AusNet services

TAX TRANSPARENCY REPORT 2017

CHIEF FINANCIAL OFFICER STATEMENT

I am pleased to present the inaugural Tax Transparency Report for the AusNet Services group. AusNet Services welcomes the opportunity to present a report on taxes paid in Australia, and to highlight the governance and policy mechanisms in place within AusNet Services to ensure that the group meets its Australian tax obligations.

Tax transparency, together with the broader focus on ensuring that Australian corporates pay their fair share of Australian tax, continues to be a significant issue for regulators, customers, shareholders, employees and the community alike. AusNet Services publishes this report on a voluntary basis, as a part of our commitment to tax transparency and to meeting the information needs of all stakeholders, with the aim of making tax information more accessible and understandable.

We have adopted the disclosure recommendations outlined in the Board of Taxation's Tax Transparency Code, including how our tax payments reconcile with the tax information presented in our financial statements.

In June 2015, AusNet Services restructured and simplified its corporate and capital structure, moving to a single listed head company ownership structure and a single consolidated group for tax purposes. Prior to restructure and since listing of AusNet Services in 2005, the group maintained a triple-stapled security structure, whereby two separate tax consolidated operating groups (AusNet Transmission and AusNet Distribution) were stapled to a Finance Trust entity. Stapled structures, often adopted by capital intensive infrastructure businesses, have been the subject of Australian Taxation Office ("ATO") concern and audit activity for several years.

In order to broaden investor appeal and avoid potential disputation with the ATO, AusNet Services transitioned to the new structure, outlined above. We engaged extensively with the ATO throughout the restructure process, to ensure our new structure met with ATO approval, as evidenced by ATO Class and Private Rulings issued. The restructure transaction straddled two income years and lead to the cancellation of historical tax losses (2015) and an offsetting increase in tax bases (2016) of certain assets in the newly formed single consolidated tax group. These significant reported impacts are highlighted in this tax transparency report.

Following the 2015 restructure, together with resolution of legacy tax disputes dating back to privatisation of the electricity transmission network in 1997, I am very pleased to say that AusNet Services moves forward with a high degree of tax certainty, exhibiting one of the most transparent and simple structures in the regulated infrastructure sector. AusNet Services has no outstanding disputes with the ATO.

AusNet Services maintains a strong commitment to governance, transparency and compliance. We value the principles of being transparent, particularly with respect to our tax strategy and compliance with Australian tax obligations.

We support the adoption of the voluntary tax transparency code and believe it provides our stakeholders with a comprehensive picture of the significant tax contribution made by AusNet Services.

The final page of this report provides a summary of the $264m in taxes paid by AusNet Services at both a State and Federal level for the year ended 31 March 2017.

Adam Newman

Adam Newman
Chief Financial Officer

7 August 2017

GOVERNANCE AND TAX STRATEGY

AusNet Services is committed to understanding and effectively managing business risk to provide greater certainty and confidence for its shareholders, employees, customers, suppliers and the communities in which it operates.

Complex, evolving or untested tax law contributes to circumstances where a diverse, but plausible, range of tax interpretations may exist. In this regard, it has become increasingly difficult for Australian corporate taxpayers to meet their compliance obligations, particularly where legislative or interpretive change is applied retrospectively or where existing law is applied inconsistently across different taxpayer groups.

Over the past decade, tax risk management has represented a key business risk for AusNet Services, involving extensive governance and risk management actions and protocols, where the right balance between risk and reward was critically assessed.

The AusNet Services Board reviews and guides AusNet Services' overall systems of risk management and internal controls, sets the risk appetite, and ensures that shareholders are informed in a timely manner of material changes to AusNet Services' risk profile.

AusNet Services uses its risk management capabilities to maximise the value from its assets, projects and other business opportunities, whilst managing its regulatory, environmental and social obligations. Risks faced by AusNet Services are managed on an enterprise-wide basis and are identified, analysed, evaluated and prioritised in a consistent manner utilising common systems and methodologies. Management and employees are responsible for embedding sound risk management practices across all AusNet Services' business activities.

AusNet Services has a robust risk management process that actively assesses both internal and external drivers of risk, including economic, environmental and social sustainability risks, and considers potential impacts to sustainable value generation and the broader environment and community as part of its strategic planning. Material risks have been identified through this process.

TAX RISK MANAGEMENT

Tax risk management practices within AusNet Services are aligned with the risk appetite and risk tolerance principles adopted in the broader business. As a part of AusNet Services' business strategy and objectives, we pursue a tax strategy that is principled, transparent and sustainable. In this regard, AusNet Services does not undertake aggressive tax planning. We do however, pursue tax concessions and incentives that are available under State and Commonwealth laws. AusNet Services should pay no more tax that what is due under a reasonable interpretation of the law.

AusNet Services' approach to tax risk management practices are based on the following objectives:

- AusNet Services seeks to fully comply with tax laws and compliance obligations in all jurisdictions and seeks to reduce the incidence of disputation with the ATO and tax uncertainty generally;
- AusNet Services is committed to the ATO's Cooperative Compliance model and will act in good faith with tax authorities, fostering positive working relationships and trust;
- Optimal commercial outcomes are pursued through tax positions that are supportable in law (as demonstrated by external professional advice or ATO confirmation) and do not contribute a significant level of financial or reputational risk, relative to the benefit pursued;
- Overall, a conservative approach to tax risk management is preferred, as driven by AusNet Services' regulated business model and shareholder expectations;
- Be recognised as maintaining ethical, well managed and appropriate tax practices that are aligned to corporate social responsibility obligations;
- The AusNet Services Board and/or Audit and Risk Management Committee is actively involved in tax risk management policy and issues, such that managing tax risk is an integral part of corporate governance. The Board reviews and approves the tax risk management policy and management's adherence to it, on an annual basis.

ATO Risk Differentiation Framework

The ATO maintains a risk differentiation framework ("RDF") for assessing tax risk. The RDF classification dictates the ATO compliance approach deployed for any large taxpayer. AusNet Services is classified as a 'key taxpayer' under the RDF.

Pursuant to the RDF, key taxpayers are perceived relatively less likely to adopt a position that is contrary to ATO views. However, to the extent that a contrary view does arise, the threat to the revenue and/or the tax system is perceived to be relatively higher. Key taxpayers are subjected to continuous monitoring by the ATO, in the form of annual pre-lodgement (income tax return lodgement) compliance reviews.

In December 2016, the Commissioner of Taxation issued its annual RDF letter to AusNet Services. In that correspondence, the ATO states:

"I am pleased that AusNet Services continues to be categorised as a key taxpayer for income tax. This categorisation reflects your significant role within the tax system.

Over the past year, AusNet Services has continued to demonstrate a willingness to maintain a cooperative and open relationship with us. We appreciate the efforts of your staff and their genuine desire to work with us and we look forward to continuation of this strong relationship in the coming year".

INCOME TAXES DISCLOSED IN THE 2017 ANNUAL REPORT

Income tax expense ('ITE') of $108.2m is disclosed in Note B.4 of AusNet Services' 2017 Annual Report and represents 30% (the Australian company tax rate) of profit before tax, adjusted for amounts which are not assessable or deductible in calculating net taxable income for the year.

In any one income year, there are differences between the ITE disclosed in the Annual Report and the total income tax payable to the ATO. These deferred tax items (commonly referred to as timing differences) occur because revenues and expenses for accounting purposes may be assessable or deductible in different periods for taxation purposes. In 2017, the group utilised its remaining balance of carried forward tax losses and was entitled to accelerated deductions in respect of property plant and equipment, relative to the write-off profile recognised for accounting purposes. AusNet Services maintains a significant maintenance capital expenditure program relating to bushfire mitigation recommendations emanating from the Bushfire Royal Commission into the Black Saturday bushfires. Significant elements of bushfire safety mitigation have been confirmed as immediately deductible, pursuant to a binding private ATO ruling received by AusNet Services.

AusNet Services capital expenditure profile in upcoming years incorporates various programmes designed to make the electricity distribution network safer. In respect of the undergrounding of high risk areas of the electricity distribution network, AusNet Services has obtained a private ruling from the ATO confirming the immediate deductibility of such expenditure. This initiative is anticipated to cost $100 million over the next 5 years.

Furthermore, asset replacement expenditure in respect of certain electricity distribution poles, cross-arms, conductors (above and below ground) has been confirmed by the ATO as immediately deductible for tax purposes.

Differences in accounting and cash tax outcomes have also arisen because of prior year tax litigation and Audit settlement events (Section 163AA, Intellectual property and Staple Structure matters).

For the March 2017 financial year, AusNet Services recorded an Effective Tax Rate ('ETR') of 29.8%. The ETR is determined as ITE divided by accounting profit before tax. In the 2015 and 2016 income years, AusNet Services' ETR was notably different to the corporate tax rate of 30%, due to ATO disputes and Audit outcomes and the impact of June 2015 restructure. The ETR for the 2017 year recognises the transformation from the previous triple-stapled structure to the simplified single share ownership structure.

RECONCILIATION OF ACCOUNTING PROFIT TO INCOME TAX EXPENSE (ITE)

	2017 $M	2016 $M	2015 $M
Profit before income tax	363.3	457.9	354.4
Tax at the Corporate rate of 30.0%	109.0	137.4	106.3
Tax effect of amounts which are not (taxable)/deductible in calculating taxable income:			
Impact of entry into new tax consolidated group (i)	–	(135.0)	–
ATO settlement – primary tax cash payment (ii)	–	–	24.6
ATO settlement – cancellation of tax losses (ii)	–	–	118.0
Net tax and interest on intellectual property dispute (ii)	–	(28.1)	84.1
Prior year (over)/under provisions	(0.4)	0.6	(2.4)
Sundry items	(0.4)	(6.3)	1.2
Income tax expense/(benefit)	**108.2**	**(31.4)**	**331.8**

RECONCILIATION OF INCOME TAX EXPENSE TO CASH TAX

	2017 $M	2016 $M	2015 $M
Income Tax Expense on Profit before Tax	108.2	(31.4)	331.8
Timing differences recognised in deferred tax	(58.8)	(84.0)	(50.6)
Section 163AA dispute (iv)	–	69.0	–
ATO settlement – stapled structure (ii)	–	25.0	(24.6)
Net tax and interest in intellectual property dispute – non cash	–	28.1	(84.1)
ATO settlement – cancellation of tax losses	–	–	(118.0)
Impact of entry into new tax consolidated group – non cash	–	135.0	–
Cash taxes paid per cash flow statement	**49.4**	**141.7**	**54.5**

(i) In 2016, AusNet Services Ltd formed a single tax consolidated group that replaced the previous two tax consolidated groups of AusNet Services (Distribution) Ltd and AusNet Services (Transmission) Ltd. As a result of this change:
- the tax bases of the assets of the AusNet Services (Distribution) Ltd tax consolidated group were reset with a valuation uplift of $976.3 million recognised. As a result, deferred tax liabilities have been reduced by $292.9 million (being the tax effect of the valuation uplift);
- the change to a new tax consolidated group triggered the cancellation of certain historical tax losses under the Same Business Test and an increase in deferred tax liabilities of $153 million; and
- the change to a new tax consolidated group required the reversal of historical deferred tax on derivative financial instruments ($4.9 million)

(ii) In March 2015 we executed a binding Settlement Deed with the ATO regarding all matters concerning:
- making a primary tax payment of $23.5 million and an interest payment (deductible) of $1.5 million
- cancelling $506.5 million of carried forward tax losses of which $393.2 million were previously recognised in the statement of financial position and as such have been written off; and
- ceasing to take interest deductions in respect of AusNet Services Finance Trust loans from 1 April 2014

(iii) In September 2015, we executed a binding Settlement Deed with the ATO to settle the dispute relating to intellectual property deductions claimed by us in the 1998 to 2010 tax years. As at 31 March 2015, we had recognised an $84.1 million tax charge in relation to the total disputed amounts. As a result of the settlement, $28.1 million or prior period tax expense has been credited to income tax expense.

(iv) 2016 includes $69.0m tax paid in relation to the section 163AA dispute

Total Tax Contributions – By Category

During the year ended 31 March 2017, the AusNet Services group made the following tax payments

Description	Amount ($M)
Income Tax	49.4
Goods & Services Tax	78.5
Land Tax (Transmission Easements) **	111.3
Land Tax (non Transmission Easements)	4.6
Fringe Benefits Tax	1.2
Payroll Tax	18.9
TOTAL	**263.9**

** In 2004, the State Government of Victoria expanded the provisions of the Land Tax Act to include Electricity Transmission Easements for land tax purposes. The rate at which Electricity Transmission Easements are assessed for land tax purposes is 5% compared to 2.25% for interests in freehold land.

The land tax on Electricity Transmission Easements was introduced by the State Government to replace a levy that was previously imposed on Alcoa's Portland aluminium smelter which was terminated by the State Government of Victoria.

It should be noted that land tax is a "pass-through" cost for AusNet Services pursuant to its Transmission Revenue Reset process, meaning that AusNet Services receives this amount as revenue from the Australian Energy Market Operator.

AusNet Services

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