

Ofwat

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Dear Sirs

Anglian response to Ofwat's draft determination of Anglian Water's in-period outcome delivery incentives for 2022-23

We are pleased to have an opportunity to respond to our in-period draft determination for 2022-23.

We have no comments on the minor changes to performance payments which Ofwat has proposed. However, we disagree with Ofwat's proposed treatment of the marginal tax rate applied to penalties. In the draft determination Ofwat has retained a tax rate of 19% despite the detailed evidence initially provided to Ofwat in order to support our view that our marginal tax rate should be zero for the in-period determination for 2022-23. In view of our already submitted evidence along with the below considerations, we maintain our said view and would like to stress its importance going forward for both Anglian and our customers.

Alongside our 2022/23 APR we submitted detailed information to support our view that our marginal tax rate for the rest of the AMP will be zero. This included forecast tax computations and forecast capital allowances for the rest of the AMP. Also, in responding to an APR query (ANH-APR-IP-007) we provided the necessary additional information requested including updated forecast tax computations that reinforce the basis for our submission on the in-period payments.

After reviewing the determinations published for other companies regarding the marginal rate of tax for performance payments, and Ofwat's draft determination of our own submission for 2022/23, we are not clear why our case has been rejected while other companies' apparently similar claims have been accepted. Therefore it is not clear what criteria are being applied by yourselves to determine the marginal rate of tax.

In its Draft determination of our in-period outcome delivery incentives for 2022-23, Ofwat states that:

"We note that the company's tax computations show it expects to be profitable in 2024-25, and that it expects tax on these profits to be covered by the available capital allowances."

We do not understand the relevance of this statement. Using capital allowances to offset profits is an accepted method of reducing tax liability, and indeed is used in Ofwat's price determinations when setting tax allowances included within allowed revenues. This observation should not therefore influence the decision on the marginal tax rate to be applied to in-period payments.

Ofwat also states:

“The company also confirms that it is surrendering tax losses to group companies and receiving tax credits. The total value of tax losses surrendered will be finalised by March 2024. As these tax losses have a value if other group companies are able to use them, we consider it is possible that the company will benefit within the 2020-25 period from the additional tax losses.”

We do not understand Ofwat’s reasoning as to why this should affect the marginal rate of tax applied to penalties or rewards. Any tax losses which are surrendered by the regulated company to other group companies are surrendered at full tax value. Therefore, although the other group companies are able to use these losses to reduce their taxable profits, the regulated company (and our customers) gets immediate value for those losses rather than carrying them forward to obtain value in future years. Leaving this to one side, we do not in any case understand why the way that the losses are utilised should have any effect on how the size of the losses penalty should be calculated, by using a marginal rate of either zero % or the full rate of 19%.

Given our claim that our actual marginal tax rate will be zero for all of AMP7 can be fully evidenced, we request that this should be reflected in the rate applied to the 2022/23 performance payment determination on an ex ante basis, rather than assuming that it can be corrected on an ex post basis through a PR24 reconciliation reversing material impacts arising from differences between actual and assumed rates across the AMP as a whole. Making the appropriate assumption on the effective marginal tax rate in the determination is equally in customers’ favour as it provides better bill smoothing across the remainder of AMP7 and into AMP8.

Ofwat close the rationale for retaining a non-zero marginal tax rate with the following:

“We will be in a better position to consider whether such an adjustment to tax is appropriate as part of our decisions for the 2024 price review (PR24) determinations, when we will have information on the value of tax losses surrendered by the company over 2020-25 and the company's proposed opening tax loss balance at PR24.”

As explained above, we do not support Ofwat's rationale that surrendered tax losses should impact the decision on application of a marginal tax rate. We therefore consider that there should be equivalent treatment of the Anglian case for a zero-marginal tax rate for ODI penalties to other companies where Ofwat has accepted, and applied, a zero marginal tax rate. This should be independent of the PR24 process.

We would be grateful for an opportunity to meet with Ofwat to discuss this issue at your earliest convenience prior to the 15th of November 2023, and in advance to provide any further information if Ofwat could indicate what that additional information is in order to assist you in the consideration of our claim.

Yours faithfully



Darren Rice
Regulation Director