Northern Ireland Electricity Networks

2015 / 16 TAX REPORT

Transmission & Distribution RP5 Price Control

11 February 2021

Contents

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

2015/16 Tax calculation

The following paragraphs set out the calculation of the tax amount included within Transmission Entitlement for the regulatory reporting year 2015/16.

Tax Amount – TAX_t

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_t 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_t

TR_t represents the corporation tax rate applicable in Northern Ireland as specified by HMRC which in 2015/16 is 20%. The tax factor $TR_t / (1 – TR_t)$ is therefore 25.0%.

Return Amount – RET_t

RET_t represents the return on the Regulatory Asset Base (RAB). It is calculated by taking the average value of the opening ($ORAB\_X_t$) and closing ($CRAB\_X_t$) values of the individual RABs and multiplying them by the adjusted vanilla weighted average cost of capital ($AVWACC_t$). The formula for calculating RET_t 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 2015/16 the average value of the Transmission RABs is £280m and the adjusted vanilla WACC is 4.018%. The RET_t value for 2015/16 is therefore **£11.238m.**

Depreciation amount – DEP_t

DEP_t represents the depreciation amount and is calculated in accordance with the formula set out in Paragraph 4.45 of Annex 2:

$$DEP_t = \sum_{\text{All RAB\_X}} (DEPADD\_X_t + FDEP\_X_t)$$

$DEPADD\_X_t$ represents the depreciation amount for capex incurred on network assets from 2012/13 onwards.

$FDEP\_X_t$ represents the depreciation amount of capex incurred on network assets prior to 2012/13.

The DEP_t value for 2015/16 is **£13.356m.**

Interest amount – INT_t

INT_t 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 2015/16 the average value of all RABs is £280m which equates to an INT_t figure of **£8.117m.**

Regulatory capital allowances – CA_t

CA_t 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 2015/16	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_t 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 WDVs for 2015/16 are set out in Table 4 of the 2014/15 Tax Report and shown in Table 1 below.

Table 1: 2015/16 Opening Written Down Values

Pool	£m
Long Life Asset Pool	95.863
General Pool	0.751
Deferred Revenue Pool	31.099
Cumulative additions for Deferred Revenue Pool	36.271

Regulatory additions

The statutory capex additions for Transmission in 2015/16 are £35.996m. Regulatory additions are £27.547m which includes a capex incentive adjustment of £4.846m. 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
A	Gross Statutory Capex per "Rec 2 – Capex" of Financial Data RIGs	35.996
	Items included in Regulatory Additions but not in Statutory Capex Additions	
B	Customer Contributions	(15.260)
C	Related Party Margin	(0.007)
	Items in Statutory Capex additions but not included in Regulatory Additions	
D	Connection income: Unapproved cluster costs	2.106
E	Capex cluster costs recovered through Opex Allowance	(0.135)
F	**Total Regulatory Additions**	**22.700**
G	Capex Incentive Adjustment	4.846
H	**Total Regulatory Additions (Including Capex Incentive)**	**27.547**

This Regulatory additions figure is then adjusted for non qualifying capex items to give capital additions eligible for capital allowances of £27.252m. 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
A	Regulatory Additions	19.546	0.158	2.996	**22.700**
B	Capex Incentive Adjustment	4.601	0.245	-	**4.846**
C	Adjustment for Non Qualifying Capex	(0.295)	-	-	**(0.295)**
D	**Total Additions for TAX_t Capital Allowances**	**23.853**	**0.403**	**2.996**	**27.252**

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 2015/16.

Table 4: 2015/16 Capital Allowance Calculation

Description	Long Life Asset Pool	General Pool	Deferred Revenue Pool	Total
	£m	**£m**	**£m**	**£m**
Opening WDV @ 01/04/2015	95.863	0.751	31.099	**127.713**
Additions	23.853	0.403	2.996	**27.252**
Adjusted WDV	119.715	1.154	34.095	**154.965**
Capital Allowances	(9.577)	(0.208)	(0.982)	**(10.767)**
Closing WDV @ 31/03/2016	**110.138**	**0.947**	**33.114**	**144.199**
CA Rate	8% Reducing Balance	18% Reducing Balance	2.5% Straight Line	
Deferred Revenue Pool				
Cumulative Additions to 01/04/2015			36.271	
Additions			2.996	
Cumulative Additions to 31/03/2016			39.268	
Capital Allowances			0.982	

The CA_t amount for 2015/16 is **£10.767m**.

Calculation of TAX_t

When the various components of TAX_t are inserted into the licence formula, the value of TAX_t for 2015/16 is **£1.428m** 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_t

Formula	£m
Return on RAB – RET_t	11.238
RAB Depreciation – DEP_t	13.356
Less Interest – INT_t	(8.117)
Less Capital Allowances – CA_t	(10.767)
	5.710
Tax Factor – TR_t / (1 - TR_t)	25.0%
Tax Entitlement – TAX_t	**1.428**

3. DISTRIBUTION TAX ENTITLEMENT

2015/16 Tax calculation

The following paragraphs set out the calculation of the tax amount included within Distribution Entitlement for the regulatory reporting year 2015/16.

Tax Amount – TAX_t

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_t 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_t

TR_t represents the corporation tax rate applicable in Northern Ireland as specified by HMRC which in 2015/16 is 20%. The tax factor TR_t / (1 – TR_t) is therefore 25.0%.

Return Amount – RET_t

RET_t represents the return on the Regulatory Asset Base (RAB). It is calculated by taking the average value of the opening ($ORAB\_X_t$) and closing ($CRAB\_X_t$) values of the individual RABs and multiplying them by the adjusted vanilla weighted average cost of capital ($AVWACC_t$). The formula for calculating RET_t 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 2015/16 the average value of the Distribution RABs is £1,034m and the adjusted vanilla WACC is 4.018%. The RET_t value for 2015/16 is therefore **£41.542m.**

Depreciation amount – DEP_t

DEP_t represents the depreciation amount and is calculated in accordance with the formula set out in Paragraph 4.52 of Annex 2:

$$DEP_t = \sum_{\text{All RAB\_X}} (DEPADD\_X_t + FDEP\_X_t)$$

$DEPADD\_X_t$ represents the depreciation amount for capex incurred on network assets from 2012/13 onwards.

$FDEP\_X_t$ represents the depreciation amount of capex incurred on network assets prior to 2012/13.

The DEP_t value for 2015/16 is **£64.201m.**

Interest amount – INT_t

INT_t 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 2015/16 the average value of all RABs is £1,034m which equates to an INT_t figure of **£30.005m.**

Regulatory Capital Allowances – CA_t

CA_t 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 2015/16	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_t 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 WDVs for 2015/16 are set out in Table 9 of the 2014/15 Tax Report and shown in Table 6 below.

Table 6: 2015/16 Opening Written Down Values

Pool	£m
Long Life Asset Pool	321.206
General Pool	48.227
Deferred Revenue Pool	165.666
Cumulative additions for Deferred Revenue Pool	190.492

Regulatory additions

The statutory capex additions for Distribution in 2015/16 are £122.533m. Regulatory additions are £80.728m which includes a capex incentive adjustment of £0.780m. 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
A	Gross Statutory Capex per “Rec 2 – Capex” of Financial Data RIGs	122.533
	Items included in Regulatory Additions but not in Statutory Capex Additions	
B	Customer Contributions	(42.923)
C	Related Party Margin	(0.046)
D	IT Contestability opex costs recovered through Regulatory additions	0.535
	Items in Statutory Capex additions but not included in Regulatory Additions	
E	Connection expenditure: Electric Cars Charging Points	(0.001)
F	Capitalised Interest	(0.150)
G	**Total Regulatory Additions**	**79.949**
H	Capex Incentive Adjustment	0.780
I	**Total Regulatory Additions (Including Capex Incentive)**	**80.728**

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 £82.989m. 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
A	Regulatory Additions	45.569	12.406	21.974	**79.949**
B	Capex Incentive Adjustment	2.206	(1.427)	-	**0.780**
C	Domestic Contributions	4.940	-	-	**4.940**
D	Asset Disposals	(0.028)	-	-	**(0.028)**
E	Non Qualifying Capex	(2.651)	-	-	**(2.651)**
F	**Total Additions for TAX_t Capital Allowances**	**50.036**	**10.979**	**21.974**	**82.989**

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 2015/16.

Table 9: 2015/16 Capital Allowance Calculation

Description	Long Life Asset Pool	General Pool	Deferred Revenue Pool	Total
	£m	£m	£m	£m
Opening WDV @ 01/04/2015	321.206	48.227	165.666	**535.099**
Additions	50.036	10.979	21.974	**82.999**
Adjusted WDV	371.242	59.206	187.640	**618.088**
Capital Allowances	(29.699)	(10.657)	(5.312)	**(45.668)**
Closing WDV @ 31/03/2016	**341.542**	**48.549**	**182.329**	**572.420**
CA Rate	8% Reducing Balance	18% Reducing Balance	2.5% Straight Line	
Deferred Revenue Pool				
Cumulative Additions to 01/04/2015			190.492	
Additions			21.974	
Cumulative Additions to 31/03/2016			212.466	
Capital Allowances			5.312	

The CA_t amount for 2015/16 is **£45.668m**.

Calculation of TAX_t

When the various components of TAX_t are inserted into the licence formula, the value of TAX_t for 2015/16 is **£7.517m** 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_t

Formula	£m
Return on RAB – RET_t	41.542
RAB Depreciation – DEP_t	64.201
Less Interest – INT_t	(30.005)
Less Capital Allowances – CA_t	(45.668)
	30.069
Tax Factor – TR_t / (1 - TR_t)	25%
Tax Entitlement – TAX_t	**7.517**

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 2015 to Mar 2016, consideration needs to be given to the tax returns filed by NIE Networks for both calendar years 2015 and 2016.

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	Apr - Mar 2016	Total
	£m	£m	£m	£m	£m
Tax Entitlement – TAX_t - Transmission (Table 5[1])	2.308	1.975	1.659	1.428	7.370
Tax Entitlement – TAX_t - Distribution (Table 10[1])	10.271	10.716	8.526	7.517	37.031
Total Tax Entitlement	12.578	12.692	10.186	8.945	44.401
Tax amount per Tax computation	15.560	13.095	7.980	6.523	43.159
Variance	**(2,982)**	**(0.403)**	**2.206**	**2.421**	**1.242**

The total variance for the period Apr 2012 to Mar 2016 is explained in Table 12 below.

Table 12: Reconciliation of Tax Entitlement to Statutory Tax

Date	Apr 2012 - Mar 2016	Comment
	£m	
Capital Allowances	2.625	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. The difference in the capital allowance pool mainly related to the general pool and was due to the following factors: a) some allowances prior to RP5 being recovered as opex rather than capex. b) differences between actual market opening costs incurred and allowances granted along with the recovery of a proportion by Power NI. Additionally there are differences in the treatment of capital additions as detailed in Sections 5 and 6 of this and previous reports.
Pension Deficit	3.573	Difference due to the ERDC disallowance of Pension deficit contributions.
Income / Opex Differences	(4.965)	This mainly relates to timing differences between actual income received and regulatory entitlement.
Interest Amount	0.572	Differences between notional interest in the tax entitlement calculation and actual interest paid.
Other	(0.564)	Relates to other minor adjustments within the tax return.
Variance	**1.242**	

[1] 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 2015 Tax Return

Ref	A	B	C
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	(7.472)	(38.507)	(45.980)
Total Net Capex Additions	19.261	77.963	97.223
Add: Domestic Capital Contributions	1.180	4.103	5.283
Total Net Additions eligible for Capital Allowances	**20.441**	**82.065**	**102.506**
Analysis for tax purposes			
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	0.038	0.112	0.150
Total	**20.441**	**82.066**	**102.507**

Table 14: Analysis of Capital Additions in 2016 Tax Return

Ref	D	E	F
Date	**Jan - Mar 2016**	**Apr - Dec 2016**	**Jan - Dec 2016**
Gross Additions	**£m**	**£m**	**£m**
Total Capex Additions per Tax Returns	42.060	157.916	199.976
Less: Total Customer Capital Contributions	(19.676)	(65.096)	(84.772)
Total Net Capex Additions	22.384	92.820	115.204
Add: Domestic Capital Contributions	0.837	4.295	5.132
Total Net Additions eligible for Capital Allowances	**23.221**	**97.115**	**120.336**
Analysis for tax purposes			
Long Life Asset Pool	12.724	64.027	76.752
General Pool	3.497	12.088	15.585
Deferred Revenue Pool	6.250	18.751	25.001
Non Qualifying Capex	0.712	2.137	2.849
Revenue deduction for Capitalized Interest	0.038	0.112	0.150
Total	**23.221**	**97.115**	**120.336**

The information in Table 13 for the 9 month period April to December 2015 and Table 14 for the 3 month period January – March 2016 is combined to show the analysis of the Regulatory period April – March 2016 in Table 15.

Table 15: Analysis of 2015/16 per tax returns

Ref	**Table 13 – B**	**Table 14 – D**	**G**
Date	**Apr - Dec 2015**	**Jan - Mar 2016**	**Apr - Mar 2016**
Gross Additions	**£m**	**£m**	**£m**
Total Capex Additions per Tax Returns	116.470	42.060	158.530
Less: Total Customer Capital Contributions	(38.507)	(19.676)	(58.183)
Total Net Capex Additions	77.963	22.384	100.346
Add: Domestic Capital Contributions	4.103	0.837	4.940
Total Net Additions eligible for Capital Allowances	**82.065**	**23.221**	**105.287**
Analysis for tax purposes			
Long Life Asset Pool	52.470	12.724	65.194
General Pool	8.530	3.497	12.027
Deferred Revenue Pool	18.720	6.250	24.970
Non Qualifying Capex	2.234	0.712	2.946
Revenue deduction for Capitalized Interest	0.112	0.038	0.150
Total	**82.066**	**23.221**	**105.287**

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 amounts to the tax returns the amounts need to be collated in a combined Transmission and Distribution view 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)	23.853	0.403	2.996	**27.252**
Distribution (Table 8)	50.036	10.979	21.974	**82.989**
Total Regulatory Additions	**73.888**	**11.382**	**24.970**	**110.241**

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 2015/16 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)	65.194	12.027	24.970	**102.191**
Transmission Capex Incentive Adjustment (Table 3 – B)	4.601	0.245	-	**4.846**
Distribution Capex Incentive Adjustment (Table 8 – B)	2.206	(1.427)	-	**0.780**
Less Transmission Related Party Margin (Table 2 – C)	(0.007)	-	-	**(0.007)**
Less Distribution Related Party Margin (Table 7 – C)	(0.046)	-	-	**(0.046)**
Add IT Contestability opex costs recovered through Regulatory additions (Table 7 – D)	-	0.535	-	**0.535**
Add Connection income: Unapproved cluster costs (Table 2 – D)	2.106	-	-	**2.106**
Less Cluster Costs recovered through opex allowance (Table 2 – E)	(0.135)			**(0.135)**
Less Connection expenditure: Electric cars charging points (Table 7 – E)	(0.001)	-	-	**(0.001)**
Less Asset Disposals (Table 8 – D)	(0.028)	-	-	**(0.028)**
Other	(0.001)	(0.001)	-	**(0.000)**
Regulatory Additions (Table 16)	**73.888**	**11.382**	**24.970**	**110.241**

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.

Building a better
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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.

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