's $14b.

In addition, Energy Queensland had the largest average net tax liability of $3,616.33m which, when compared to average net assets, was 100.25% of those net

assets. Also, the liabilities to equity ratio was the highest of any company surveyed at 585.10%, which is, in part, driven by high borrowings of 60.24% of total assets, again the highest for any company studied. Tax payments were also quite large, accounting for 9.15% of total revenue, the second highest of the companies surveyed.

These results indicate that the Queensland Government stripped a significant amount of equity out of the business after it consolidated Ergon and Energex.

5.3.3 Overall comparison

This section seeks to compare the State-owned corporations against their privately-owned counterparts. Typically, the State-owned corporations had smaller and simpler consolidated groups, if any. There were no consolidated groups containing any foreign entities. This could be due to the restrictions placed by State and Territory Treasuries as to group structuring and entities.

The following table compares the averages of the privately owned and state-owned corporations.

OWNERSHIP AVERAGES

Ratios	Private	Government
Return on assets	0.88%	3.23%
Return on equity	2.49%	13.52%
Liabilities to equity	139.62%	301.00%
Liabilities to assets	55.83%	73.13%
Net profit margin	4.30%	12.34%
Dividend payout ratio	49.43%	80.74%
Tax compared to total tax + dividend	23.51%	34.85%
Net tax assets/(liabilities) / Net assets	2.50%	40.73%
Tax paid as a percentage of net profit	13.54%	34.13%
Total borrowings as a percentage of total assets	37.43%	44.51%
Interest paid as a percentage of total income	7.92%	11.57%
Interest paid as a percentage of total borrowings	5.62%	6.29%
Total tax and dividends compared to total equity	6.83%	17.78%
Total dividends compared to total equity	5.24%	12.49%
Net tax paid compared to total revenue	1.97%	4.61%
Total income compared to total expenses	93.29%	82.53%

A: ACTUAL FINANCIAL RESULTS FROM FINANCIAL STATEMENTS	Ausnet	Origin	AGL	Synergy	Ergon	Energex	Energy Queensland	Tasnetworks	Aurora Energy	Essential Energy
	$'000	$M	$M	$'000	$'000	$M	$M	$'000	$'000	$M
Cash Flow Statement										
Interest paid	325.16	521.80	212.80	47,823.60	357.00	386.00	725.33	67,021.00	23,388.60	338.84
	-	-	-	-		-		-	-	-
Tax refund received	-	-	-	- 8,142.00	-	-	-	-	-	-
Tax Paid	64.36	101.20	173.42	52,390.60	17.00	57.00	471.33	48,993.20	18,080.00	106.76
Dividend Paid	283.76	420.20	357.98	46,259.60	324.67	233.33	1,648.33	50,282.80	19,120.00	105.76
Total dividend and tax paid	348.12	521.40	531.40	90,508.20	341.67	290.33	2,119.67	99,276.00	37,200.00	212.52
Income Statement										
Total income	1,814.64	13,477.40	10,763.80	2,767,805.80	2,690.33	2,365.67	5,150.67	441,943.60	1,099,364.00	1,853.72
Total expenses	- 1,455.40	- 13,896.60	- 10,393.60	- 2,696,964.60	- 2,021.33	- 1,828.33	- 3,704.00	- 330,406.80	- 1,046,259.60	- 1,594.94
Net profit	- 359.24	- 419.20	- 370.20	- 70,841.20	- 669.00	- 537.33	- 1,446.67	- 111,536.80	- 53,104.40	- 258.78
Tax expense	- 115.50	- 18.60	- 108.46	- 26,746.60	- 197.67	- 161.00	- 436.33	- 33,462.00	- 12,252.20	- 66.66
Net profit after tax	- 243.74	- 400.60	- 261.74	- 44,094.60	- 471.33	- 423.00	- 1,010.33	- 78,074.80	- 40,852.20	- 192.12
Balance Sheet										
Total borrowings	6,425.10	9,297.20	3,431.80	333,453.80	5,148.33	6,425.67	14,888.67	1,294,865.60	302,476.60	4,820.80
					-					
Total assets	11,238.06	29,637.80	14,447.16	2,905,962.60	11,292.33	12,074.00	24,713.67	2,620,509.40	933,067.00	8,145.32
Total liabilities	7,760.72	15,631.80	6,598.76	1,892,580.40	8,425.67	9,337.00	21,106.33	1,758,319.60	649,477.40	5,926.70

Total equity (also Net assets)	3,477.34	14,006.00	7,848.40	1,013,382.20	2,866.67	2,737.00	3,607.33	862,189.80	283,589.60	2,218.62
Current tax asset	5.18	62.40	-	19,898.60	-	-	-	2,807.40	-	-
	-	-	-	-	-	-	-	-	-	-
Current tax liability	44.30	24.80	80.92	11,819.60	47.00	86.00	154.00	3,748.60	9,465.40	27.56
Deferred tax asset	18.46	7.00	757.44	15,505.40	-	-	-	-	26,662.80	-
	-	-	-	-	-	-		-	-	-
Deferred tax liability	424.60	455.20	29.88	10,118.40	1,687.33	1,776.33	- 3,462.33	219,961.80	71,500.20	257.40
	-	-			-	-		-	-	-
Total	445.26	410.60	646.64	13,466.00	1,734.33	1,862.33	- 3,616.33	220,903.00	54,302.80	284.96
B: RATIOS										
Return on assets	2.17%	-1.35%	1.81%	1.52%	4.17%	3.12%	4.09%	2.98%	4.38%	2.36%
Return on equity	7.01%	-2.86%	3.33%	4.35%	16.44%	13.75%	28.01%	9.06%	14.41%	8.66%
Liabilities to equity	223.18%	111.61%	84.08%	186.76%	293.92%	341.14%	585.10%	203.94%	229.02%	267.13%
Liabilities to assets	69.06%	52.74%	45.68%	65.13%	74.61%	77.33%	85.40%	67.10%	69.61%	72.76%
Net profit margin	13.43%	-2.97%	2.43%	1.59%	17.52%	15.91%	19.62%	17.67%	3.72%	10.36%
Dividend payout ratio	116.42%	-104.89%	136.77%	104.91%	68.88%	62.00%	163.15%	64.40%	46.80%	55.05%
Tax compared to total tax + dividend	18.49%	19.41%	32.63%	48.89%	4.98%	19.63%	22.24%	49.35%	48.60%	50.24%
Net tax assets/(liabilities) / Net assets	12.80%	2.93%	-8.24%	-1.33%	60.50%	68.04%	100.25%	25.62%	19.15%	12.84%
Tax paid as a percentage of net profit	17.92%	-24.14%	46.84%	73.95%	2.54%	10.61%	32.58%	43.93%	34.05%	41.26%
Total borrowings as a percentage of total assets	57.17%	31.37%	23.75%	11.47%	45.59%	53.22%	60.24%	49.41%	32.42%	59.18%
Interest paid as a percentage of total income	17.92%	3.87%	1.98%	1.73%	13.27%	16.32%	14.08%	15.17%	2.13%	18.28%
Interest paid as a percentage of total borrowings	5.06%	5.61%	6.20%		6.93%	6.01%	4.87%	5.18%	7.73%	7.03%
Total tax and dividends compared to total equity	10.01%	3.72%	6.77%	8.93%	11.92%	10.61%	58.76%	11.51%	13.12%	9.58%
Total dividends compared to total equity	8.16%	3.00%	4.56%	4.56%	11.33%	8.53%	45.69%	5.83%	6.74%	4.77%
Net tax paid compared to total revenue	3.55%	0.75%	1.61%	1.60%	0.63%	2.41%	9.15%	11.09%	1.64%	5.76%
Total income compared to total expenses	80.20%	103.11%	96.56%	97.44%	75.13%	77.29%	71.91%	74.76%	95.17%	86.04%

As can be seen from the table above, the State-owned corporations carry significantly higher liabilities compared to total equity compared to their privately-owned counterparts, at 301% to 139.2%.

Borrowings and interest

Total borrowings compared to total assets is higher for State-owned corporations at 44.51% compared to 37.43% for their privately-owned counterparts. Also, the total interest paid compared to total borrowings is also higher for State-owned corporations than it is for their privately-owned counterparts at 6.29% versus 5.62%. This suggests that although State and Territory Treasuries require all State-owned corporations to borrow from their own financial institutions, and sometimes impose a government guarantee fee in order to uphold competitive neutrality, that competitive neutrality might not be upheld to the disadvantage of the State-owned corporations. An area for further research could be to determine whether State-owned corporations are in fact at a disadvantage compared to their privately-owned counterparts by being required to borrow from the State rather than seek their own borrowing and financing options. A possible reason for the difference in the average interest rate could be the age of the borrowings. For example, older State-owned corporations could have older fixed debt (which could have been fixed at a time when interest rates were higher) than a newly privatised company which could be taking advantage of historically low interest rates. Alternatively, this difference could be due to an availability of lower cost debt in other countries (as per Ausnet).

The State-owned sector had a higher return on assets than the private sector with 3.23% compared to 0.88%.

Tax and dividends

The dividend payout ratio is much higher for State-owned corporations than their privately-owned counterparts, at an average of 80.74% of net profit after tax, compared to 49.43% in the private sector companies studied. In addition, the State-owned sector paid a higher rate of dividends compared to total equity than the private sector, with 12.49% compared to 5.24%. This indicates that the hypothesis tested that the private sector paying less tax would result in more dividends to shareholders has failed, because when comparing the average dividends paid over five years to the

average total equity over five years, the State-owned sector still paid more. In addition, the State-owned sector paid more tax as a percentage of net profit before tax. As a five-year average of net tax paid over net profit before tax, the public sector paid 34.13% whereas the private sector paid only 13.54%. When net tax paid is compared to the average revenue over the five years studied, the State-owned sector still pays more tax than the private sector with 4.61% tax paid compared to total revenue in the State-owned sector compared to 1.97% in the private sector. Although still low, the private sector figures would have been distorted by the tax payment that Ausnet made to the ATO in settlement of its tax dispute.

However, when total expenses from the Income Statement are compared to the total revenue, State-owned corporations return a lower result than the private sector. This result equates to total expenses being 82.53% of total revenue in the government sector, whereas they are 93.29% in the private sector. This means that the private sector spends more to earn each dollar of revenue than the State-owned sector.

These results indicate that the State and Territory Government take more out of their state-owned corporations than their privately-owned counterparts, both in the way of tax and as a dividend. When this result is added to the additional interest and government guarantee fee being paid, above, it indicates that governments are gaining more benefit from these corporations than they would if they were privately owned taxpayers, both in terms of tax paid, but also as a rate of dividends returned.

Net tax liabilities as a percentage of net assets

Also, the net tax assets/liabilities as a percentage of net assets is much higher in the State-owned sector than it is in the privately-owned sector. In the privately-owned companies studied, the net tax liabilities form only 2.50% of the total net assets (or equity), whereas in the State-owned sector they form 40.73% of the total net assets (or equity). This indicates that the State-owned sector carries a much higher tax liability than the private sector.

Overall

Whilst the figures overall indicate that State-owned corporations are not as efficient as their privately-owned counterparts in the energy sector, on closer examination, this appears to be in part due to the excess payments made to their owner State or

Territory government, in the way of dividends, or taxes, or via borrowings which are required to be financed through the State treasury corporation. When a comparison is made of how much operating costs are required to generate each dollar of revenue, the State-owned sector out-performed their privately-owned counterparts. This could potentially be an area for further research.

5.4 Conclusion

Chapter 5 presented the financial data and analysis undertaken in this study. It examined debt neutrality and privatisation as alternatives to competitive neutrality. It further considered monopolies and their role in competition policy, specifically in the water and electricity industries.

Two case studies were researched. Firstly, the tax exemption granted to the privatisations of Ausgrid and Transgrid were studied. The effect of the tax exemption on key financial ratios was calculated. Further, a second case study considered the effect of removing tax neutrality payments and instead increasing the dividend paid to each NTER's owner State or Territory Treasury. The effect on key financial ratios was quantified and found to be material.

Overall, it was found that NTER entities pay more tax than their privately-owned counterparts, pay a higher rate of interest on borrowings, carry more liabilities compared to total equity, and have a lower ratio of total expenses to total income. This data appears to suggest that the NTER has limited State-owned corporations' ability to minimise their tax, whilst at the same time out-performing their privately-owned counterparts across a number of key financial ratios. As noted in section 5.3.1, the findings of this case study were consistent with the findings of a larger case study, and also in the work done to date by PwC for the AER.

6 Price Regulation, the Tax Allowance and Actual Tax Payable

The Hilmer report contained five policy elements which later formed part of the National Competition Policy. These policy elements are aimed at improving the efficiency and competition within the State-owned and government business sector. These policy elements came about after concerns were raised regarding monopolies, monopoly pricing, access to infrastructure to enable competition, and the competitive advantage enjoyed by government business.[573] The five policy elements are as follows:

- Regulatory restrictions on competition
- Structural reform of public monopolies
- Access to essential facilities
- Monopoly pricing; and
- Competitive neutrality.

Of the policy elements listed above, the one examined in greatest detail in this thesis is competitive neutrality. In answering Objective 6: Consideration of whether another tool could have been more effective, this chapter will examine whether another of the above policy elements could have been more effective or appropriate. The focus of this chapter will be on monopoly pricing. It will consider price regulation in Australia, with a focus on the electricity and water industries. It will also examine, through the use of case studies, whether the tax allowance set by the price regulator could be a more effective and efficient replacement for the NTER.

The main goal and purpose of price regulation is to ensure that prices are charged based on what an efficient, well-managed, privately owned organisation would charge in a competitive market. The price regulator seeks to impose these competitive prices on corporations which might not, due to the nature of their industry, have any real competition. This is mainly the case for companies in a monopoly market (refer to section 5.2.1).

[573] National Competition Council, above n 6, 183.

Part of determining and setting a price for the goods or services supplied involves a decision by the price regulator on how to treat tax. A price regulator can choose a pre-tax pricing model, or a post-tax pricing model. Under a pre-tax pricing model, tax is assumed to be 30% of profit, without taking into account any tax adjustments which are needed to arrive at taxable income. Under a post-tax pricing model, the price regulator makes an estimate based on data provided by the regulated entity and based on what the price regulator determines to be efficient, of the tax liability which would be paid by the organisation if it were well-managed, efficient, and privately owned. Most pricing regulators in Australia operate using a post-tax pricing model.

Given that the aim of the pricing regulator is only to allow prices based on efficient use of resources, thereby achieving competitive neutrality (as both privately and publicly owned organisations are assessed against the same benchmarks), and that the aim of the NTER is to ensure that NTER entities remain competitive and efficient by imposing a tax equivalent, it could be argued that the amount of tax paid by an NTER entity should closely mirror the amount of tax allowance allowed by a pricing regulator in its determination of prices, and that any differences arising between the tax allowance and tax paid could be the result of inefficiencies. In addition, it could be expected that the taxes paid by privately owned entities should also mirror the tax allowance determined by the pricing regulator. This has been the subject of recent and ongoing reviews, and will be discussed in more detail in section 6.4.4.

This chapter seeks to examine this proposition and to look at whether the NTER is needed if the pricing regulator already allows for tax based on its concepts of efficiency and competitive neutrality in its price determination.

6.1 The background of price regulation in Australia

Similar to the NTER, price regulation in Australia was introduced as a result of a recommendation of the Hilmer Report. In the terms of reference, set out in Annex A of the Final Report, paragraph 3(c) states that the Committee of Inquiry needs to consider "the best structure for regulation including price regulation, in support of:

(i) pro-competitive conduct by government businesses and trading enterprises and in areas currently outside the scope of the *Trade Practices Act 1972*; and

(ii) the interests of consumers and users of goods and services."[574]

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.

There are five main forms of regulation:

- Cost of service regulation (including direct price setting and rate of return)
- Price cap regulation
- Performance-based regulation
- Franchise regulation
- Yardstick regulation.[575]

The function of price regulation is best summarised by Handley[576], as follows:

> The fundamental task of the regulator is to set prices which provide the regulated firm with an opportunity to earn a fair compensation for the efficient delivery of the regulated service. Specifically, the regulatory framework requires the determination of allowed revenues on a nominal, post-tax basis using a building block approach and which includes building blocks for operating costs, depreciation (a return of capital), a return on capital and the cost of corporate income tax. The return on capital is to be determined within a weighted average cost of capital ("WACC") framework such that the regulated firm is allowed a rate of return commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk. Allowed operating costs are those that a prudent operator would incur in order to achieve efficient delivery, security of supply and maintain the safety of the regulated service.[577]

Two main methods of price regulation will be considered in this thesis: incentive-based regulation and "cost plus" regulation.

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[574] Ibid 362.
[575] Berg, Sanford V., 1997, 'Introduction to the fundamentals of incentive regulation', in Australian Competition and Consumer Commission and Public Utility Research Centre (eds.) (1997), cited in 'Price Regulation of Utilities' (n.d.) 59. http://archive.treasury.gov.au/documents/194/PDF/round5.pdf
[576] Handley, above n 292, 4.
[577] Ibid.

Incentive-based regulation involves the forecasting of operating and capital expenditure at the beginning of a regulatory period.[578] This then provides an incentive for the regulated business to operate in a more efficient manner, as any savings made are then able to be retained by the business during that price path, rather than passed straight onto the customers. Regulated entities are permitted to depart from the benchmarks set by the regulator, but they do so at their own expense (or benefit).

"Cost plus" regulation (referred to as cost of service regulation, above) involves using the actual costs and then allowing for a mark-up. This method provides no incentive or motivation for regulated entities to attempt to reduce costs or behave in a more efficient manner.[579]

In Australia, the main method of price regulation is an incentive-based regulation. This uses the "building block" approach.

6.2 The Building Block approach

Price regulators in Australia set their prices using the "building block approach". Under the building block approach, the price regulator determines the most efficient costs of running the business, that is, 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."[580]

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

[578] Australian Energy Regulator (AER), *Overview of the better regulation reform package*, (2014) 6.
[579] Energy Networks Australia, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018, 7; Jemena, Submission to Australian Energy Regulator, *Review of regulatory tax approach,* 31 May 2018, 2.
[580] 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.

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 way in which the price regulator determines prices is subject to interpretation, and price regulators are not bound to a set methodology of determining prices. As a result, there can be variation in the treatment of certain elements affecting the prices, and variation between price regulators.

As discussed above, one of the building blocks in a price determination is tax. 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, as will be seen in the following section.

6.3 Comparison of the tax building block between IPART and the AER

The Independent Pricing and Regulatory Tribunal (IPART) conducted a study comparing the tax building block calculations between IPART and the Australian Energy Regulator (AER). They found some differences and similarities between the methods and approaches used by IPART and the AER to determine the tax allowance. These will be summarised below in order to illustrate that there is no consistency in the calculation of the tax building block between price regulators.

6.3.1 Similarities

Both IPART and the AER use a post-tax model and include a benchmark tax liability in the building block. Both calculate the tax allowance through the use of a statutory tax rate, and tax depreciation, and allow for an adjustment for imputation credits.[581] Note that NTER entities are not subject to imputation credits. This was discussed in section 4.1.5 and will be discussed further in section 6.5.4 below.

Capital contributions and carried forward tax losses are also taken into consideration in both the IPART and AER models.[582] However, although IPART states in its research paper that an allowance for capital contributions is made when calculating its tax building block component of the price allowance, this was found not to be the case when a water utility carried out an analysis and comparison of the actual tax paid and the tax allowance provided in the price determination. (Refer to the case study in section 6.4.3.) Note, however, that in the current price determination (2016 – 2020) IPART has allowed for capital contribution/gifted assets in its calculation of the tax building block component.

6.3.2 Differences

IPART calculates the tax liability in nominal terms and converts it to a real tax liability, whereas the AER's calculation of the tax liability is nominal.[583] A nominal figure refers to the price at the time the figure was calculated. However, real prices are adjusted for inflation.

The AER includes the imputation credits as a separate line item in the building block, whereas IPART benchmarks the tax liability. IPART states that these methods make no difference overall to the final figure in the tax allowance.[584]

On the calculation of tax depreciation for inclusion into the tax allowance, IPART bases tax depreciation on the regulated entity's forecast actual tax depreciation,

[581] Independent Pricing and Regulatory Tribunal, *Comparison of financial models – IPART and Australian Energy Regulator* (2012) 5.
[582] Ibid.
[583] Ibid.
[584] Ibid.

adjusted to remove unregulated activities.[585] However, the AER uses a straight-line tax depreciation estimate based on its own forecasts in the tax allowance model.[586]

Note that the AER tax allowance model is currently under review. This is discussed further in the case study below.

The differences and similarities outlined above relate only to the setting of the tax allowance. Other differences in the calculation of the other components of the building block, for example in setting the forecast income or expenses, or assumptions around gearing or interest rates used, will also impact the tax allowance ultimately calculated.

6.4 Case study: A comparison of the tax allowance to the tax paid

This section will compare and examine the difference between the tax allowance provided by a price regulator and the actual amount of tax paid by a regulated entity. This topic has received a lot of media attention of late, and is currently the subject of a review by the AER (discussed further in section 6.5.2).

The comparison of the tax allowance to the tax paid is being performed to determine whether these are comparable and, if they are, whether the tax allowance is an adequate replacement for the NTER. If the tax allowance is an adequate replacement for the NTER, rather than employ tax personnel to performance tax compliance and consulting tasks, NTER entities can make a saving on these costs and instead return the tax allowance calculated by the price regulator to their owner State or Territory Treasury as a tax equivalent payment.

6.4.1 Data collection and issues for the comparison of the tax allowance to the tax paid

This section will outline the various sources of data to be used for the comparison of the tax allowance to the tax paid and possible issues and assumptions resulting from these.

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[585] Independent Pricing and Regulatory Tribunal, *The incorporation of company tax in pricing determinations* (2011) 2.
[586] Australian Energy Regulator, *Issues paper: Review of regulatory tax approach* (2018) 16.

6.4.1.1 ATO data – Tax Transparency Report

Since 2015, the ATO has published a "Tax Transparency Report" each year. The report outlines the tax paid by the largest companies in the country. These include:

- "Australian public and foreign owned corporate tax entities with total income of $100 million or more
- Australian-owned resident private companies with total income of $200 million or more
- Entities that have petroleum resource rent tax (PRRT) payable."[587]

Companies lodge their tax returns on a consolidated basis. Where a regulated entity is a subsidiary and part of a larger tax group, the information reported to the ATO is on a consolidated basis. Extraction of tax payments made by a regulated entity which is part of a larger consolidated group would be very difficult to obtain without having a reliable means by which to allocate the regulated entity portion.

NTER entities are exempt from having to lodge a Tax Transparency Report. However, they have the option to do so.

6.4.1.2 Annual report/Financial statement

Annual reports and financial statements are prepared on a consolidated basis. If the regulated entity is part of a larger consolidated group, data relating to the regulated entity could be extracted either through the segment data reported in the financial statements, or by head entity data if the regulated entity is the head entity of the consolidated group. The data provided in the annual report or financial statement could be useful in assigning a means of allocation of tax payments.

Cash flow statement

The Cash Flow Statement in the financial statements represents all the cash movements in the organisation during the year. The tax payments from the Cash Flow Statement are an unreliable measure of tax assessed in any one income year. The tax payments in the cash flow statement will usually relate to two financial (and therefore tax) years. In any one year, the last instalment and any outstanding tax

[587] Australian Taxation Office, *Report of entity tax information* <https://www.ato.gov.au/Business/Large-business/In-detail/Tax-transparency/Tax-transparency--reporting-of-entity-tax-information/>

payment/refund for the prior year are included in the current year tax payments, and the final instalment and any outstanding tax payment/refund for the current year will be included in the following year's Cash Flow Statement. In addition, the current year tax payments from the Cash Flow Statement could also include tax payments or refunds resulting from prior year amendments or the result of ATO audits.

The tax payments in the cash flow statement are a measure of tax paid in a financial year, not the tax paid relating to that financial year.

Tax expense note

The Total Tax Expense is the sum of Current Tax Expense and Deferred Tax Expense. The accounting standard AASB112 defines current tax as "the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period." The deferred tax expense relates to "amounts of income taxes payable in future periods in respect of taxable temporary differences."[588]

Many of the tax adjustments that occur affect both the Current Tax Expense and the Deferred Tax Expense (except for any "permanent" differences), resulting in a Total Tax Expense that is not indicative of tax paid or payable. For example, a tax depreciation adjustment might reduce the taxable income (and therefore Current Tax Expense) by $100m. However, as a result of the increased tax depreciation, the Deferred Tax Expense will increase by $100m, resulting in a nil difference to Total Tax Expense. Therefore, using the Total Tax Expense as an indicator of tax payable is inaccurate.

The closest indicator of tax payable is the Current Tax Expense in the Financial Statements. The Current Tax Expense is, in effect, a calculation of the tax on taxable income at that time. It should be noted that the Current Tax Expense in the financial statements contains only preliminary tax payable figures which are then "trued-up" after the financial statements have been finalised and when the tax return is prepared. Any differences between the preliminary figures in the financial statements and the final figures in the tax return are reported as "prior year adjustments" in the

[588] AASB112: Income taxes. Para 5, definitions.

following year's tax expense note. In addition, any tax payable/refundable resulting from amendments to tax returns are also reported as "prior year adjustments."

Deferred tax asset/(loss)

AASB112 requires the carry-forward of unused tax losses to be recognised as a deferred tax asset. Therefore, any tax losses are normally recognised in the deferred tax asset note of the financial statements. However, these losses will likely be the consolidated group tax losses, and any losses relating to regulated activities will need to be extracted.

6.4.2 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.[589] 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.[590] 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 not the case for government-owned entities, because the government-owned entity's owner State or Territory Treasury is in receipt of both the tax and the dividend.[591]

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

[589] CME, above n 487, 6.
[590] Ibid 26.
[591] Ibid 27.

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.[592]

6.4.3 Case study: A comparison of the tax allowance and tax paid in the water sector

This section will examine the tax paid with the tax allowance for a water entity in the NTER. It will outline how prices are set, and the reasons for the differences between the tax allowance and the actual tax paid.

6.4.3.1 Comparison for water utility based in NSW

IPART (the Independent Pricing and Regulatory Tribunal of NSW) sets prices or a method by which to calculate prices, for the company's water, wastewater, stormwater and recycled water services.

The first step taken by IPART in determining prices for the water utility is to calculate its annual revenue requirement (ARR). The ARR is made up of three components:

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

The ARR is then divided by the demand to estimate a price which will fully recover the ARR.

The resulting price, therefore, has two components – a capital and an operating component. The capital component of any price set by IPART recovers the return on and return of assets. These are in turn derived from the regulatory asset base (RAB).

The return on assets is derived by multiplying the RAB by an appropriate rate of return. The return of assets is calculated by dividing the RAB by the remaining life of the assets within the RAB.

[592] Ibid 27-28.

The RAB includes only assets that the water utility buys or builds that need to be recovered through water, wastewater and stormwater postage stamp prices.

As part of its 2015 price submission, the water utility undertook an exercise to identify why the prior price submission had included a tax allowance that was far below the tax actually paid by the organisation over that price path.

The price regulator is IPART (Independent Pricing and Regulatory Tribunal). In the current Pricing Determination (2012 to 2016), the tax allowed by IPART as part of its tax building block was significantly less than the tax paid by the water utility. A comparison of actual/forecast tax to the Pricing Determination is shown below.

($million, nominal)	2012-13 (A)	2013-14 (A)	2014-15 (F)	2015-16 (F)	Total
Tax Paid	$181	$177	$151	$165	$674
IPART Determined Regulatory Tax Allowance	$31	$37	$45	$51	$164
Shortfall	($150)	($140)	($106)	($114)	($510)
Shortfall as a %	83%	79%	70%	69%	76%

Using 2012 as an example, the water utility identified the following as reasons for the difference between the tax allowed as part of the price determination, and the tax paid as part of the NTER assessment of tax payable on lodgement of the tax return:

- Higher than forecast revenue, resulting in a higher taxable income and therefore a higher tax payable;
- Lower operating expenses resulting in lower tax deductions, and a resulting higher amount of tax paid;
- Tax depreciation included in the tax return was higher than tax depreciation forecast at the time of the price submission (this was due to the water utility moving to the diminishing value method of tax depreciation for all new eligible assets), therefore resulting in a higher tax deduction and reduced taxable income and tax payable;
- The inclusion of abnormal items (in that year the utility made large gains on abnormal sales); and

- The inclusion of non-regulated and unregulated revenue/gains in the actual tax expense.[593]

Although IPART aimed to base its calculation of the tax building block on actual tax laws, further investigation revealed a number of items were not allowed for, despite being subject to tax under current tax law.

6.4.3.2 Capital gains

The Regulated Asset Base (RAB) is similar to an asset register for pricing purposes. However, the RAB does not allow gifted assets or developer contributions to be included, as the regulated entity did not pay to acquire these assets. In addition, when assets are sold, rather than factoring in a gain on sale in determining prices, the regulator deducts the sale proceeds from the total value of the RAB. The oversight is when it comes to the tax regulatory treatment of these property sales. After deducting the sale proceeds from the RAB, IPART did not make an allowance or adjustment for the tax treatment on these gains on sale.

For tax purposes, the gain on sale of property is subject to capital gains tax, and any capital losses arising can be applied only against capital gains or carried forward to future years to be offset against any future capital gains.

However, in its calculation of the tax allowance in the price determination, IPART had not allowed for the tax on any capital gains. This meant that IPART had not based its calculation of the tax allowance on actual tax laws in this case.

6.4.3.3 Conclusion

Although the aim of price regulation and the introduction of the NTER was essentially to achieve the same aim, that is, to achieve the most efficient use of resources and encourage competitive neutrality, it has been shown, above, that one cannot replace the other. Nor is the use of both methods 'doubling-up'. The reason for this is that the price regulators typically do not calculate a correct tax allowance. In some instances, the tax allowance calculated is not based on current tax laws, as seen in the case studies above. In addition, the tax allowance is based on forecasts, with no allowance being made for under or over-recovery during the price path. Furthermore, all price regulators operate differently and have their own models and

[593] Removed because commercial in confidence.

rules governing the setting of prices. This results in an inconsistency between regulators and jurisdictions and means that the tax liability calculated by one regulator may not match the tax liability calculated by another regulator, all other things being equal.

In contrast to the regulators, the NTER does not base its calculation of tax liabilities on what is efficient, or what is considered the best in that industry. The NTER bases the tax liability on what actually is; on the real results, regardless of whether they are efficient, inefficient, or so on. The tax is based on the real profit and business outcomes, as opposed to what is ideal. This would be the same for the private sector – a private company might not be efficient but would still have to pay tax. The ATO's aim is not to ensure efficiency, but rather, to ensure that the correct taxes are paid as they fall due. This will be further examined in the following section.

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

In addition to the work done by the ESC in determining the high-level differences between the tax allowance and tax paid in the water 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 that 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.[594] 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."[595]

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 was the entity structure (for example, stapled structures, companies and partnerships); the amount

[594] Australian Taxation Office, 'ATO Note', above n 363.
[595] Ibid.

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.[596]

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.[597]

The review came about after recent reports in the media of a $400m power "price gouging'" by electricity companies.[598] 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 at the time, Hon Josh Frydenberg, requested that the AER investigate whether the setting of the tax allowance had resulted in overcompensation of tax liabilities incurred in the energy sector. He 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.[599]

The following day, 15 May 2018, the AER released an issues paper "Review of Regulatory Tax Approach".[600] 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

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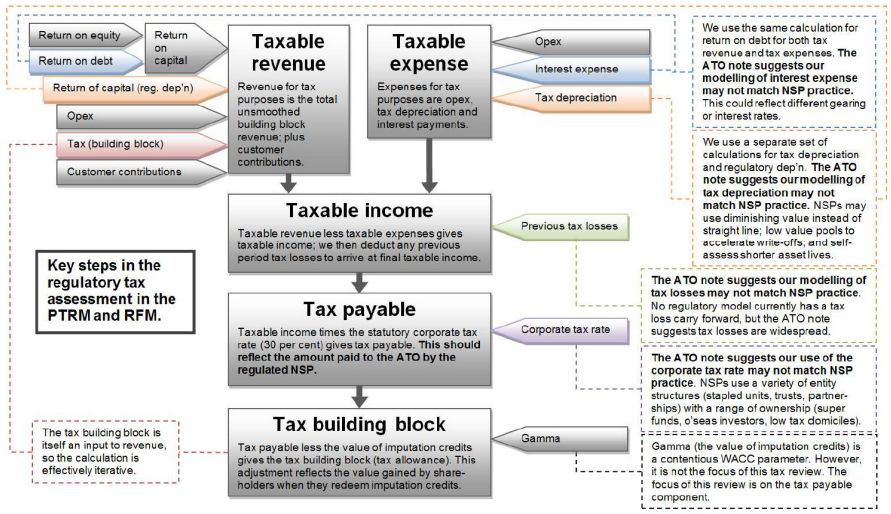
[596] Ibid.
[597] Ibid.
[598] Nicole Hasham, '$400m power price 'gouging'', *The Sydney Morning* Herald (Sydney), 15 May 2018 1.
[599] Australian Taxation Office, 'ATO Note', above n 363.
[600] Ibid.

sought submissions from interested parties by 31 May 2018 and aimed 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 (below) outlines how the AER determines its tax allowance in comparison to how the ATO arrives at the taxable income and tax payable.

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.[601] 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 similarly 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

[601] Australian Energy Regulator, *Issues paper: Review of regulatory tax approach*, above n 586, Table 5.1; 16.

or straight-line depreciation, to group low value assets into low value pools, and also 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.[602]

Also, the AER outlines further possible differences between the tax allowance and tax payable in its Issues Paper.[603] 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.[604]

This review closely mirrors the work undertaken in this thesis and will be further discussed in section 6.5.3.

6.4.4.1 Submissions

The AER received 16 submissions to its Issues Paper before initial submissions closed on 31 May 2018.

Incentive-based regulation

Many expressed a view that as the AER sets prices using a system of incentive-based regulation, it can be expected that not just tax, but rather, all expenses will have a variance between what the regulator allows in its building block and the actual

[602] Ibid Table 5.1; 16.
[603] Ibid Table 5.2; 17.
[604] Ibid Table 5.2; 17.

expenses incurred.[605] This does not necessarily indicate that there is a problem in the approach or calculation of expenses, including tax.[606]

Tax as a cost pass-through

A number of submissions expressed concern that moving away from the current method of the AER calculating a tax allowance to tax as a cost pass-through (that is, where actual tax costs are included as the tax allowance) would result in a loss of incentive for regulated entities to pursue the most efficient tax costs possible.[607] This is because, if the AER chose to use tax as a cost pass-through, any tax savings (and tax inefficiencies) would be passed on to the customer. The regulated entity receives no benefit and makes no loss by pursuing one method over another.

Ownership structure

Several submissions expressed the view that ownership structure should not be factored into the tax allowance; and that the tax allowance should be based only on the tax liability incurred by an efficient business.[608] The submissions by IFM/Australian Super/Ausgrid and Energy Networks Australia expressed concern that prices linked to ownership structures would result in fluctuations in prices when ownership of the network assets changed.[609]

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[605] Australian Pipelines and Gas Association (AGPA), Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; IFM/Australian Super/Ausgrid, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; Consumer Challenge Panel (CCP), Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; Energy Networks Australia, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; Jemena, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; SA Power Networks, Australian Gas Infrastructure Group, CitiPower, United Energy and Powercor (joint submission) Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018.

[606] Energy Networks Australia, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; Jemena, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; SA Power Networks, Australian Gas Infrastructure Group, CitiPower, United Energy and Powercor (joint submission) Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018.

[607] IFM/Australian Super/Ausgrid, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; Energy Networks Australia, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; Jemena, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018.

[608] IFM/Australian Super/Ausgrid, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018; Consumer Challenge Panel (CCP), Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018.

[609] IFM/Australian Super/Ausgrid, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018, 12; Energy Networks Australia, Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018, 4-5.

6.5 Comparison of tax paid by NTER entity with privately-owned entity: Case study

As part of the current AER review of regulatory tax approach, the ATO submitted a note to the AER, stating that:

> "the aggregate AER tax allowance provided to NTER entities consistently understated the 'notional' tax payable by those entities" whereas "the aggregate AER tax allowance provided to taxpaying entities consistently overstated the actual tax payable by those entities."[610]

This observation indicates a possible underlying problem in the NTER entities. Either the NTER entities are not operating as efficiently as their privately-owned counterparts, or there are barriers in place to stop NTER entities from accessing the same methods of tax minimisation available to privately owned entities.

In an attempt to explain the difference, the ATO Note states "in relation to NTER entities, we suspect the reason their notional tax payable under the NTER regime is higher than their AER allowance is that 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)".[611] This quote indicates that NTER entities, by the mere nature of their ownership, are actually disadvantaged when compared to their private sector counterparts. As examined in the Debt Neutrality section (refer to section 5.1.1), beyond enabling the State and Territory Treasuries to make additional revenue from their State-owned corporations, there is no real reason that NTER entities should not be free to borrow from other lenders. Indeed, there are many financial institutions available in the market to allow NTER entities to seek out their own debt and borrowing needs.

The CCP submission to the AER review states, in regard to ownership "[…]however, if data shows that a material reason for the difference in tax paid between the two ownership structures is, say, their corporate structure, then this may be a good reason

[610] Australian Taxation Office, 'ATO Note', above n 363, 1.
[611] Ibid.

to have different efficient calculations for each."[612] It should not be the role of the price regulator to allow for different levels or types of efficiencies. The NTER should be administered in such a way as to allow for this. If it is unable to do so, then it has not achieved its goal of competitive neutrality.

The following case study will examine the tax paid according to ownership to determine whether this statement by the ATO was correct.

6.5.1 Comparison of tax paid between privately owned and publicly owned companies in the electricity industry

In order to test the theory above that NTER entities pay more tax, this case study will further examine tax payments made by publicly-owned electricity companies with those paid by their privately-owned counterparts. Although this was covered in part of the case study in section 5.3: Comparison of NTER entities with their privately-owned counterparts, this section utilises the information available in the ATO's Tax Transparency Report to allow for a greater number of privately-owned entities to be examined.

In 2014, the ATO introduced the mandatory tax reporting of tax returns and amendments of:

- "Australian public and foreign owned corporate tax entities with total income of $100 million or more
- Australian-owned resident private companies with total income of $200 million or more
- entities that have petroleum resource rent tax (PRRT) payable.[613]

This data is then published each year in the ATO's *Report of entity tax information*. The report is required to be produced under section 3C of the *Taxation Administration Act 1953*. The report contains the following information:

- total income;
- taxable income; and

[612] Consumer Challenge Panel (CCP), Submission to Australian Energy Regulator, *Review of regulatory tax approach*, 31 May 2018, 8.
[613] Australian Taxation Office, *Report of entity tax information* <https://www.ato.gov.au/Business/Large-business/In-detail/Tax-transparency/Tax-transparency--reporting-of-entity-tax-information/>

- tax payable, after adjusting for franking credits, tax offsets, and R&D tax offsets.

Where a number of companies in the electricity industry were exempted from publishing their financial statements because of foreign ownership, or other ownership structures, they were not exempted from having to comply with this legislation that requires them to disclose their tax paying status. Therefore, where case study 5.3: Comparison of NTER entities with their privately-owned counterparts was limited in the number of privately-owned entity information available, this case study enabled a more comprehensive review.

There is no requirement for NTER entities to provide such data under this section of the legislation. However, for the purposes of this case study, the relevant information was able to be extracted from the Financial Statements and Annual Reports of the NTER entities, as indicated below.

Total Income

The Total Income was extracted from the Income Statement in the Financial Statements.

Tax Payable

The Tax Payable was calculated using the Current Tax from the Income Tax Expense Note in the Financial Statements as follows:

> Current Tax Expense – the current year amount reported as Prior Year (over)/under provided + the prior year amount reported as Prior Year (over)/under provided.

Adjusting for the prior year amounts results in a true representation of what the tax payable was for the year being studied.

Taxable Income

The Taxable Income was calculated by adding back any R&D tax offsets and then grossing up the resultant adjusted tax payable. Franking credits are not recognised in the NTER, so there was no need to remove any possible franking credit adjustments, as there would have been none.

6.5.1.1 Entities studied

The entities studied in this case study are in the electricity industry, and are as follows:

Privately owned

AGL Energy Limited

Origin Energy Limited

Electranet Pty Limited

ERM Power Limited

Bluewaters Power Cat Pty Ltd

EnergyAustralia Holdings Limited

Infigen Energy Limited

Click Energy Group Holdings Pty Ltd

State-owned

Synergy

Ergon Energy

Energex

Energy Queensland

TasNetworks

Aurora Energy

Essential Energy

Western Power

Horizon Power

6.5.1.2 *Tables of data*

The following tables contain the data for the entities studied by year, with an average at the end.

2014

	Total income $	Taxable income $	Tax payable $	% Taxable income to Total income	% Tax payable to Total income
Private					
AGL ENERGY LIMITED	8,852,853,753	424,942,168	127,054,079	4.80%	1.44%
ORIGIN ENERGY LIMITED	12,574,554,876	501,252,871	108,004,529	3.99%	0.86%
ELECTRANET PTY LIMITED	342,766,917	59,550,650	17,865,195	17.37%	5.21%
ERM POWER LIMITED	2,038,986,111	1,372,885	390,893	0.07%	0.02%
BLUEWATERS POWER 2 PTY LTD	196,796,679			0.00%	0.00%
ALINTA POWER CAT PTY LTD	1,698,802,352	449,839		0.03%	0.00%
ENERGYAUSTRALIA HOLDINGS LIMITED	8,843,049,950	51,800,099		0.59%	0.00%
INFIGEN ENERGY LIMITED	149,918,610			0.00%	0.00%
CLICK ENERGY GROUP HOLDINGS PTY LTD	126,048,210			0.00%	0.00%
Average				2.98%	0.84%
Government					
Synergy	2,781,881.00	291,857	87,557	10.49%	3.15%
Ergon	2,440	33	10	1.37%	0.41%
Energex	2,248	307	92	13.64%	4.09%
Energy Queensland					
TasNetworks	234,644	86,380	25,914	36.81%	11.04%
Aurora Energy	1,202,971	77,453	23,236	6.44%	1.93%
Essential Energy	1,965	429	129	21.81%	6.54%
Western Power (WA)	1,648,870	0	0	0.00%	0.00%
Horizon Power (WA)	591,658	139,513	41,854	23.58%	7.07%
Average				14.27%	4.28%

2015

	Total income $	Taxable income $	Tax payable $	% Taxable income to Total income	% Tax payable to Total income
Private					
AGL ENERGY LIMITED	10,601,156,586	616,577,246	184,844,603	5.82%	1.74%
ORIGIN ENERGY LIMITED	12,200,600,757			0.00%	0.00%
ELECTRANET PTY LIMITED	340,685,391	74,229,419	22,268,826	21.79%	6.54%
ERM POWER LIMITED	2,331,518,403			0.00%	0.00%
BLUEWATERS POWER 2 PTY LTD	155,599,491			0.00%	0.00%
ALINTA POWER CAT PTY LTD	1,575,189,251	271,517		0.02%	0.00%
ENERGYAUSTRALIA HOLDINGS LIMITED	7,302,401,958			0.00%	0.00%
INFIGEN ENERGY LIMITED	140,791,385			0.00%	0.00%
CLICK ENERGY GROUP HOLDINGS PTY LTD	154,735,938			0.00%	0.00%
Average				3.07%	0.92%
Government					
Synergy	3,240,566.00	20,763	6,229	0.64%	0.19%

Ergon	2,627	603	181	22.97%	6.89%
Energex	2,575	790	237	30.68%	9.20%
Energy Queensland					
TasNetworks	583,613	194,897	58,469	33.39%	10.02%
Aurora Energy	948,951	43,883	13,165	4.62%	1.39%
Essential Energy	2,054	476	143	23.18%	6.95%
Western Power (WA)	1,767,429	0	0	0.00%	0.00%
Horizon Power (WA)	517,072	42,433	12,470	8.21%	2.41%
Average				15.46%	4.63%

2016

	Total income $	Taxable income $	Tax payable $	% Taxable income to Total income	% Tax payable to Total income
Private					
AGL ENERGY LIMITED	13,307,459,873	710,850,726	207,808,441	5.34%	1.56%
ORIGIN ENERGY LIMITED	11,917,688,617	94,061,718		0.79%	0.00%
ELECTRANET PTY LIMITED	364,943,613	90,897,487	27,269,246	24.91%	7.47%
ERM POWER LIMITED	2,574,950,500	25,775,433	7,391,420	1.00%	0.29%
BLUEWATERS POWER 2 PTY LTD	146,305,963	4,048,128		2.77%	0.00%
ALINTA POWER CAT PTY LTD	547,022,650	42,125		0.01%	0.00%
ENERGYAUSTRALIA HOLDINGS LIMITED	7,755,881,032			0.00%	0.00%
INFIGEN ENERGY LIMITED	235,647,376			0.00%	0.00%
CLICK ENERGY GROUP HOLDINGS PTY LTD	173,790,518			0.00%	0.00%
Average				3.87%	1.04%
Government					
Synergy	3,121,922	127,723	38,317	4.09%	1.23%
Ergon					
Energex					
Energy Queensland	5,265	1,470	441	27.92%	8.38%
TasNetworks	597,778	201,393	60,418	33.69%	10.11%
Aurora Energy	866,282	44,357	13,307	5.12%	1.54%
Essential Energy	1,552	91	27	5.86%	1.76%
Western Power (WA)	1,840,554	0	0	0.00%	0.00%
Horizon Power (WA)	490,371	61,827	18,350	12.61%	3.74%
Average				12.76%	3.82%

Averages

	Total income $	Taxable income $	Tax payable $	% Taxable income to Total income	% Tax payable to Total income
Private					
AGL ENERGY LIMITED	10,920,490,071	584,123,380	173,235,708	5.35%	1.59%
ORIGIN ENERGY LIMITED	12,230,948,083	198,438,196	36,001,510	1.62%	0.29%
ELECTRANET PTY LIMITED	349,465,307	74,892,519	22,467,756	21.43%	6.43%
ERM POWER LIMITED	2,315,151,671	9,049,439	2,594,104	0.39%	0.11%
BLUEWATERS POWER 2 PTY LTD	166,234,044	1,349,376	0	0.81%	0.00%
ALINTA POWER CAT PTY LTD	1,273,671,418	254,494	0	0.02%	0.00%
ENERGYAUSTRALIA HOLDINGS LIMITED	7,967,110,980	17,266,700	0	0.22%	0.00%
INFIGEN ENERGY LIMITED	175,452,457	0	0	0.00%	0.00%
CLICK ENERGY GROUP HOLDINGS PTY LTD	151,524,889	0	0	0.00%	0.00%
Average				3.32%	0.94%

Government						
Synergy		3,048,123	146,781	44,034	4.82%	1.44%
Ergon		2,534	318	96	12.56%	3.77%
Energex		2,412	548	165	22.74%	6.82%
Energy Queensland		5,265	1,470	441	27.92%	8.38%
TasNetworks		472,012	160,890	48,267	34.09%	10.23%
Aurora Energy		1,006,068	55,231	16,569	5.49%	1.65%
Essential Energy		1,857	332	100	17.87%	5.36%
Western Power (WA)		1,752,284	0	0	0.00%	0.00%
Horizon Power (WA)		533,034	81,258	24,225	15.24%	4.54%
	Average				15.64%	4.69%

6.5.1.3 Observations

As can be seen from the tables above, most of the privately-owned entities studied did not pay any tax over the three years studied (five of the nine companies studied). A further two of the privately-owned companies studied did not pay tax in every year studied (Origin Energy and ERM Power). Also, three of the privately-owned electricity companies studied had taxable income but no tax payable. This suggests there were tax losses available, or tax credits resulting from either research and development tax concessions or franking credits.

For all years studied, NTER entities paid more tax than their privately-owned counterparts in the electricity industry. Of the nine NTER entities studied, only one (Western Power) did not pay any tax at all during the time studied.

The percentage of taxable income to total income averaged over the three years studied was nearly five times higher for the NTER entities than their privately-owned counterparts, at 15.64% compared to 3.32%. In addition, the percentage of tax payable to total income was also nearly five times higher for NTER entities than it was for their privately-owned counterparts, at 4.69% compared to 0.94% for the private sector.

Many more privately-owned entities in the electricity sector are in losses than their publicly owned counterparts. This is also evidenced by their own release of tax transparency data, to be discussed further below. However, losses were evident in the NTER entities too, just not to the same extent as the private sector.

The NTER could possibly consider ways of improving competitive neutrality in favour of NTER entities, for example, by allowing a lower rate of company tax for NTER entities to offset the differences detailed above.

6.5.1.4 *Tax transparency data released by the companies*

Some companies have released their own additional tax transparency data in the form of Tax Contribution Reports. These reports disclose the company's tax position and could include data on tax risk and policy. The following will discuss the information provided in those reports that contributed to the results above.

Energy Australia

According to Energy Australia's tax contribution report for the year ended 31 December 2016, Energy Australia paid no tax because it had tax losses from prior years available to offset any current year taxable income.[614]

Origin Energy

In 2016, Origin Energy reported total income of $11,917,688,617 and a taxable income of $94,061,718. However, Origin Energy paid no tax.[615] Origin Energy provided further detail about why it paid no tax in its own tax transparency report. In that report, Origin Energy stated that the $28.2m of tax which resulted from the $94m taxable income was offset by a foreign tax credit of $2.4m, franking credits of $4.8m and an R&D tax offset of $21m.[616]

6.5.2 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 commissioned PwC to perform 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 indicated in Figure 2, below.

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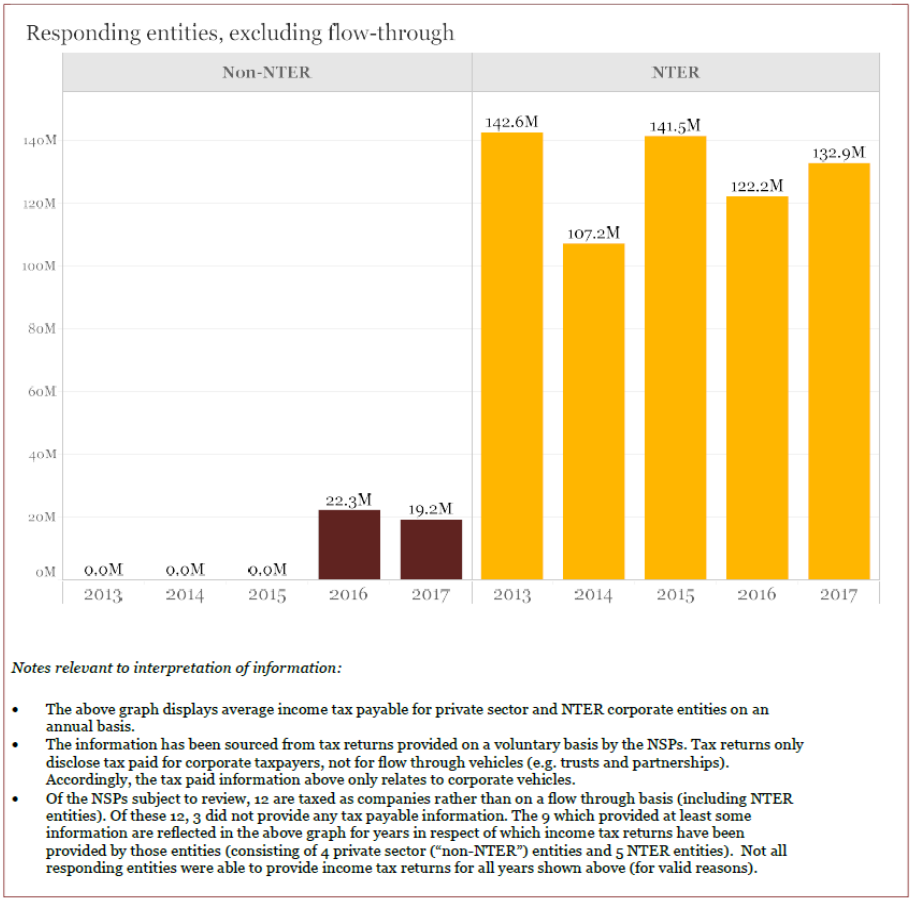
[614] Energy Australia, *2017 tax contribution report*, (2017) 6.

[615] Australian Taxation Office, *2016 Tax transparency report*, (2016).

[616] Origin Energy, *Tax Transparency Report, 30 June 2016*, (2016) 2.

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



PwC, *AER Tax Review 2018: Expert Advice* (2018) 28.[617]

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[618] 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:

[617] PwC, *AER Tax Review 2018: Expert Advice* (2018) 28.
[618] PwC, 'PwC Report - Findings and Recommendations' (Paper presented at AER Tax Review Forum, Sydney, 7 November 2018) 6.

- 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.[619]

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).[620]

6.5.2.1 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

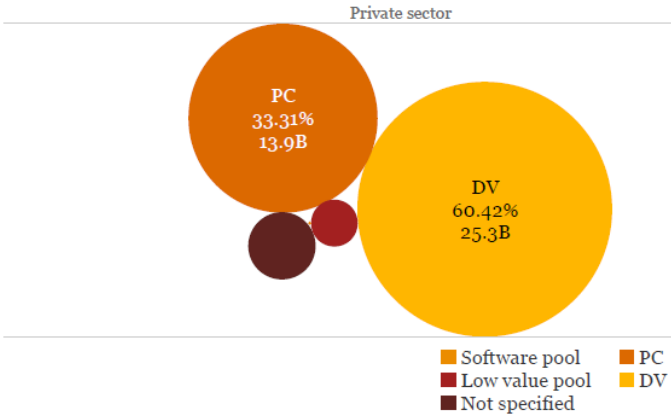
[619] Ibid.
[620] Ibid 7.

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 illustrated in Figure 23.

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.

PwC, *AER Tax Review 2018: Expert Advice* (2018) 76.[621]

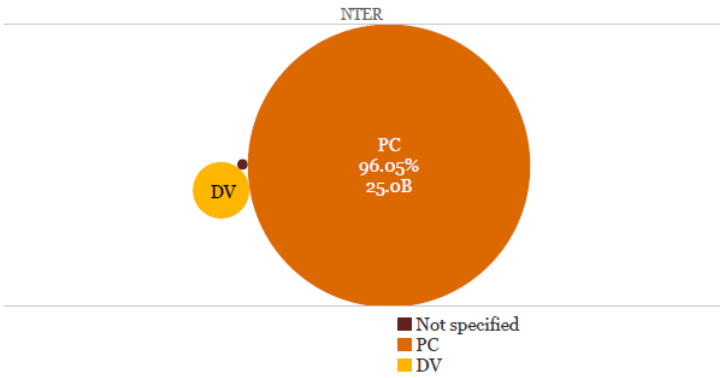
The above table indicates that, of the total tax asset registers carried by the privately-owned electricity network businesses who voluntarily provided their information,

[621] PwC, *AER Tax Review 2018: Expert Advice*, above n 617, 76.

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 is illustrated in Figure 24, below.

Figure 24: Depreciation method adopted by NTER entities



Overall

	TFAR CWDV (nearest available date as provided)	% of total CWDV
PC	25.03B	96.05%
DV	0.99B	3.82%
Not specified	0.03B	0.13%
Grand Total	**26.05B**	**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.

PwC, *AER Tax Review 2018: Expert Advice* (2018) 77.[622]

The above table indicates that, of the total tax asset registers carried by the NTER entity network businesses which 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

[622] Ibid 77.

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 where the State and Territory Treasuries dictated the method used by NTER entities, there would have been a preference for the prime cost method because it maximised the tax returned to those State and Territory Treasuries.

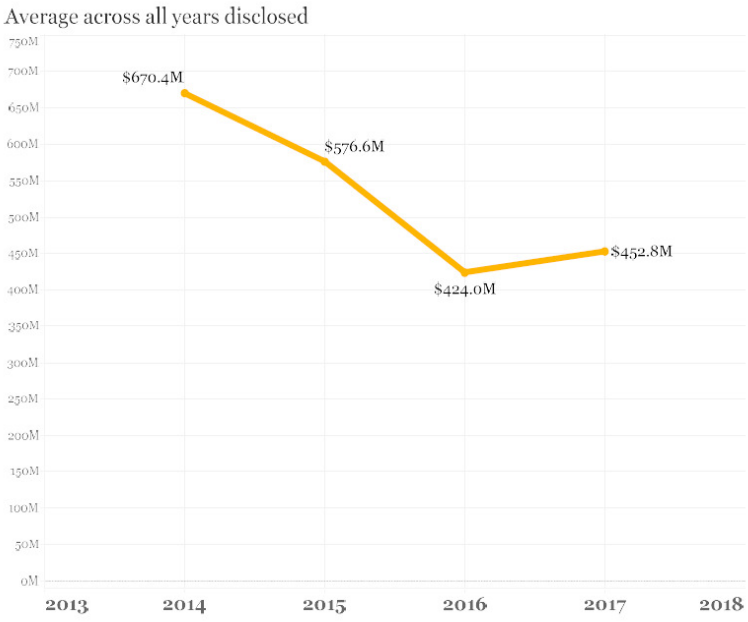
6.5.2.2 Privatisation and M&A costs

There has been a lot of privatisation and merger and acquisition (M&A) activity in the electricity sector 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, and 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.

6.5.2.3 Carry forward tax losses

A number of privately-owned electricity network businesses have tax losses carried forward, which minimised the amount of tax those companies paid. The availability of tax losses over the years studied are illustrated in the following diagram.

Figure 5: Tax losses carried forward



Notes relevant to interpretation of information:

- The above graph outlines the average total carried forward revenue tax losses disclosed in the tax returns for private sector corporate taxpaying NSPs.
- Consistent with the tax paid graphs noted above, carried forward tax losses have only been depicted for entities which are taxed as a company.

PwC, *AER Tax Review 2018: Expert Advice* (2018) 31.[623]

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.

6.5.3 Case study: A comparison of the tax allowance and tax paid in the energy sector

This section of the thesis seeks to draw on the work undertaken by the AER to date, and to test this to a greater level of detail than provided in the Issues Paper. In doing so, this research aims to prove that the tax allowance set by the price regulator is not an adequate replacement for the NTER. It will further prove that the tax allowance is not an adequate indicator of tax payable in either the public or private sectors.

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 to provide

[623] PwC, *AER Tax Review 2018: Expert Advice*, above n 617, 31.

an expert opinion and advice 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 which had voluntarily provided data as part of the AER's information request.

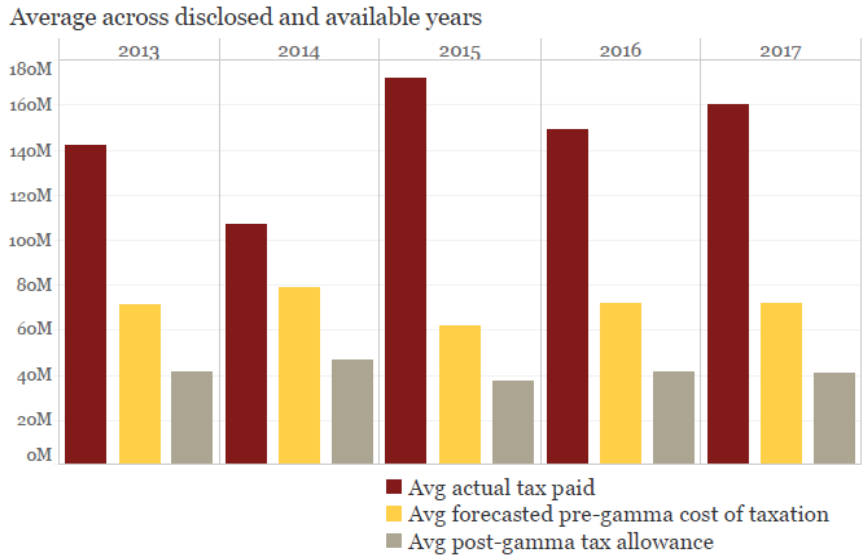
There were a number of limitations in PwC's report, the main one being that regulated and unregulated activities were not separated. Regulated activities are those activities for which the AER (or any price regulator) sets prices and provides a tax allowance. Unregulated activities are those activities 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. 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. This 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.

6.5.3.1 NTER entities

The tax paid compared to the tax allowance for NTER entities which participated in the AER voluntary request for tax information is illustrated in the following figure.

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

PwC, *AER Tax Review 2018: Expert Advice* (2018) 30.[624]

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.

[624] Ibid 30.

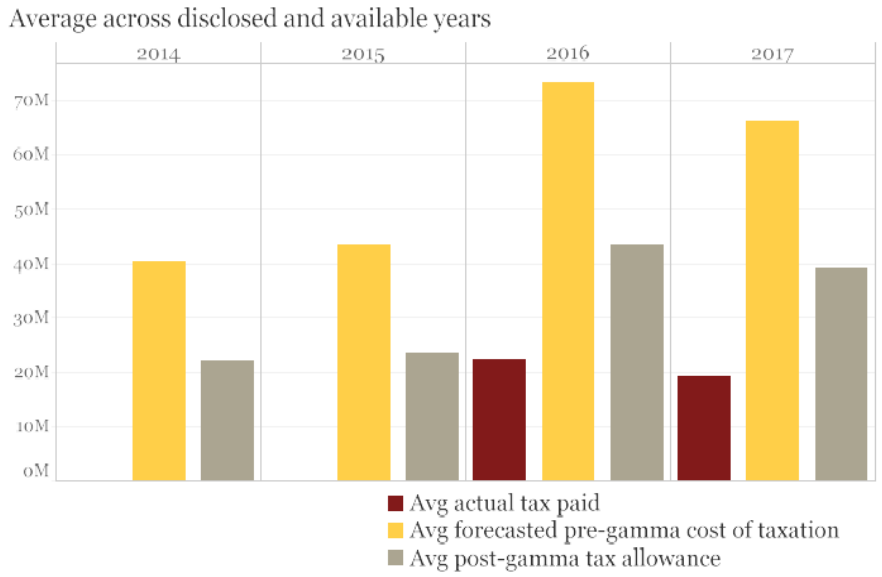
If the tax allowance is based on the theoretical efficient, well-managed, privately-owned organisation, and the NTER tax payments returned a result that was so materially higher than the tax allowance, it could be argued that this is because the NTER entities are not efficient in the management of their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

6.5.3.2 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 as shown in Figure 3, below.

Figure 3: Private sector NSPs taxed as companies – actual tax paid v regulatory tax allowance



Notes relevant to interpretation of information:

- Of the 12 private sector NSPs subject to review, 7 are taxed as companies rather than on a flow through basis. Of these 7, 3 did not provide any tax paid information. The remaining 4 who provided at least some information are reflected above, in an annual year-on-year comparison of average actual tax paid against the average forecast of tax cost and related regulator tax allowance.
- The number of private sector NSPs (taxed as companies) that have provided income tax returns and are therefore reported above are as follows:
    - 2014: 3
    - 2015: 3
    - 2016: 4
    - 2017: 4

PwC, *AER Tax Review 2018: Expert Advice* (2018) 29.[625]

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 in section 6.5.2: Comparison of tax paid in the AER Review of Regulatory Tax Approach 2018.

[625] Ibid 29.

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 either the privately-owned or 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. The possible reasons for this were outlined in section 6.5.2 above.

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.

6.5.4 Imputation credits and the setting of prices

Price regulators include imputation credits in their setting of prices. This is included as a gamma (γ) in the price setting formulas. The reason imputation credits are included in the setting of prices is because they have value to investors in the form of offsetting personal tax liabilities.[626] The price regulator aims to reflect this value that investors place on the imputation credits in its price determinations.

The tax allowance is adjusted for imputation credits as follows:

$$Tax\ allowance = taxable\ income \times tax\ rate(1 - \gamma)$$ [627]

The gamma is set between 1 and 0, and the rate used can have a material impact on the tax allowance received by the regulated entity. IPART notes that "a lower gamma increases the tax liability, which in turn increases the notional revenue, while a higher gamma value decreases the notional revenue."[628] This value, while not

[626] Independent Pricing and Regulatory Tribunal, *Review of imputation credits (gamma)* (2011) 2; Australian Energy Regulator, *Discussion paper: Value of imputation credits* (2018) 6.
[627] Australian Energy Regulator, *Discussion paper: Value of imputation credits* (2018) 6.
[628] Independent Pricing and Regulatory Tribunal, *Review of imputation credits (gamma)* (2011) 3.

relating to a difference in income and deductions allowed in the tax allowance and actual income and deductions in the tax return, still can result in one of the main differences between tax allowed and tax paid.

So why would imputation credits be taken into account, especially since the price regulator is setting prices for entities that are in a monopoly industry, and so do not have competition from privately owned companies? The reason lies in the benchmarks that price regulators use. As discussed in this chapter, regulated entities are benchmarked on the basis of efficient privately-owned organisations.

Therefore, are regulated NTER entities disadvantaged by the pricing process since they are not privately owned? It has been shown above that allowing for imputation credits in the price determination of a State-owned corporation accounts for one of the main differences between the tax allowance and tax paid for these entities. Indeed, Handley states that the gamma is the company tax that is returned to shareholders as an imputation credit.[629] If no imputation credits are returned to shareholders, as is the case in the NTER (refer to section 4.1.5), then could this be argued to be a limitation of the NTER when taken in the context of price regulation?

Although it may appear that NTER entities which are also subject to price regulation are at a disadvantage when it comes to the treatment of imputation credits, a vital piece of the puzzle has been missing in the research and papers written about the topic to date. That is, that the shareholder (in the case of NTER entities, the owner State or Territory Treasury) actually receives the tax in the form of a tax equivalent. State and Territory Treasuries might not receive, or have a use for, imputation credits, but they do receive the actual tax in the form of tax equivalent payments made by the NTER entities. This is similar to the value an individual with no other income receives from an imputation credit. An individual with no other income is able to claim a refund for the full amount of the imputation credit (assuming that total income is below the tax-free threshold). So too, does the Treasury in question, receive the full benefit of the imputation credit, although, rather than the income stream being recognised as an imputation credit, it is in the form of a tax equivalent payment.

[629] Handley, above n 292, 12.

6.5.4.1 *Imputation credits in the comparison of the tax allowance to the tax paid*

As discussed above, when setting the tax allowance, the price regulator allows an adjustment for gamma, which is included to reflect the advantage that investors receive by way of imputation credits available from company tax paid. This adjustment for gamma in the tax allowance has no corresponding adjustment in the tax paid as part of the tax return.

Therefore, in order to enable a like-for-like comparison, the method of comparing the tax allowance to tax paid needs to start with the removal of the effect of the imputation credits from the tax allowance when it performs its comparison to the tax payable.

To illustrate:

AER	ATO
AER calc of estimated taxable income Tax at 30% (a) (Less: Imputation credits) = Tax allowance	Actual taxable income per tax return Tax at 30% - This is the tax payable

As can be seen from the above table, in order to compare like-with-like, the AER needs to compare the difference between the tax allowance before the application of any imputation credits. This is illustrated as (a) in the table above. This is because the tax payable as the ATO calculates it does not recognise a similar imputation credit adjustment in the tax return. Therefore, the basis of calculation of gamma, or the value that gamma (whether 0 or 1, or anywhere between) is given when arriving at the tax allowance is irrelevant – the effect gamma needs to be removed before any comparison of tax paid to tax allowance.

6.6 Conclusion: Why the tax allowance is not be a suitable replacement for the tax payable

Two case studies involved comparing key financial ratios and data of NTER entities and their privately-owned counterparts. After comparing data from each entity's annual report or financial statement to determine the tax effect of the NTER, the last

of the case studies involved comparing data provided in the ATO's Tax Transparency reports, and additional data provided by a number of entities in their own tax transparency releases.

To sum up, the progress of the AER review into the regulatory tax approach was discussed. This review also found that the NTER entities paid more tax than their privately-owned counterparts (in the electricity network sector) and attempted to give some high-level reasons for this. In time, the AER will undertake further studies into this and attempt to give more solid reasons for the variance.

There has been considerable media coverage about the variance between the tax allowance determined by the price regulator and the tax paid by the regulated entity and, at the time of writing, this is subject to review by the AER. This thesis examined the difference from the perspective of using the tax allowance as a replacement for the tax payments made by State-owned entities. Rather than having the administrative burden of administering a tax equivalent regime, in addition to the compliance costs associated with preparing tax returns, and so on, it was explored whether the tax allowance determined by the regulator could instead replace the actual tax paid. Tax law and price regulation are based on two different frameworks. It has been demonstrated through other research papers, government reviews, case studies, and submissions to the AER's Review of Regulatory Tax Approach that, by nature of price regulation in Australia, there will always be a difference not only between the tax allowance and tax paid, but also between all forecasts of expenses and actual expenses. This is an intended consequence of regulation and is not necessarily an indicator of an underlying issue or problem. Rather, the differences highlight that the function of price regulation is vastly different to the function of the tax law. Price regulation seeks to determine what is efficient, and provides an incentive for regulated entities to attempt to match or better that for their gain during the price path. However, tax law seeks to tax actual results within the confines of tax law. Further, where the price regulator considers only the monopoly segment of the business which needs to be regulated to ensure efficient costs are charged to customers, the tax system considers this as part of a usually much larger scope, especially where consolidated groups and overseas related party transactions are involved.

7 Conclusion

7.1 Introduction

This thesis examined the effectiveness of the National Tax Equivalent Regime (NTER) in encouraging competitive neutrality. In order to answer this question, the central objectives of this research were:

- To evaluate how effective a tool the NTER is in achieving competitive neutrality, and
- Whether other methods could be more effective.

In order to address the objectives, the thesis:

- Provides an outline and history of the NTER and competitive neutrality;
- Defines what is meant by "competitive neutrality" in this context;
- Identifies alternative tools to achieve competitive neutrality and examine whether they were also subject to variation from to state due to differences arising from the workings of each State's Treasury;
- Examines a different existing regulatory structure and the impact it has on competitive neutrality;
- Determines why tax was the policy used to achieve competitive neutrality in this circumstance; and
- Looks at whether or not another tool (instead of tax) could have been more effective or appropriate.

7.2 Chapter conclusions

Chapter 1 gave a brief introduction to the thesis and background to the issues being studied, and the existing legislation and frameworks in which the NTER operates. It also outlined the significance of the research and the research methods which were used in the thesis.

Chapter 2 gave an outline and history of the NTER and competitive neutrality. It outlined the reasons for the need for a national competition policy and tax neutrality and provided a timeline on how the Hilmer Report recommendations were implemented, and the successive Harper Review. In addition, it considered the

OECD recommendations into competitive neutrality. Lastly, this chapter considered the benefits of the National Competition Policy and criticisms of the Hilmer Report.

Chapter 3 provided a further literature review, encompassing the definition of competitive neutrality and drawing on alternative tools for achieving competitive neutrality. This chapter considered who should be subject to competitive neutrality measures and touched on privatisation (an issue which was expanded in later chapters).

Chapter 4 examined key features of the NTER, the dividend setting policies that State and Territory Treasuries employed in the calculation of dividends to be paid by State-owned corporations, and the taxation of the public sector outside of what is covered by the NTER. It was the first chapter to use case studies to demonstrate how NTER entities were advantaged over their privately-owned counterparts. Such advantage occurred firstly, by the ability of NTER entities to seek a letter from the ATO which allows tax treatment that does not strictly comply with tax legislation and, secondly, by being able to apply prospective rather than retrospective treatment when the ATO issued ATOIDs outlining the tax treatment of capitalised labour.

Chapter 5 began by examining two different regulatory structures and the effect they had on competitive neutrality. The first was debt neutrality, and it was found that NTER entities are required to borrow from their State or Territory treasury despite there being alternative financing options available in the market. In order to counteract any advantages that government businesses might have by borrowing from the State, entities are required to pay government guarantee fees or debt neutrality adjustments. These government guarantee fees or debt neutrality adjustments are intended to ensure that State-owned corporations meet competitive neutrality requirements relating to debt.

Chapter 5 followed with a case study to examine the effect on financial ratios if tax equivalent payments were to be abolished, and instead replaced with larger dividend payments to the State (section 5.2.4). As tax is classified as an expense and dividends are a return on equity, this case study found that there would be a material difference to the financial ratios resulting in a competitive advantage to State-owned corporations if they were not subject to tax. A single payment to the State or Territory Treasury cannot replace the current tax and dividend payment. Nor can a

tax payment be abolished in favour of an increased dividend. Either course of action would result in the distortion of the financial ratios and indicate a level of profitability that is not accurate. It would also result in incomparable financial statements between the private and public sectors.

Further, chapter 5 compared the financial results for NTER entities with their privately-owned counterparts (section 5.3). However, the research appears to indicate that State-owned corporations are at a disadvantage, or at least less efficient when compared to their private sector ownership in some key areas. When State-owned corporations were compared to their privately-owned counterparts in the electricity industry, it was found that they pay more tax as both a percentage of profit and as a percentage of total revenue. In addition, State-owned corporations paid more dividends to their shareholders than their privately-owned counterparts, both as a percentage of net profit after tax, and as a percentage of total equity.

Chapter 6 considered the role of price regulators in determining the prices allowed to be charged by businesses in sectors which are natural monopolies. This chapter considered whether the tax allowance set by a price regulator would make an adequate replacement for a tax neutrality regime. It was found that the two frameworks – the one in which prices are set, and the tax law framework - are too different to allow for the NTER to be abolished and instead be replaced with the tax payments based on the tax allowance calculated by the price regulators. In addition, the chapter covered the Australian Energy Regulator's Review into the Regulatory Tax Approach, and how this work is relevant to this thesis.

Additional comparisons of tax transparency data and the comparison of tax paid in the AER Review of Regulatory Tax Approach both supported the view that NTER entities do pay more tax than their privately-owned counterparts. Some of the reasons were due to more conservative tax treatments (for example, the use of the prime cost depreciation method instead of diminishing value depreciation) and others were due to the nature of the NTER (for example, the inability of NTER entities to structure their tax in order to minimise tax).

7.3 Significance of research

Although the NTER has been in place since 2001, this is an area which has not been subject to any research.

This thesis contributes to knowledge on whether the tax allowance could be a substitute to the National Tax Equivalent Regime. This research compared the tax payments made to the tax allowance allowed by the price regulator. At the time of writing this thesis, the Australian Energy Regulator (AER) considered removing the tax allowance and replacing it with an allowance for total tax paid. In doing so, work that was done overlapped with studies being undertaken as part of this research. I was able to act as an independent adviser and submitted papers to the AER review and attended forums to discuss the potential pros and cons of options in closing the gaps between the tax allowance and tax paid.

This thesis has also examined the effect on the financial ratios of the removal of the tax equivalent payments and replacing these with a single payment to the owner State or Territory Treasury. The contribution to knowledge was through the illustration of how the comparability of financial statements between companies in the same industry would change if the tax expense was instead classified as a return on equity (by way of greater dividend).

A further contribution to knowledge has been through the quantification of the effect of the tax exemptions granted under paragraph 103 of the NTER Manual on gains made on the privatisation of state-owned businesses.

7.4 Limitations of the study

7.4.1 Industries studied

This research examined whether the National Tax Equivalent Regime (NTER) achieved its goal of competitive neutrality only in the water and electricity sectors. The NTER operates across a number of other industries, not all of which involve infrastructure and large capital investment.

7.4.2 Electricity industry

Many of the privatised entities in the electricity industry are operating through a consortium, meaning that there was no publicly available annual reports or financial statements. Therefore, the studies were completed using only a small number of players in the industry, although they were companies with influence in the industry. However, despite the small number of participants studied in the case study in chapter 5, findings were also supported by a larger case study in section 6.5, and by

the data and findings PwC collated through the AER's collection of data during its Review of Regulatory Tax Allowance.

7.4.3 Consolidated financial statements

The analysis of financial statements relied on consolidated figures which often related to a number of subsidiaries operating in more than one sector. However, entities selected were those in which their main operations were in the same sectors and industries.

7.5 Areas for further research

7.5.1 Comparison of the tax paid to the tax allowed by the price regulator

This issue is currently the subject of a study and investigation by the Australian Energy Regulator (AER), as discussed in section 6.4.4. At the time of writing, this is yet to be completed. The comparison of the difference between the tax paid and the tax allowance provided by the price regulator will be easier to compare and analyse once the AER puts in place a more detailed information gathering requirement on its regulated entities. These additional information requirements will mean that privately owned electricity consortiums which do not currently have any publicly available published financial statements or annual reports will be able to be more closely scrutinised.

7.5.2 Extension of the case studies

The main industries studied in this thesis were the water and electricity sectors. Areas for further research could include expanding beyond these two industries to determine whether similar results would be found in other industries that have been privatised or other industries which contain both State-owned and privately-owned players.

7.5.3 Debt neutrality

In the case study which compared the total interest paid to the total borrowings in section 5.3.3 it was revealed that the state-owned corporations paid higher interest compared to total borrowings than the private sector. This higher rate of interest could potentially indicate an issue with debt neutrality. Although government guarantee fees are put in place in the State-owned sector to ensure that State-owned corporations do not benefit from their government ownership by having access to

lower debt costs, it is possible that they are paying too much. This is an area for further research. Also, the State and Territory Governments might want to consider lifting the restrictions on State-owned corporations being allowed to borrow only from their State or Territory Treasury Corporation. As discussed earlier, there is a multitude of borrowing and financing options available in the market so that this restriction could go against the principle of competitive neutrality. However, from a State perspective, requiring all State-owned entities to borrow through the State results in the State being able to negotiate cheaper borrowing from its own lenders due to size of borrowings and economies of scale.

7.5.4 Privatisation

Chapter 5 provided an overview of privatisation and drew on experiences overseas. It examined the differences between NTER entities and their privatised counterparts and found that NTER entities pay more tax, more dividends, a higher overall rate of interest, and had less expenses per dollar of revenue earned. For this reason, further work could be done around privatised NTER entities, and whether privatisation of NTER entities has been successful in Australia.

7.5.5 Privatisation and price regulation

Although outside the scope of this thesis, section 5.1.2.4 quoted a report by The Australia Institute which stated that the private sector would pay more for assets in a monopoly market as there is potential to earn more from these assets due to the lack of competition in the market. The result of paying above market value also comes with additional borrowings which also need to be funded by increased prices.[630] This could be an area for further work to determine whether the high electricity prices are due to above-market prices paid by the private sector.

7.6 Recommendations

7.6.1 Who should be subject to the NTER

Section 3.1.8.1: Definition of Government Entity provided case law guidelines about what constituted a government business. In section 2.13: The National Tax Equivalent Regime (NTER), it was found that it is the decision of owner State and

[630] Richardson, above n 348, 10.

Territory governments to nominate which government businesses should be subject to tax equivalents and nominated for inclusion into the NTER.

Rather than enabling the owner State or Territory governments to decide which government businesses should be included in the NTER, it is a recommendation of this thesis that a more definitive guideline based on case law and OECD recommendations be put in place. This guideline could be included as part of the NTER Manual and be administered by the ATO. This removes the possible conflict of interest involved where a State or Territory government has the power to decide the tax status of its own businesses.

7.6.2 "Letters of comfort" from the ATO

Section 4.4.1: Letter from the ATO described circumstances in which the NTER section of the ATO will issue a "letter of comfort" to an NTER entity about the tax treatment of a scheme or arrangement. These "letters of comfort" allow an agreed tax treatment that might not necessarily comply with the strict letter of tax law, especially in times where applying the tax treatment required under tax law could contravene competitive neutrality. Examples include agreements which provided for the private sector to benefit from favourable tax treatment at the expense of the SOC, made during a time where the SOC was not subject to any tax equivalent regimes. These letters are largely provided confidentially, and details are not permitted to be disclosed to any third parties.

A recommendation of this thesis is that there should be more transparency by both the ATO and State and Territory Treasuries around agreements of this type. The NTER Administrator should consider publishing them as an appendix to the NTER.

7.6.3 Tax decisions made by State and Territory governments

Potential conflict of interest has been outlined as an issue where governments have a hand in decisions made which in turn can impact the amount of dividends they receive. For example, Infrastructure Australia noted that there was a potential conflict of interest where governments regulated and managed their own assets and "governments can be tempted to make sub-optimal regulatory decisions to protect their dividends from the asset."[631] This conflict of interest could clearly be seen in

[631] Infrastructure Australia, above n 341, 11.

the administration of the NTER. The NTER required that all State and Territory Treasuries agree on how tax outcomes would be treated in the NTER. This allowed State and Territories to have input into decisions which would ultimately impact the amount of tax they received. This outcome was illustrated in the case study which compared the State-owned corporations to their privately-owned counterparts and found that State-owned corporation paid both more tax and more dividends overall than privately owned companies. It is recommended that a structure is put in place to eliminate this conflict of interest. State and Territory treasuries should not be in a position to have input into decisions which ultimately impacts the amount of tax they receive from NTER entities. It is recommended that the NTER Administrator should make decisions that have tax implications based on current tax laws.

7.6.4 CGT neutral treatment of government-imposed restructure and privatisations

Certain government-imposed restructures and privatisations are permitted to be treated in a tax neutral manner under paragraph 103 of the NTER Manual. This was first discussed in section 4.1.2: Government imposed restructures or privatisations. Further, a case study relating to the privatisations of Ausgrid and Transgrid quantified the effect of this tax neutral treatment on key financial ratios in section 5.1.3: Privatisation of Ausgrid and Transgrid.

The effect of the ATO granting rulings that saw these privatisations treated in a tax-neutral manner was quantified and found to be material. It is a recommendation of this thesis that no transfers or privatisation should be treated in a tax neutral manner. Privately-owned companies are taxable on merger and acquisition type transactions, so NTER entities should not receive a tax exemption by virtue of their public sector ownership, even if that transfer is being made to another State-owned entity which does not have commercial returns as a primary objective. The ATO should consider removing this paragraph from the NTER Manual, or restricting its application.

7.6.5 Additional ways to improve tax neutrality

NTER entities are currently exempt from providing tax transparency data. The requirement to provide tax transparency data should apply to the NTER, in the same manner it applies to the private sector entities. The ATO should consider requiring NTER entities to provide tax transparency data.

In addition, where a tax decision is made that requires possible prospective treatment (for example, capitalised labour, discussed in section 4.4.2), the treatment should be consistent for both NTER entities and the private sector. If privately owned entities are required to amend the prior four years tax returns and pay any tax outstanding, the same should be required of the NTER entities. The ATO should ensure consistency between privately owned and publicly owned entities.

7.7 Conclusion

This chapter provided a summary of the findings of this thesis and included limitations, areas for further research, and recommendations. This thesis set out to examine whether the NTER had achieved its goal of competitive neutrality, and consider whether any other method could be more effective. Overall, it was found that the NTER has been vital in ensuring that competitive neutrality requirements are met. However, it has also been found that there are areas of improvement which could be introduced. One of these areas of improvement relates to instances where the State or Territory Treasury can influence the amount of tax paid by an NTER entity by either allowing or disallowing certain tax treatments. Also, the NTER could be administered in such a way that results in NTER entities not being allowed advantages over their privately-owned counterparts, for example, the letters allowing more lenient tax treatment, and the tax neutral treatment of privatisations.

When NTER entities were compared to their private sector counterparts, it was found that NTER entities paid more tax, both as a percentage of profit, and as a percentage of total revenue. NTER entities also paid more dividends to their shareholders, both as a percentage of net profit after tax, and as a percentage of total equity. Further, as part of its Review of Regulatory Tax Approach, the AER study supported the conclusion that NTER entities do pay more tax than their privately-owned counterparts. Some of the reasons for this are due to inefficiencies, for example, using the prime cost method of depreciation as opposed to diminishing value where it is available. Other reasons are due to the nature of the NTER, and NTER entities being unable to structure their tax in the same manner as privately-owned businesses. At the time of writing, the AER review was completed in December 2018. However, the full extent of the difference between tax paid by State-owned and privately owned corporations will not be available until the AER has received the reporting data now mandatory from these corporations.

It was found that tax neutrality cannot be abandoned in favour of a larger dividend payment because doing so would distort the financial ratios and would indicate a level of profitability that would not be a true reflection of the overall financial health of the business. In addition, the current regime of basing tax neutrality payments on current tax laws cannot be replaced by tax neutrality payments based on the tax allowance set by a price regulator. It was found that the tax allowance is set in too different a framework, and is subject to variation according to the price regulator.

Overall, the NTER has been a very good regime for achieving tax neutrality, although it can be improved by implementing a number of recommendations outlined in this thesis.

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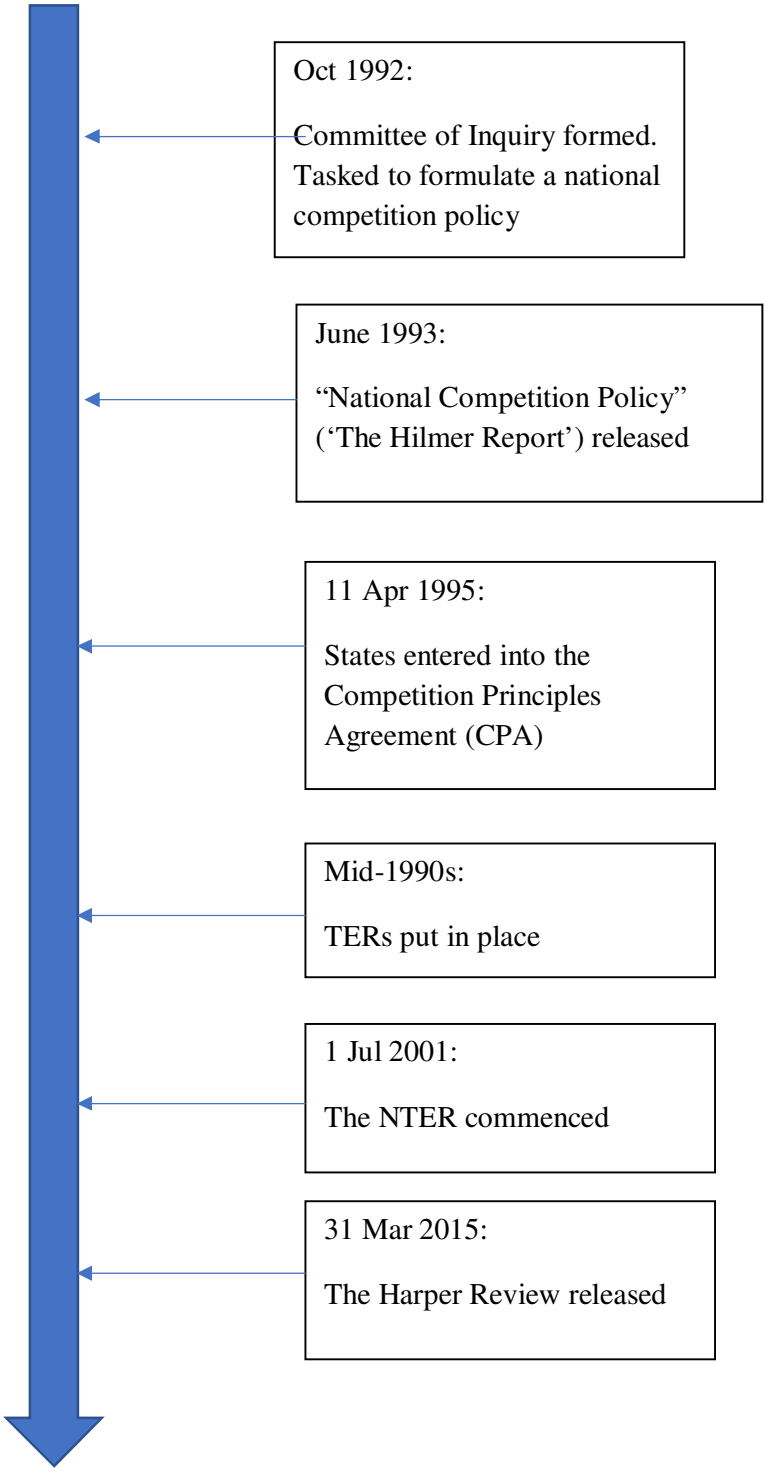
9 Appendices

9.1 Timeline of Competition Policy in Australia



9.2 The States' definitions of competitive neutrality

The following outlines the competitive neutrality definition taken by each state:

9.2.1 New South Wales

"The application of competitive neutrality principles is aimed at eliminating any net competitive advantages accruing to government businesses as a result of their public sector ownership. Such action removes potential market distortions and promotes an efficient allocation of resources between public and private businesses.

Typically, the application of competitive neutrality principles may require adjustments to the price of a good or service that make allowance for the following:

• taxes that may not be paid by a government business but would be paid by a private sector

competitor;

• the cost of capital;

• any other material costs not borne by a government business purely as a result of its

public ownership status."[632]

9.2.2 Victoria

The principle of competitive neutrality requires that 'government owned businesses competing with private sector businesses should compete on the same footing: business activities of government owned bodies should not enjoy any net competitive advantage simply as a result of their public sector ownership.'[633] This includes making both government owned business and privately-owned entities subject to the same taxation and regulatory regimes.

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[632] New South Wales Treasury, *Policy statement on the application of competitive neutrality*, (2002) 1. <http://www.treasury.nsw.gov.au/__data/assets/pdf_file/0007/3868/tpp02-1.pdf>

[633] Department of Treasury and Finance (Vic), *Guide to National Competition Policy*, above n 1, 19.

"It is common for private businesses (including both for profit and not-for profit entities) to coexist with government businesses in a variety of markets. They do not always compete on equal terms. Such inequalities arise from a variety of circumstances and it is the goal of competitive neutrality policy to offset these where appropriate. The inequalities of concern arise from differences in tax treatment, differences in the need to provide a return on investment, and related cost advantages or disadvantages which might impact on the prices that are set by government businesses. The aim of competitive neutrality policy is to account for these factors in such a way that where governments undertake significant business activities in markets, they do so on a fair and equitable basis. Competitive neutrality policy measures are designed to achieve a fair market environment without interfering with the innate differences in size, assets, skills and organisational culture which are inherent in the economy. Differences in workforce skills, equipment and managerial competence, which contribute to differing efficiency across organisations, are not the concern of competitive neutrality policy."[634]

9.2.3 Queensland

"Competitive neutrality refers to the process of identifying and, where appropriate, removing any advantages (and disadvantages) that may accrue to a Government business by virtue of its Government ownership. Once this has been achieved the Government business competes on the same basis as its competitors."[635]

9.2.4 Western Australia

"The application of competitive neutrality involves the introduction of measures which effectively neutralise any net competitive advantage flowing from government ownership. Its objective is to foster the allocation of resources in the economy to where they can be used to their best effect. It is important to realise that the implementation of competitive neutrality should not be at the expense of social welfare and equity, economic and regional development, or the interests of a class of consumers or consumers generally. Government can still pursue social and economic development objectives, but

[634] Ibid 4.

[635] Queensland Treasury, *National Competition Policy Implementation in Queensland*, above n 18, 9.

needs to do so through more transparent measures. This highlights that competition is not an objective in its own right but is desirable for the broader benefits it brings to the community."[636]

9.2.5 South Australia

"Competitive neutrality policy applies to the business activities of publicly owned entities, that is the business activities of Government that are producing goods and/or services for sale in the market place with the intention of making a profit and providing financial returns to their owners.

The objective of the competitive neutrality policy is to remove competitive advantages and disadvantages that arise solely through the ownership differences between public sector and private sector organisations.."[637]

9.2.6 Northern Territory

"Competitive neutrality aims to create a level playing field by removing resource allocation distortions so no net competitive advantage is held by government businesses as a direct result of public ownership. When properly implemented, the range of reforms aims to create a competitively neutral environment.

The Territory has already adopted a range of reform measures based on the principles of competitive neutrality including cost-reflective pricing, corporatisation and commercialisation, which are discussed later in this statement."[638]

9.2.7 Tasmania

"Competitive neutrality aims to promote the efficient use of resources in public sector business activities by removing any net competitive advantage that businesses may have solely as a result of public ownership. Government businesses must pay debt guarantee fees and make income tax equivalent and

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[636] Government of Western Australia, *Policy Statement on Competitive Neutrality*, above n 20, 2.
[637] Department of Treasury and Finance (SA), *A guide to the implementation of Competitive Neutrality Policy*, (2010) 1. <https://www.dpc.sa.gov.au/documents/rendition/B18578>
[638] Department of Treasury and Finance (NT), *Competitive Neutrality*, (2018) 4.

dividend payments to the State Government under the Government Business Enterprises Act 1995."[639]

Tasmania also provides guidelines for local councils which participate in significant business activities.

[639]Department of Treasury and Finance, *National Competition Policy* <https://www.treasury.tas.gov.au/economy/economic-policy-and-reform/national-competition-policy>

9.3 Criteria the State and Territory Governments use to determine whether competitive neutrality measures should apply[640]

	Cth	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Government business activities:									
User charging									
An actual or potential competitor Allow managers a degree of independence in production or supply, and price decisions									
Have some form of government ownership									
Engaged in trading in goods and/or services									
Have a large measure of self-sufficiency Result in the sale of goods or services to a purchaser through an arms length contract									
Are set up such that users make a significant contribution to costs									
Fall within the ABS definition of a PFE or PTE							Also GBE		
Charge users for goods and services									
Required to recover all or significant proportion of the costs from supply of goods or services									
Have a commercial or profit making focus									
Extend to the provision of goods and services to other parts of the public sector Include specialist activities located within Govt depts, separate legal entities such as statutory authorities and Territory-owned corporations									
May include CSOs that private organisations could provide under contract									
Recover a proportion of costs through user charges									
Supply good and services to external client or to the state government									
Significant business activities include:									
All GBEs and their subsidiaries									
Other share-limited trading companies									
All designated business units Other activities that are businesses and have commercial receipts >$10m/pa									
State-owned corporations									
Other businesses monitored by NSW Treasury The importance of competition in their relevant market (size of the business activity in the relevant market)									
The costs of providing the goods and services (the extent of user charging)									
The scale of operation (generally >$10m threshold)									
The impact of poor performance on the state economy									
The significance of their market to the WA economy									
Cat 1: Earn revenue >$2m, assets >$20m									
Cat 2: All other significant businesses									
Government businesses to which the corporatisation model applies									

[640] Based on Andrew Trembath, *Competitive Neutrality: Scope for Enhancement*, (National Competition Council Staff Discussion Paper, AusInfo, Canberra, 2002).

They are a separate legal entity

Predominant activity is trading goods and services

Commercial or profit making focus

Actual or potential impact on the relevant market

Significant business activities

9.4 Circumstances around the issue of an ATO letter

This appendix has been removed as it is commercial in confidence and subject to the confidentiality restrictions noted in section 4.1.1.

9.5 Sample letter from the ATO

This appendix has been removed as it is commercial in confidence and subject to the confidentiality restrictions noted in section 4.1.1.