

# 2014 / 15 TAX REPORT

Transmission & Distribution RP5 Price Control

11 February 2021

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## 1. LICENCE REQUIREMENT

Paragraph 12.35 of Annex 2 of Northern Ireland Electricity Ltd's Electricity Distribution and Participate in Transmission Licences requires NIE Networks to furnish the Utility Regulator with an annual tax report which sets out the following:

- a) audited tax reports that enables a full reconciliation between:
  - i. information submitted to HMRC on the Licensee's tax affairs; and
  - ii. Information used for the calculation of the tax element of the Licensee's Maximum Regulated Distribution / Transmission Revenue, as calculated at paragraph 9 of Annex 2 of the Licences;
- b) information submitted to HMRC on the Licensee's tax affairs;
- c) information used for the calculation of the tax element of the Licensee's Maximum Regulated Distribution / Transmission Revenue, as calculated at paragraph 9 of Annex 2 of the Licences; and
- d) any retrospective adjustments in respect of previous years together with any restatement of 12.35 (a), 12.35 (b) and 12.35 (c).

This audited report has been designed to fulfil this licence requirement. Sections 2 to 6 address the requirements of Paragraphs 12.35 (a), 12.35 (b) and 12.35 (c) and Section 7 addresses the requirement of Paragraph 12.35 (d).

Note that all figures in this report are in nominal prices.

## 2. TRANSMISSION TAX ENTITLEMENT

### 2014/15 Tax calculation

The following paragraphs set out the calculation of the tax amount included within Transmission Entitlement for the regulatory reporting year 2014/15.

#### Tax Amount – TAX<sub>t</sub>

The maximum regulated transmission revenue for NIE Networks is set out in Paragraph 3.5 of Annex 2 of the Transmission Licence. This formula is as follows:

$$RP5R_t = DEP_t + RET_t + BD_t + O_t + P_t + COI_t + TAX_t + K_t$$

TAX<sub>t</sub> is one of the components of allowed revenue and is calculated in accordance with the following formula set out in Paragraph 9.1 of Annex 2:

$$TAX_t = TR_t / (1 - TR_t) * (RET_t + DEP_t - INT_t - CA_t)$$

#### Tax Rate – TR<sub>t</sub>

TR<sub>t</sub> represents the corporation tax rate applicable in Northern Ireland as specified by HMRC which in 2014/15 is 21%. The tax factor TR<sub>t</sub> / (1 – TR<sub>t</sub>) is therefore 26.6%.

#### Return Amount – RET<sub>t</sub>

RET<sub>t</sub> represents the return on the Regulatory Asset Base (RAB). It is calculated by taking the average value of the opening (ORAB<sub>X<sub>t</sub></sub>) and closing (CRAB<sub>X<sub>t</sub></sub>) values of the individual RABs and multiplying them by the adjusted vanilla weighted average cost of capital (AVWACC<sub>t</sub>). The formula for calculating RET<sub>t</sub> is set out in Paragraph 5.1 of Annex 2:

$$RET_t = \left( \sum_{\text{All RAB}_X} (ORAB_{X_t} + CRAB_{X_t}) / 2 \right) * AVWACC_t$$

In 2014/15 the average value of the Transmission RABs is £264m and the adjusted vanilla WACC is 4.018%. The RET<sub>t</sub> value for 2014/15 is therefore **£10.605m.**

#### Depreciation amount – DEP<sub>t</sub>

DEP<sub>t</sub> represents the depreciation amount and is calculated in accordance with the formula set out in Paragraph 4.45 of Annex 2:

$$DEP_t = \sum_{\text{All RAB}_X} (DEPADD_{X_t} + FDEP_{X_t})$$

DEPADD<sub>X<sub>t</sub></sub> represents the depreciation amount for capex incurred on network assets from 2012/13 onwards.

FDEP<sub>X<sub>t</sub></sub> represents the depreciation amount of capex incurred on network assets prior to 2012/13.

The DEP<sub>t</sub> value for 2014/15 is **£12.705m.**

### Interest amount – INT<sub>t</sub>

INT<sub>t</sub> means an amount equal to the interest on the value of the average of all RABs calculated in accordance with the following formula set out in Paragraph 9.1 of Annex 2:

:

$$INT_t = \left( \sum_{\text{All RAB}_X} (ORAB_{X_t} + CRAB_{X_t}) / 2 \right) * G * NCOD$$

Where: G represents notional gearing and has a value of 45%

NCOD represents a notional nominal cost of debt with a value of 6.45%.

In 2014/15 the average value of all RABs is £264m which equates to an INT<sub>t</sub> figure of **£7.660m.**

### Regulatory capital allowances – CA<sub>t</sub>

CA<sub>t</sub> represents the value of capital allowances calculated in accordance with guidelines published by HMRC. There are three main groupings or ‘pools’ used in the calculation of capital allowances; a) a long life asset pool, b) a general pool and c) a deferred revenue pool. There are three pools because different types of assets attract different capital allowance percentages.

Each pool is classed as follows:

| Capital Allowance Pool | Useful economic life | Capital allowance rate for 2014/15 | Comments   |
|------------------------|----------------------|------------------------------------|--|
| Long life asset pool   | 25 years or greater  | 8% reducing balance                | This includes transmission and renewables 40 year capex and tree cutting capex.  |
| General pool           | Less than 25 years   | 18% reducing balance               | This includes non network IT capex.  |
| Deferred revenue pool  | N/A                  | 2.5% straight line                 | This represents the proportion of capital expenditure which is classified as non-load related expenditure where we are replacing worn assets on a like-for-like basis or the nearest modern equivalent basis |

The classification of capital expenditure for tax purposes across various tax pools is determined by tax legislation and HMRC working agreements.

CA<sub>t</sub> is calculated by taking the opening written down value of the various capital allowance pools for the relevant year. Capital additions are then added to the opening value to give a total value on which capital allowances can be claimed for that year. The capital allowance figure is then deducted to give the closing written down value (WDV) which becomes the opening value for the next year.

The opening WDV's for 2014/15 are set out in Table 4 of the 2013/14 Tax Report and shown in Table 1 below.

**Table 1: 2014/15 Opening Written Down Values**

| Pool   | £m     |
|--|--------|
| Long Life Asset Pool                           | 81.599 |
| General Pool                                   | 0.527  |
| Deferred Revenue Pool                          | 28.922 |
| Cumulative additions for Deferred Revenue Pool | 33.188 |

### Regulatory additions

The statutory capex additions for Transmission in 2014/15 are £19.879m. Regulatory additions are £26.253m which includes a capex incentive adjustment of £8.825m. The reconciliation of statutory capex additions to regulatory additions is shown in Table 2 below.

**Table 2: Reconciliation of Statutory Capex to Regulatory Additions**

| Ref      | Description   | £m            |
|----------|---|---------------|
| <b>A</b> | Gross Statutory Capex per "Rec 2 – Capex" of Financial Data RIGs            | 19.879        |
|          | Items included in Regulatory Additions but not in Statutory Capex Additions |               |
| <b>B</b> | Customer Contributions  | (2.293)       |
| <b>C</b> | Related Party Margin  | (0.098)       |
|          | Items in Statutory Capex additions but not included in Regulatory Additions |               |
| <b>D</b> | Capex cluster costs recovered through Opex Allowance                        | (0.061)       |
| <b>E</b> | <b>Total Regulatory Additions</b>   | <b>17.428</b> |
| <b>F</b> | Capex Incentive Adjustment  | 8.825         |
| <b>G</b> | <b>Total Regulatory Additions (Including Capex Incentive)</b>               | <b>26.253</b> |

This Regulatory additions figure is then adjusted for non qualifying capex items to give capital additions eligible for capital allowances of £26.072m. This is then split across the three tax pools shown in Table 3 in line with HMRC guidance.

**Table 3: Allocation of Additions by Capital Allowance Pool**

| Ref      | Description   | Long Life Asset Pool | General Pool | Deferred Revenue Pool | Total          |
|----------|---|----------------------|--------------|-----------------------|----------------|
|          |   | £m                   | £m           | £m                    | £m             |
| <b>A</b> | Regulatory Additions  | 14.216               | 0.128        | 3.083                 | <b>17.428</b>  |
| <b>B</b> | Capex Incentive Adjustment                                    | 8.565                | 0.261        | -                     | <b>8.825</b>   |
| <b>C</b> | Adjustment for Non Qualifying Capex                           | (0.181)              | -            | -                     | <b>(0.181)</b> |
| <b>D</b> | <b>Total Additions for TAX<sub>i</sub> Capital Allowances</b> | <b>22.599</b>        | <b>0.389</b> | <b>3.083</b>          | <b>26.072</b>  |

The capex additions are then added to the opening WDV and capital allowances are calculated. Table 4 sets out the capital allowances used in the calculation of regulated revenue entitlement for 2014/15.

**Table 4: 2014/15 Capital Allowance Calculation**

| Description                        | Long Life Asset Pool      | General Pool               | Deferred Revenue Pool    | Total          |
|------------------------------------|---------------------------|----------------------------|--------------------------|----------------|
|                                    | £m                        | £m                         | £m                       | £m             |
| Opening WDV @ 01/04/2014           | 81.599                    | 0.527                      | 28.922                   | <b>111.049</b> |
| Additions                          | <u>22.599</u>             | <u>0.389</u>               | <u>3.083</u>             | <b>26.072</b>  |
| Adjusted WDV                       | 104.199                   | 0.916                      | 32.006                   | <b>137.121</b> |
| Capital Allowances                 | <u>(8.336)</u>            | <u>(0.165)</u>             | <u>(0.907)</u>           | <b>(9.408)</b> |
| <b>Closing WDV @ 31/03/2015</b>    | <b>95.863</b>             | <b>0.751</b>               | <b>31.099</b>            | <b>127.713</b> |
| CA Rate                            | 8%<br>Reducing<br>Balance | 18%<br>Reducing<br>Balance | 2.5%<br>Straight<br>Line |                |
| Deferred Revenue Pool              |                           |                            |                          |                |
| Cumulative Additions to 01/04/2014 |                           |                            | 33.188                   |                |
| Additions                          |                           |                            | <u>3.083</u>             |                |
| Cumulative Additions to 31/03/2015 |                           |                            | <u>36.271</u>            |                |
| Capital Allowances                 |                           |                            | 0.907                    |                |

The CA<sub>t</sub> amount for 2014/15 is **£9.408m**.

### Calculation of TAX<sub>t</sub>

When the various components of TAX<sub>t</sub> are inserted into the licence formula, the value of TAX<sub>t</sub> for 2014/15 is **£1.659m** as detailed in Table 5 below.

$$TAX_t = TR_t / (1 - TR_t) * (RET_t + DEP_t - INT_t - CA_t)$$

**Table 5: Calculation of TAX<sub>t</sub>**

| Formula   | £m             |
|---|----------------|
| Return on RAB – RET <sub>t</sub>                      | 10.605         |
| RAB Depreciation – DEP <sub>t</sub>                   | 12.705         |
| Less Interest – INT <sub>t</sub>                      | (7.660)        |
| Less Capital Allowances – CA <sub>t</sub>             | <u>(9.408)</u> |
|   | 6.242          |
| Tax Factor – TR <sub>t</sub> / (1 - TR <sub>t</sub> ) | <u>26.6%</u>   |
| Tax Entitlement – TAX <sub>t</sub>                    | <b>1.659</b>   |

### 3. DISTRIBUTION TAX ENTITLEMENT

#### 2014/15 Tax calculation

The following paragraphs set out the calculation of the tax amount included within Distribution Entitlement for the regulatory reporting year 2014/15.

#### Tax Amount – TAX<sub>t</sub>

The maximum regulated distribution revenue for NIE Networks is set out in Paragraph 3.5 of Annex 2 of the Distribution Licence. This formula is as follows:

$$RP5R_t = DEP_t + RET_t + BD_t + O_t + P_t + COI_t + TAX_t - RPSI_t + K_t$$

TAX<sub>t</sub> is one of the components of allowed revenue and is calculated in accordance with the following formula set out in Paragraph 9.1 of Annex 2:

$$TAX_t = TR_t / (1 - TR_t) * (RET_t + DEP_t - INT_t - CA_t)$$

#### Tax Rate – TR<sub>t</sub>

TR<sub>t</sub> represents the corporation tax rate applicable in Northern Ireland as specified by HMRC which in 2014/15 is 21%. The tax factor TR<sub>t</sub> / (1 – TR<sub>t</sub>) is therefore 26.6%.

#### Return Amount – RET<sub>t</sub>

RET<sub>t</sub> represents the return on the Regulatory Asset Base (RAB). It is calculated by taking the average value of the opening (ORAB<sub>X<sub>t</sub></sub>) and closing (CRAB<sub>X<sub>t</sub></sub>) values of the individual RABs and multiplying them by the adjusted vanilla weighted average cost of capital (AVWACC<sub>t</sub>). The formula for calculating RET<sub>t</sub> is set out in Paragraph 5.1 of Annex 2:

$$RET_t = \left( \sum_{\text{All RAB}_X} (ORAB_{X_t} + CRAB_{X_t}) / 2 \right) * AVWACC_t$$

In 2014/15 the average value of the Distribution RABs is £1,015m and the adjusted vanilla WACC is 4.018%. The RET<sub>t</sub> value for 2014/15 is therefore **£40.806m.**

#### Depreciation amount – DEP<sub>t</sub>

DEP<sub>t</sub> represents the depreciation amount and is calculated in accordance with the formula set out in Paragraph 4.52 of Annex 2:

$$DEP_t = \sum_{\text{All RAB}_X} (DEPADD_{X_t} + FDEP_{X_t})$$

DEPADD<sub>X<sub>t</sub></sub> represents the depreciation amount for capex incurred on network assets from 2012/13 onwards.

FDEP<sub>X<sub>t</sub></sub> represents the depreciation amount of capex incurred on network assets prior to 2012/13.



The DEP<sub>t</sub> value for 2014/15 is **£64.023m.**

## Interest amount – INT<sub>t</sub>

INT<sub>t</sub> means an amount equal to the interest on the value of the average of all RABs calculated in accordance with the following formula set out in Paragraph 9.1 of Annex 2:

$$INT_t = \left( \sum_{\text{All RAB}_X} (ORAB\_X_t + CRAB\_X_t) / 2 \right) * G * NCOD$$

Where: G represents notional gearing and has a value of 45%

NCOD represents a notional nominal cost of debt with a value of 6.45%.

In 2014/15 the average value of all RABs is £1,015m which equates to an INT<sub>t</sub> figure of **£29.474m.**

## Regulatory Capital Allowances – CA<sub>t</sub>

CA<sub>t</sub> represents the value of capital allowances calculated in accordance with guidelines published by HMRC. There are three main groupings or ‘pools’ used in the calculation of capital allowances; a) a long life asset pool, b) a general pool and c) a deferred revenue pool. There are three pools because different types of assets attract different capital allowance percentages.

Each pool is classed as follows:

| Capital Allowance Pool | Useful economic life | Capital allowance rate for 2014/15 | Comments   |
|------------------------|----------------------|------------------------------------|--|
| Long life asset pool   | 25 years or greater  | 8% reducing balance                | This includes distribution 40 year capex, tree cutting capex and domestic contributions.   |
| General pool           | Less than 25 years   | 18% reducing balance               | This includes metering, market opening and IT capex.   |
| Deferred revenue pool  | N/A                  | 2.5% straight line                 | This represents the proportion of capital expenditure which is classified as non-load related expenditure where we are replacing worn assets on a like-for-like basis or the nearest modern equivalent basis |

The classification of capital expenditure for tax purposes across various tax pools is determined by tax legislation and HMRC working agreements.

CA<sub>t</sub> is calculated by taking the opening written down value of the various capital allowance pools for the relevant year. Capital additions are then added to the opening value to give a total value on which capital allowances can be claimed for that year. The capital allowance figure is then deducted to give the closing written down value (WDV) which becomes the opening value for the next year.

The opening WDV's for 2014/15 are set out in Table 9 of the 2013/14 Tax Report and shown in Table 6 below.

**Table 6: 2014/15 Opening Written Down Values**

| Pool   | £m      |
|--|---------|
| Long Life Asset Pool                           | 306.343 |
| General Pool                                   | 52.032  |
| Deferred Revenue Pool                          | 147.817 |
| Cumulative additions for Deferred Revenue Pool | 167.880 |

### Regulatory additions

The statutory capex additions for Distribution in 2014/15 are £92.457m. Regulatory additions are £69.928m which includes a capex incentive adjustment of £10.964m. The reconciliation of statutory capex additions to regulatory additions is shown in Table 7 below.

**Table 7: Reconciliation of Statutory Capex to Regulatory Additions**

| Ref      | Description   | £m            |
|----------|---|---------------|
| <b>A</b> | Gross Statutory Capex per "Rec 2 – Capex" of Financial Data RIGs            | 92.457        |
|          | Items included in Regulatory Additions but not in Statutory Capex Additions |               |
| <b>B</b> | Customer Contributions  | (32.448)      |
| <b>C</b> | Related Party Margin  | (0.710)       |
|          | Items in Statutory Capex additions but not included in Regulatory Additions |               |
| <b>D</b> | Connection expenditure: Electric Cars Charging Points                       | (0.022)       |
| <b>E</b> | Network Management System capex included within opex allowance              | (0.142)       |
| <b>F</b> | Enduring Solution Project Disallowance                                      | (0.000)       |
| <b>G</b> | Capitalised Interest  | (0.172)       |
| <b>H</b> | <b>Total Regulatory Additions</b>   | <b>58.964</b> |
| <b>I</b> | Capex Incentive Adjustment  | <u>10.964</u> |
| <b>J</b> | <b>Total Regulatory Additions (Including Capex Incentive)</b>               | <b>69.928</b> |

This Regulatory additions figure is then adjusted for items such as asset disposals, domestic contributions and non qualifying capex to give additions that are eligible for capital allowances of £72.187m. This is then split across the three tax pools shown in Table 8 in line with HMRC guidance.

**Table 8: Allocation of Additions by Capital Allowance Pool**

| Ref      | Description  | Long Life Asset Pool | General Pool | Deferred Revenue Pool | Total          |
|----------|--|----------------------|--------------|-----------------------|----------------|
|          |  | £m                   | £m           | £m                    | £m             |
| <b>A</b> | Regulatory Additions                               | 29.589               | 6.763        | 22.612                | <b>58.964</b>  |
| <b>B</b> | Capex Incentive Adjustment                         | 10.946               | 0.018        | -                     | <b>10.964</b>  |
| <b>C</b> | Domestic Contributions                             | 3.912                | -            | -                     | <b>3.912</b>   |
| <b>D</b> | Asset Disposals                                    | (0.022)              | -            | -                     | <b>(0.022)</b> |
| <b>E</b> | Non Qualifying Capex                               | <u>(1.630)</u>       | -            | -                     | <b>(1.630)</b> |
| <b>F</b> | <b>Total Additions for TAX, Capital Allowances</b> | <b>42,794</b>        | <b>6.781</b> | <b>22.612</b>         | <b>72.187</b>  |

The capex additions are then added to the opening WDV and capital allowances are calculated. Table 9 sets out the capital allowances used in the calculation of regulated revenue entitlement for 2014/15.

**Table 9: 2014/15 Capital Allowance Calculation**

| Description                        | Long Life Asset Pool      | General Pool               | Deferred Revenue Pool    | Total                  |
|------------------------------------|---------------------------|----------------------------|--------------------------|------------------------|
|                                    | £m                        | £m                         | £m                       | £m                     |
| Opening WDV @ 01/04/2014           | 306.343                   | 52.032                     | 147.817                  | <b>506.192</b>         |
| Additions                          | <u>42.794</u>             | <u>6.781</u>               | <u>22.612</u>            | <b><u>72.187</u></b>   |
| Adjusted WDV                       | 349.137                   | 58.813                     | 170.429                  | <b>578.379</b>         |
| Capital Allowances                 | <u>(27.931)</u>           | <u>(10.586)</u>            | <u>(4.762)</u>           | <b><u>(43.280)</u></b> |
| <b>Closing WDV @ 31/03/2015</b>    | <b>321.206</b>            | <b>48.227</b>              | <b>165.666</b>           | <b>535.099</b>         |
| CA Rate                            | 8%<br>Reducing<br>Balance | 18%<br>Reducing<br>Balance | 2.5%<br>Straight<br>Line |                        |
| <u>Deferred Revenue Pool</u>       |                           |                            |                          |                        |
| Cumulative Additions to 01/04/2014 |                           |                            | 167.880                  |                        |
| Additions                          |                           |                            | <u>22.612</u>            |                        |
| Cumulative Additions to 31/03/2015 |                           |                            | <u>190.492</u>           |                        |
| Capital Allowances                 |                           |                            | 4.762                    |                        |

The CA<sub>t</sub> amount for 2014/15 is **£43.280m**.

## Calculation of TAX<sub>t</sub>

When the various components of TAX<sub>t</sub> are inserted into the licence formula, the value of TAX<sub>t</sub> for 2014/15 is **£8.526m** as detailed in Table 10 below.

$$TAX_t = TR_t / (1 - TR_t) * (RET_t + DEP_t - INT_t - CA_t)$$

**Table 10: Calculation of TAX<sub>t</sub>**

| Formula   | £m              |
|---|-----------------|
| Return on RAB – RET <sub>t</sub>                      | 40.806          |
| RAB Depreciation – DEP <sub>t</sub>                   | 64.023          |
| Less Interest – INT <sub>t</sub>                      | (29.474)        |
| Less Capital Allowances – CA <sub>t</sub>             | <u>(43.280)</u> |
|   | 32.075          |
| Tax Factor – TR <sub>t</sub> / (1 - TR <sub>t</sub> ) | <u>26.6%</u>    |
| <b>Tax Entitlement – TAX<sub>t</sub></b>              | <b>8.526</b>    |

## 4. COMPARISON OF TAX ENTITLEMENT TO STATUTORY TAX

NIE Networks submits statutory tax returns to HMRC in line with its statutory year end which is on a calendar year basis. For the regulatory period Apr 2014 to Mar 2015, consideration needs to be given to the tax returns filed by NIE Networks for both calendar years 2014 and 2015.

Table 11 below shows the comparison of Tax Entitlement calculated above and statutory tax paid. As the information contained within the tax returns does not specify between Transmission and Distribution the entitlement amount is collated into a combined Transmission and Distribution view.

**Table 11: Comparison of Tax Entitlement and Tax Paid**

| Date   | Apr - Mar 2013 | Apr - Mar 2014 | Apr - Mar 2015 | Total          |
|--|----------------|----------------|----------------|----------------|
|  | £m             | £m             | £m             | £m             |
| Tax Entitlement – TAX <sub>t</sub> - Transmission (Table 5 <sup>1</sup> )  | 2.308          | 1.975          | 1.659          | 5.942          |
| Tax Entitlement – TAX <sub>t</sub> - Distribution (Table 10 <sup>1</sup> ) | <u>10.271</u>  | <u>10.716</u>  | <u>8.526</u>   | <u>29.513</u>  |
| Total Tax Entitlement  | 12.578         | 12.692         | 10.186         | 35.456         |
|  |                |                |                |                |
| Tax amount per Tax computation   | <u>15.560</u>  | <u>13.095</u>  | <u>7.980</u>   | <u>36.635</u>  |
|  |                |                |                |                |
| <b>Variance</b>  | <b>(2,982)</b> | <b>(0.403)</b> | <b>2.206</b>   | <b>(1.180)</b> |

The total variance for the period Apr 2012 to Mar 2015 is explained in Table 12 below.

**Table 12: Reconciliation of Tax Entitlement to Statutory Tax**

| Date                      | Apr 2012 – Mar 2015 | Comment  |
|---------------------------|---------------------|--|
|                           | £m                  |  |
| Capital Allowances        | 2.284               | At 1 April 2012 the opening pool figure for capital allowances was lower in the Regulatory Entitlement model than in the statutory tax pool. This has resulted in the tax entitlement allowance being greater than the Statutory tax paid.<br><br>The difference in the capital allowance pool mainly related to the general pool and was due to the following factors:<br>a) some allowances prior to RP5 being recovered as opex rather than capex.<br>b) differences between actual market opening costs incurred and allowances granted along with the recovery of a proportion by Power NI.<br><br>Additionally there are differences in the treatment of capital additions as detailed in Sections 5 and 6 of this and previous reports. |
| Pension Deficit           | 2.765               | Difference due to the ERDC disallowance of Pension deficit contributions.  |
| Income / Opex Differences | (6.393)             | This mainly relates to timing differences between actual income received and regulatory entitlement.   |
| Interest Amount           | 0.744               | Differences between notional interest in the tax entitlement calculation and actual interest paid.   |
| Other                     | <u>(0.581)</u>      | Relates to other minor adjustments within the tax return.  |
| <b>Variance</b>           | <b>(1.180)</b>      |  |

<sup>1</sup> Relates to Tables 5 and 10 from the specific year's Tax Report.

## 5. ANALYSIS OF CAPITAL ADDITIONS IN TAX RETURNS

The capital additions eligible for capital allowances and the analysis across the various pools in the submitted tax returns are shown in Table 13 and Table 14 below.

**Table 13: Analysis of Capital Additions in 2014 Tax Return**

| Ref  | A              | B               | C               |
|--|----------------|-----------------|-----------------|
| Date   | Jan - Mar 2014 | Apr - Dec 2014  | Jan - Dec 2014  |
| Gross Additions  | £m             | £m              | £m              |
| Total Capex Additions per Tax Returns                      | 29.850         | 85.604          | 115.453         |
| Less: Total Customer Capital Contributions                 | <u>(6.162)</u> | <u>(27.268)</u> | <u>(33.431)</u> |
| Total Net Capex Additions                                  | 23.687         | 58.335          | 82.022          |
| Add: Domestic Capital Contributions                        | <u>0.859</u>   | <u>2.732</u>    | <u>3.590</u>    |
| <b>Total Net Additions eligible for Capital Allowances</b> | <b>24.546</b>  | <b>61.067</b>   | <b>85.613</b>   |
| <b>Analysis for tax purposes</b>                           |                |                 |                 |
| Long Life Asset Pool                                       | 15.702         | 34.824          | 50.526          |
| General Pool   | 2.925          | 5.586           | 8.511           |
| Deferred Revenue Pool                                      | 5.443          | 19.456          | 24.899          |
| Non Qualifying Capex                                       | 0.431          | 1.067           | 1.498           |
| Revenue deduction for Capitalized Interest                 | <u>0.045</u>   | <u>0.134</u>    | <u>0.179</u>    |
| <b>Total</b>   | <b>24.546</b>  | <b>61.067</b>   | <b>85.613</b>   |

**Table 14: Analysis of Capital Additions in 2015 Tax Return**

| Ref  | D              | E               | F               |
|--|----------------|-----------------|-----------------|
| Date   | Jan - Mar 2015 | Apr - Dec 2015  | Jan - Dec 2015  |
| Gross Additions  | £m             | £m              | £m              |
| Total Capex Additions per Tax Returns                      | 26.733         | 116.470         | 143.203         |
| Less: Total Customer Capital Contributions                 | <u>(7.472)</u> | <u>(38.507)</u> | <u>(45.980)</u> |
| Total Net Capex Additions                                  | 19.261         | 77.963          | 97.223          |
| Add: Domestic Capital Contributions                        | <u>1.180</u>   | <u>4.103</u>    | <u>5.283</u>    |
| <b>Total Net Additions eligible for Capital Allowances</b> | <b>20.441</b>  | <b>82.065</b>   | <b>102.506</b>  |
| <b>Analysis for tax purposes</b>                           |                |                 |                 |
| Long Life Asset Pool                                       | 11.970         | 52.470          | 64.440          |
| General Pool   | 1.449          | 8.530           | 9.979           |
| Deferred Revenue Pool                                      | 6.240          | 18.720          | 24.960          |
| Non Qualifying Capex                                       | 0.745          | 2.234           | 2.978           |
| Revenue deduction for Capitalized Interest                 | <u>0.038</u>   | <u>0.112</u>    | <u>0.150</u>    |
| <b>Total</b>   | <b>20.441</b>  | <b>82.066</b>   | <b>102.507</b>  |

The information in Table 13 for the 9 month period April to December 2014 and Table 14 for the 3 month period January – March 2015 is combined to show the analysis of the Regulatory period April – March 2015 in Table 15.

**Table 15: Analysis of 2014/15 per tax returns**

| Ref  | Table 13 – B    | Table 14 – D   | G               |
|--|-----------------|----------------|-----------------|
| Date   | Apr - Dec 2014  | Jan - Mar 2015 | Apr - Mar 2015  |
| Gross Additions  | £m              | £m             | £m              |
| Total Capex Additions per Tax Returns                      | 85.604          | 26.733         | 112.337         |
| Less: Total Customer Capital Contributions                 | <u>(27.268)</u> | <u>(7.472)</u> | <u>(34.741)</u> |
| Total Net Capex Additions                                  | 58.335          | 19.261         | 77.596          |
| Add: Domestic Capital Contributions                        | <u>2.732</u>    | <u>1.180</u>   | <u>3.912</u>    |
| <b>Total Net Additions eligible for Capital Allowances</b> | <b>61.067</b>   | <b>20.441</b>  | <b>81.508</b>   |
| <b>Analysis for tax purposes</b>                           |                 |                |                 |
| Long Life Asset Pool                                       | 34.824          | 11.970         | 46.794          |
| General Pool   | 5.586           | 1.449          | 7.035           |
| Deferred Revenue Pool                                      | 19.456          | 6.240          | 25.696          |
| Non Qualifying Capex                                       | 1.067           | 0.745          | 1.811           |
| Revenue deduction for Capitalized Interest                 | <u>0.134</u>    | <u>0.038</u>   | <u>0.172</u>    |
| <b>Total</b>   | <b>61.067</b>   | <b>20.441</b>  | <b>81.508</b>   |

## 6. RECONCILIATION OF REGULATORY CAPITAL ALLOWANCES TO STATUTORY TAX RETURNS

The information contained within the tax returns does not specify between Transmission and Distribution. Therefore in order to reconcile the regulatory additions to the tax returns the amounts need to be collated into a combined Transmission and Distribution view as shown in Table 16 below.

**Table 16: Total Regulatory additions split by Capital Allowance pool**

|                                   | Long Life Asset Pool | General Pool | Deferred Revenue Pool | Total         |
|-----------------------------------|----------------------|--------------|-----------------------|---------------|
|                                   | £m                   | £m           | £m                    | £m            |
| Transmission (Table 3)            | 22.599               | 0.389        | 3.083                 | <b>26.072</b> |
| Distribution (Table 8)            | 42.794               | 6.781        | 22.612                | <b>72.187</b> |
| <b>Total Regulatory Additions</b> | <b>65.393</b>        | <b>7.170</b> | <b>25.696</b>         | <b>98.259</b> |

Table 17 provides a reconciliation of capital additions in each pool shown in the tax return (Table 15 – Column G`) with the additions used in the calculation of regulatory entitlement for 2014/15 as set out in Table 16.

**Table 17: Reconciliation of Additions in Tax return to Regulatory Capital Allowances Pools**

| Description   | Long Life Asset Pool | General Pool | Deferred Revenue Pool | Total          |
|---|----------------------|--------------|-----------------------|----------------|
|   | £m                   | £m           | £m                    | £m             |
| Capex per Tax Return (Table 15 - G)   | 46.794               | 7.035        | 25.696                | <b>79.524</b>  |
| Transmission Capex Incentive Adjustment (Table 3 – B)                                 | 8.565                | 0.261        | -                     | <b>8.825</b>   |
| Distribution Capex Incentive Adjustment (Table 8 – B)                                 | 10.946               | 0.018        | -                     | <b>10.964</b>  |
| Less Transmission Related Party Margin (Table 2 – C)                                  | (0.098)              | -            | -                     | <b>(0.098)</b> |
| Less Distribution Related Party Margin (Table 7 – C)                                  | (0.710)              | -            | -                     | <b>(0.710)</b> |
| Less Connection expenditure: Electric cars charging points (Table 7 – D)              | (0.022)              | -            | -                     | <b>(0.022)</b> |
| Less Cluster costs recovered through opex allowance (Table 2 – D)                     | (0.061)              | -            | -                     | <b>(0.061)</b> |
| Less Network Management System project recovered through opex allowance (Table 7 – E) | -                    | (0.142)      | -                     | <b>(0.142)</b> |
| Less Enduring Solution Project Disallowance (Table 7 – F)                             | -                    | (0.000)      | -                     | <b>(0.000)</b> |
| Less Asset Disposals (Table 8 – D)  | (0.022)              | -            | -                     | <b>(0.022)</b> |
| Other   | 0.001                | (0.001)      | -                     | <b>(0.000)</b> |
| <b>Regulatory Additions (Table 16)</b>  | <b>65.393</b>        | <b>7.170</b> | <b>25.696</b>         | <b>98.259</b>  |

## 7. RETROSPECTIVE ADJUSTMENTS

With reference to Paragraph 12.35 (d) of Annex 2 of the Licences, there are no retrospective adjustments in respect of previous years and no restatement of 12.35 (a), 12.35 (b) and 12.35 (c) is required.





## **Independent Auditors' Report to the directors of Northern Ireland Electricity Networks Limited (the Company) and Utility Regulator (the Regulator)**

***Audit of regulatory tax reports in accordance with Paragraph 12.35 of Annex 2 of Northern Ireland Electricity Distribution and Participate in Transmission Licences (the Licences) for RP5 covering the period 1 April 2012 to 30 September 2017.***

### **Introduction**

This report is produced in accordance with the terms of our engagement letter with the Company dated 15 January 2021.

### **Background**

This report is made in order to meet the requirements of Paragraph 12.35 of Annex 2 of the Company's Regulatory Licences. Our audit work has been undertaken to (a) assist the Company to meet its obligation under the Regulatory Licences to procure such a report and to (b) facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. We do not accept or assume responsibility to anyone other than the Company and the Regulator, for our audit work, for this report or for the opinions we have formed. We understand that the format and content of the tax report has been agreed with the Regulator.

For clarification, the statutory tax returns are filed on a calendar year basis and the Company's Maximum Regulated Revenue is calculated on the regulatory year April – March. The information within the tax returns is converted into regulatory periods which can cause timing differences.

### **Scope of work**

We draw your attention to the fact that the engagement is to review the reconciliation of the information submitted to HMRC on the Company's tax affairs with the information used for the calculation of the tax element of the Company's Maximum Regulated Revenue as calculated in accordance with Paragraph 9 of Annex 2 of the Licences.

### **Limitation of Scope**

We would specifically note the following limitations on our procedures;

- We have not audited the Company's statutory tax returns submitted to HMRC nor have we reviewed the appropriateness of the capital spend allocation to the respective capital allowance pools in each of those statutory tax returns.
- We have not audited the Financial Data RIGs submitted to the Utility Regulator which set out actual costs for the Company in accordance with the various licence terms.
- We have not audited the components of the Company's Maximum Regulated Revenue as calculated in Paragraph 3 of Annex 2 of the Licences.
- In various schedules figures reflected in either the statutory tax returns or the statutory financial statements have been allocated to regulatory periods on different bases e.g. on a specific allocation basis or on a time apportioned basis. We have not audited in detail these allocations to the regulatory period, however where appropriate, we have

compared the total of the relevant figures across the entire period from 1 April 2012 – 30 September 2017.

- We would specifically note across the entire period from 1 April 2012 – 30 September 2017 there is a difference of £302k between the corporation tax liability in the statutory tax returns compared to the tax liability calculated on a regulatory year basis. The main reason for this difference is the rate of tax for the statutory period compared to the regulatory periods will vary year on year due to timing differences of changes in the rate of tax. We note that the total taxable profits (i.e. before applying the tax rate) did agree across the entire period.
- We note that there are a few nominal differences between the statutory tax returns and the allocation of the capital spend in the regulatory reports and the allocation to capital allowance pools in two periods (statutory periods ended 31 December 2012 and 31 December 2015). The differences noted are timing differences only.

## Approach

In order to complete this engagement, we adopted the following approach:

- Meetings were held with the Regulatory Reporting team to discuss the content of the Tax Reports and the models used to calculate the tax entitlement amount.
- Verified the calculation of the Tax Amount per Paragraph 9 of Annex 2 of the RP5 Transmission and Distribution Licences.
- Verified the underlying numbers within the tax reports to the source documents as listed below;
  - Financial Data RIGS Reporting workbook
  - RP5 Financial model

We understand the Regulator has reviewed the numbers within the above source documents. As noted above, we have not audited the source documents.
- Verified the opening balances of the regulatory capital allowance pools. The opening values for 2012/13 reflecting the values set out in Annex 2, Tables 11 and 14 respectively of the RP5 Transmission and Distribution Licences.
- Verified the allocation of capital additions (including the incentive amounts) to the appropriate regulatory capital allowance pools to ensure these reflected the same allocations as those in the Statutory Tax submission, other than differences as noted under limitations in scope.
- Checked the analysis of the tax allowance set out in the Tax Reports to the tax returns submitted to HMRC.
- Verified the allocation of capital additions per the Statutory tax return (based on a Calendar Year) to the allocation of capital additions per the regulatory reporting period (April to March).
- Agreed the reconciliation of Tax Entitlement to Statutory Tax, subject to the timing difference as highlighted under limitations in scope above.
- Verified the reconciliation of capital additions per the statutory tax return to regulatory additions for each capital allowance pool.

**Opinion**

Based on our examination as above, we report that based on our findings, in our opinion the Tax Reports are consistent with the records we inspected and has been prepared, in all respects, in accordance with the requirements of the Licence.

A handwritten signature in black ink, appearing to read 'BMcSparran', followed by a long, wavy horizontal line.

Brendan McSparran  
Tax Director  
Ernst & Young LLP  
Belfast  
11 February 2021