Draft Decision

Australian Gas Networks (Victoria and Albury)
Access Arrangement 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 7
Corporate income tax

December 2022

AUSTRALIAN ENERGY REGULATOR

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

AER reference: AER212593

Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to Australian Gas Networks (Victoria and Albury) (AGN) for the 2023–28 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

Contents

7 Corporate income tax

Our determination of the total revenue for AGN includes the estimated cost of corporate income tax for the 2023–28 access arrangement period (2023–28 period).[1] Under the post-tax framework, a corporate income tax amount is calculated as part of the building blocks assessment using our post-tax revenue model (PTRM). This amount allows AGN to recover the estimated cost of corporate income tax for the 2023–28 period.

This attachment presents our assessment of AGN's proposed corporate income tax amount for the 2023–28 period. It also presents our assessment of the proposed opening tax asset base (TAB), and the standard and remaining tax asset lives as at 1 July 2023 used to estimate tax depreciation for the purpose of calculating tax expenses.

7.1 Draft decision

We accept AGN's proposed approach to calculate its forecast cost of corporate income tax. AGN has used our PTRM for gas pipeline service providers which implemented the findings from our 2018 *Review of the regulatory tax approach* (2018 tax review).[2]

Our draft decision determines an estimated cost of corporate income tax amount of $22.7 million ($ nominal) for AGN over the 2023–28 period. This decision represents a decrease of $2.5 million (9.9%) from AGN's proposal of $25.1 million. The key reason for the decrease is the inclusion of the tax loss over the 2023 half year extension period and our draft decision on regulatory depreciation (Attachment 4) which, in turn, decreased AGN's taxable revenue and, therefore, the cost of corporate income tax.

Our draft decision on the forecast tax amount for the 2023–28 period is significantly lower than that forecast for the 2018–22 period. This change is primarily due to the accumulated tax loss of $25.0 million ($2022–23) at the start of the 2023–28 period, and the implementation of our findings from the 2018 tax review, which introduced the immediate expensing of capital expenditure (capex) and diminishing value method of tax depreciation, resulting in a significant increase in forecast tax depreciation.[3]

We accept AGN's proposed approach for determining the forecast immediate expensing of its capex over the 2023–28 period. However, we amended the proposed amount of the forecast immediately expensed capex to $31.5 million ($2022–23) from $32.7 million consistent with AGN's revised mains replacement in its updated capex forecast model.[4]

Further, we accept the proposed opening TAB as at 1 July 2023 of $1288.8 million, since we accept AGN's approach for establishing the opening TAB including its actual and estimated capex over the 2018–22 period and a further six months (the 1 January to 30 June 2023

1 NGR, r. 76(c).

2 AER, *Final report: Review of regulatory tax approach*, December 2018.

3 The third key finding from the 2018 tax review relates to capping tax lives for certain gas assets to 20 years, which AGN has proposed for its 'Mains & services' and 'Mains & services Albury' asset classes.

4 AGN submitted updated forecast capex values which reduced total net capex by $0.8 million ($2022–23). AGN, Response to AER Information request #021, 25 October 2022.

period), subject to a minor change.[5] We also note AGN's proposed PTRM does not correctly reflect its roll forward model (RFM) outputs for the opening TAB, and have amended it to be consistent with the RFM.

We accept AGN's proposed standard tax asset lives for all of its existing asset classes as they are broadly consistent with the tax asset lives prescribed by the Australian Taxation Office's (ATO) taxation ruling 2022/1 (section 7.4.4).[6]

We also accept AGN's proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2023. This method is a continuation of the approved approach used in the 2018–23 period and applies the approach as set out in our RFM.

Our adjustments to the return on capital (Attachments 2, 3 and 5) and the regulatory depreciation (Attachment 4) building blocks affect revenues, which in turn impacts the tax calculation. The changes affecting revenues are discussed in the Overview.

7.2 AGN's proposal

AGN proposed an estimated cost of corporate income tax of $25.1 million ($ nominal) for the 2023–28 period using our PTRM,[7] and with the following inputs:

- an opening TAB value as at 1 July 2023 of $1288.8 million ($ nominal)
- an expected statutory income tax rate of 30% per year
- a value of imputation credits (gamma) of 0.585
- remaining tax asset lives of assets in existence as at 30 June 2023 calculated using a weighted average remaining life approach as set out in our RFM
- for the asset classes of 'Mains & services' and 'Mains & services Albury', AGN proposed to apply the 20 year cap to the standard tax asset lives. For all other asset classes, AGN applied the same standard tax asset lives for tax depreciation purposes of new assets for its existing asset classes in the 2023–28 period as approved for the 2018–22 access arrangement.

Table 7.1 sets out AGN's proposed TAB roll forward over the 2018–23 period.

5 The change impacts the proposed opening TAB value by less than $0.1 million.

6 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022),* p. 179.

7 Our published gas PTRM uses the diminishing value tax depreciation approach for all new assets with the exception of in-house software, buildings (capital works) and equity raising costs. All assets acquired prior to 1 July 2023 will continue to be depreciated using the straight-line depreciation method for regulatory tax purposes, until these assets are fully depreciated. The PTRM also allows for the immediate expensing of certain capex for tax purposes.

Table 7.1 AGN's proposed tax asset base roll forward over the 2018–23 period ($ million, nominal)

	2018	2019	2020	2021	2022[a]	2023[b]
Opening TAB	698.6	766.2	849.4	956.0	1091.7	1245.7
Capital expenditure[c]	94.9	114.4	142.8	177.4	203.6	71.0
Less: tax depreciation	27.2	31.2	36.2	41.7	49.6	28.0
Closing TAB	**766.2**	**849.4**	**956.0**	**1091.7**	**1245.7**	**1288.8**

Source: AGN, *AGN Revisions to Final Plan 2023-28_Attachment 1.6A GSR Response_Roll Forward Model*, September 2022.

(a) Based on estimated capex.

(b) The half year period of 1 January to 30 June 2023. Based on estimated capex.

(c) Net of disposals.

Table 7.2 sets out AGN's proposed cost of corporate income tax for the 2023–28 period.

Table 7.2 AGN's proposed cost of corporate income tax for the 2023–28 access arrangement period ($ million, nominal)

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
Tax payable	13.9	10.3	9.7	13.3	13.4	60.6
Less: value of imputation credits	8.1	6.0	5.7	7.8	7.8	35.4
Net corporate income tax	**5.8**	**4.3**	**4.0**	**5.5**	**5.5**	**25.1**

Source: AGN, *AGN Revisions to Final Plan 2023-28_Attachment 1.5A GSR Response_Post Tax Revenue Model*, September 2022.

7.3 Assessment approach

We make an estimate of taxable income for each regulatory year of the access arrangement period in accordance with the formula in the National Gas Rules (NGR) as part of our determination of the total revenue requirement for the 2023–28 period for AGN.[8] Our estimate is the taxable income a benchmark efficient entity would earn for providing reference services if it operated AGN's business and is determined in accordance with the PTRM.

In April 2020, we published our first versions of the RFM and PTRM for gas pipeline service providers under new provisions in the NGR.[9] The gas models have been developed using our published electricity distribution and transmission regulatory models, which incorporate relevant findings from our final report on the tax review.[10] They also incorporate several

8 NGR, r. 87A(1).

9 NGR, r. 75A.

10 AER, *Final report: Review of regulatory tax approach*, December 2018, p. 76. The PTRM specifies the manner in which the estimated cost of corporate income tax is to be calculated. The RFM calculates the gas pipeline service provider's tax asset base which is an input to the PTRM for the calculation of the tax building block.

amendments to account for gas specific requirements. Gas pipeline service providers are required to use the gas models for the purposes of their access arrangement proposals.[11]

In April 2021, we published a new version 2 of our gas distribution PTRM that applied the same regulatory tax approach as version 1, and implemented the changes set out in our final position paper on the treatment of inflation under the regulatory framework.[12]

How the estimated cost of corporate income tax is calculated in the PTRM

Our approach for calculating a gas pipeline service provider's estimated cost of corporate income tax is set out in our PTRM[13] and involves the following steps:[14]

1. We estimate the annual assessable income (taxable revenue) that would be earned by a benchmark efficient entity operating the gas pipeline service provider's business. This is the approved forecast revenues for the gas pipeline service provider that we determined using the building block approach.[15]
2. We then estimate the benchmark tax expenses such as operating expenditure (opex), interest expense and tax depreciation in the following ways:
   - operating expense is set equal to the opex building block[16]
   - interest expense is a function of the size of the capital base, the benchmark gearing assumption (60%) and the regulated cost of debt
   - tax depreciation expense is calculated using a TAB that is separate to the capital base, and standard and/or remaining tax asset lives for taxation purposes. Previously, AGN's 2018–22 access arrangement applied the straight-line method for calculating tax depreciation for all assets. Consistent with the findings of the tax review, the published gas PTRM applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method[17] for all assets acquired after 30 June 2023 except for in-house software, buildings and equity raising costs. The expenditure for these assets is to be depreciated using the straight-line method under Australian tax law. The PTRM also accounts for the value of certain forecast capex to be immediately expensed when estimating the benchmark tax expense. The value of immediately expensed capex is deducted from the net capex being depreciated for tax purposes for the year in which it is

---

11 NGR, r. 75A.

12 AER, *Final position: Regulatory treatment of inflation*, December 2020, pp. 6–8.

13 AER, *Gas Distribution PTRM,* April 2021.

14 The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NGR, r. 75B(2)(e).

15 The total revenue for tax purposes is the sum of the building blocks including return on capital, return of capital, operating expenditure and cost of corporate taxation (and any capital contributions if applicable). It may also include other revenue adjustments, but the assessment of whether they should give rise to a cost of corporate tax will occur on a case-by-case basis.

16 Our assessment approach for the opex building block is discussed in Attachment 6 of the draft decision.

17 For more explanation of how we calculate depreciation using the diminishing value method, please see: AER, *Distribution PTRM handbook*, April 2021, pp. 24–25.

forecast to be commissioned.[18] The immediately expensed amount is then included in the total tax depreciation amount for the relevant year.

There may be other revenue adjustments, but the assessment of whether they should give rise to a corporate tax amount occurs on a case-by-case basis.

3. We estimate the annual taxable income that would be earned by a benchmark efficient entity operating the gas pipeline service provider's business by subtracting the benchmark estimates of tax expenses (step 2) from the approved forecast revenues for the service provider (step 1).
4. We apply the statutory income tax rate to the estimated annual taxable income (after adjustment for any tax loss carried forward) to arrive at a notional amount of tax payable.
5. We deduct the expected value for the utilisation of imputation credits (gamma) by investors from the notional amount of tax payable. The tax payable net of the expected value of imputation credits represents the corporate income tax amount and is included as a separate building block in determining the gas pipeline service provider's total revenue requirement.

How we assess the tax inputs to the PTRM

The estimated cost of corporate income tax is an output of the PTRM. We therefore assess the gas pipeline service provider's proposed cost of corporate income tax by analysing the proposed inputs to the PTRM for calculating that cost. While our assessment approach for most of the tax inputs remain largely the same as the determination for the current (2018–23) period, our gas PTRM requires two new sets of inputs for the calculation of tax depreciation—the forecast immediate expensing of certain capex and the assets to be exempted from the diminishing value method of tax depreciation.

Our assessment approach for each of the tax inputs required in the PTRM, including the two new inputs are discussed in turn below:

- **Opening TAB as at the commencement of the 2023–28 period:** We consider that the roll forward of the opening TAB should be based on the approved opening TAB as at 1 January 2018 and AGN's actual capex incurred during the 2018–23 period, and the final year (2017) of the previous access arrangement period.[19] We do not adjust the TAB value for immediate expensing of past capex in the roll forward process. This is consistent with our 2018–22 access arrangement that the benchmark efficient entity at the time will not immediately expense any capex during that period.

  The roll forward of the opening TAB for the 2018–23 period is calculated in our RFM. The tax review final report set out that the required changes to the tax depreciation approach would apply to new assets only. As such, the approach for determining the opening TAB value remains the same as the previous access arrangement for the purposes of this draft decision. We have published the new gas RFM to implement the findings of the tax

[18] That is, the net capex to be added to the TAB for tax depreciation purposes is the amount of gross capex, less disposals, less the immediately deductible capex.

[19] The tax depreciation is therefore recalculated based on actual capex. The same tax depreciation approach of using actual capex applies to the roll forward of the TAB at the next review.

review.[20] We expect that this RFM will be used for the purposes of the TAB roll forward for 2023–28 at the next review.

The opening TAB value is used to estimate forecast tax depreciation for the 2023–28 period, including new assets to be added to the TAB over this period. We will continue to apply the straight-line method of tax depreciation for the opening TAB value.[21] However, for all assets forecast to be added to the TAB in the 2023–28 period (with some exceptions discussed further below), we will apply the diminishing value method of tax depreciation.

- **Standard tax asset life for each asset class:** Our assessment of a gas pipeline service provider's proposed standard tax asset lives is generally guided by the effective life for depreciating assets determined by the Commissioner of Taxation. The ATO sets a statutory life cap of 20 years on certain classes of gas transmission and distribution assets.[22] We consider that the standard tax asset lives for AGN should be consistent with the ATO taxation ruling 2022/1 regarding the effective life of depreciating assets where possible.[23]

  As discussed above, the PTRM applies the diminishing value tax depreciation method for all new assets except for in-house software, buildings and capital works, and equity raising costs. It provides for these assets to be depreciated using the straight-line method for tax purposes.[24] The tax effective lives for in-house software, buildings and capital works, and equity raising costs are not covered under the ATO taxation ruling 2022/1. Therefore, our assessment of the standard tax asset lives for these asset classes are guided by the *Income Tax Assessment Act 1997* (ITAA). Specifically, we consider that the standard tax asset life should be:

  - 40 years for buildings and capital works – This is consistent with the number of years required to completely depreciate capital works assets such as buildings for tax purposes when applying sections 43.15, 43.140 and 43.210 of the ITAA.
  - 5 years for in-house software – This is consistent with section 40.95(7) of the ITAA.
  - 5 years for equity raising costs – This is consistent with section 40.880 of the ITAA and the ATO's taxation ruling 2011/6.[25]

---

20 See https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/gas-financial-models-roll-forward-and-revenue-2020.

21 The tax review final report stated that the required changes to the tax depreciation approach would apply to new assets only. Therefore, the straight-line approach to tax depreciation that applied for AGN's 2018–22 access arrangement and extension period remains appropriate for use in the roll forward of the TAB to 1 July 2023.

22 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2021)*, p. 179. For transmission assets: compressor station assets, gas pipeline LNG station assets, pipelines–transmission, spur or lateral, regulators and underground gas storage asset. For distribution assets: low pressure gas storage holders, pipelines (high, medium and low-pressure trunks, primary or secondary mains or services) and regulators.

23 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022),* p. 179.

24 Our assessment approach on new assets to be exempted from the diminishing value method is discussed in detail below.

25 ATO, *Taxation Ruling 2011/6*, July 2016.

- **Income tax rate:** The statutory income tax rate is 30% per annum for businesses of the size we regulate, which was adopted in AGN's proposal.
- **Value of gamma:** The gamma input for AGN is 0.585 for this draft decision. This is consistent with the 2018 *Rate of Return Instrument*, which set a gamma value of 0.585, and was adopted in AGN's proposal.[26] In our final decision, we will apply the value of gamma in accordance with the 2022 *Rate of return Instrument*. Refer to Attachment 3 of this draft decision for further discussion on this matter.
- **Size and treatment of any tax losses as at 1 July 2023:** Where a business has tax losses under our benchmark approach, we require the provision of this value to determine the appropriate estimated taxable income for an access arrangement period. Any tax losses accumulated at the end of the current 2018–22 access arrangement and extension period are to be carried over to the start of the 2023–28 access arrangement, which will offset any forecast taxable income for that period. Consistent with the final decision PTRM for the 2023 half year extension period, our draft decision determines an accumulated tax loss of $25.0 million ($2022–23) is to be carried forward at the start of the 2023–28 period for AGN.
- **Forecast immediate expensing of capex:** The PTRM requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2023–28 period. Our assessment of forecast immediate expensing of capex is guided by the gas pipeline service provider's actual immediate expensing of capex from the previous access arrangement period.[27] We will collect actual data relating to this expenditure in our annual reporting Regulatory Information Notices (RIN) to further inform our decision on the amount of forecast immediate expensing of capex in future access arrangements.
- **Diminishing value multiplier:** The PTRM applies the following formula to calculate the tax depreciation under the diminishing value method:[28]

$$D_t = \left(Nominal\ net\ capex_i - \sum_{n=0}^{t-1} D_n \right) \times DV\ multiplier \div standard\ tax\ asset\ life$$

where:

D_t is the tax depreciation in year t

$D_0 = 0$

$t = 1,2,3, \ldots$

$i = year\ 0$

[26] AER, *Rate of return instrument*, December 2018, p. 19.

[27] In the tax review final report, we labelled our approach to determining the amount of capex that is to be immediately expensed as an 'actuals informed approach'. AER, *Final report, Review of regulatory tax approach*, December 2018, p. 66.

[28] This formula shows how the tax depreciation for capex in a particular year is calculated under the diminishing value method in the PTRM.

The PTRM provides an input section for the 'DV multiplier' in the above formula to be recorded for each year of the access arrangement period. This is labelled as the 'diminishing value multiplier' in the PTRM. Currently, the DV multiplier is set at 200% by the ATO. Our assessment approach for the standard tax asset life inputs is discussed above. The assessment approach for capex is discussed in Attachment 5.

- **New assets to be exempted from the diminishing value method:** The PTRM applies the diminishing value method for tax depreciation purposes to all new depreciable assets except for certain assets. It provides for the PTRM asset classes 47 to 50 to be depreciated using the straight-line method for tax purposes rather than the diminishing value method. These asset classes are to contain new assets associated with in-house software, buildings and equity raising costs.

  We consider that the benchmark equity raising costs should not be depreciated using the diminishing value method. Section 40.880 of the ITAA and the ATO's taxation ruling 2011/6[29] require that businesses claim deductions on equity raising costs in equal proportions over a five-year period. Therefore, in the PTRM, we apply the straight-line method for calculating the tax depreciation for equity raising costs, consistent with the ITAA and ATO's requirements.[30] Further, the gas pipeline service provider may propose capex associated with buildings and in-house software to be exempted from the diminishing value method of tax depreciation in the PTRM if the proposal satisfies the following requirements:

  - **Buildings**: We consider that capex for buildings may be exempted from the diminishing value method in the PTRM, consistent with sections 43.15, 43.140 and 43.210 of the ITAA. However, such capex must be consistent with the definition of a capital work under section 43.20 of the ITAA and in ATO taxation ruling 97/25.[31] This includes new buildings and structural improvements to existing buildings.[32] However, capex on separate assets within a building such as air-conditioning units, transformers and converters are not consistent with the definition of a capital work, and therefore are required to be depreciated using the diminishing value method in the PTRM. AGN did not propose this type of capex for the 2023–28 period.

  - **In-house software**: We consider that capex for in-house software may be exempted from the diminishing value method in the PTRM, consistent with section 40.72 of the ITAA. However, such capex must be consistent with the definition of in-house software under section 995.1 of the ITAA and in ATO taxation ruling 2016/3.[33] This includes computer software, or the right to use computer software that the gas pipeline service provider acquires, develops or has someone else develop for the gas pipeline service provider's business use.[34] However, capex associated with other IT assets such as computer hardware is not

29 ATO, *Taxation Ruling 2011/6*, July 2016.

30 The benchmark amount for equity raising costs is determined within the PTRM.

31 ATO, *Taxation Ruling 97/25*, July 2017.

32 ITAA, section 43.20.

33 ATO, *Taxation Ruling 2016/3*, October 2018.

34 ITAA, section 995.1.

consistent with the definition of in-house software, and therefore is required to be depreciated using the diminishing value method in the PTRM. AGN did not propose this type of capex for the 2023–28 period.

In assessing AGN's proposal, we have had regard to the National Gas Objective (NGO) and the revenue and pricing principles.[35] The NGR also require that any forecast must be arrived at on a reasonable basis and must represent the best forecast or estimate possible in the circumstances.[36]

7.3.1 Interrelationships

The cost of corporate income tax building block feeds directly into the total revenue requirement. This amount is determined by five factors:

- pre-tax revenues
- tax expenses (including tax depreciation)
- the corporate tax rate
- any tax losses carried forward
- gamma—the expected proportion of company tax that is returned to investors through the utilisation of imputation credits—which is offset against the corporate income tax payable.

Of these five factors, the corporate tax rate is set externally by the Government. The higher the tax rate, the higher the required cost of corporate tax.

The pre-tax revenues depend on all the building block components. Any factor that affects revenue will therefore affect pre-tax revenues. Higher pre-tax revenues can increase the tax payable.[37] Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.[38]

35 National Gas Law (NGL), s. 28; NGR, r. 100(1). The NGO is set out in NGL, s. 23. The revenue and pricing principles are set out in NGL, s. 24.

36 NGR, r. 74(2).

37 In fact, there is an iterative relationship between tax and revenues. That is, revenues lead to tax, being applied, which increases revenues and leads to slightly more tax and so on. The PTRM is therefore set up to run an iterative process until the revenue and corporate tax amounts become stable.

38 For example, although increased opex adds to revenue requirement, these expenses are also offset against the revenues as deductions in determining tax, so there is no net impact in this case. A higher return on equity, in contrast, gives rise to no offsetting tax expenses and therefore increases the corporate tax amount in proportion to the company tax rate.

The tax expenses (or deductions) depend on various building block components and their size. Some components give rise to tax expenses, such as opex, interest payments and tax depreciation of assets. However, others do not, such as increases in return on equity. Higher tax expenses offset revenues as deductions in the tax calculation and therefore reduce the cost of corporate income tax (all things being equal). Tax expenses include:

- Interest on debt – Interest is a tax offset. The size of this offset depends on the ratio of debt to equity and therefore the proportion of the capital base funded through debt. It also depends on the allowed return on debt and the size of the capital base.
- General expenses – These expenses generally will match the opex forecast including any revenue adjustments, but the assessment of whether they should be treated as a tax expense occurs on a case-by-case basis.
- Tax depreciation – A TAB that is separate to the capital base is maintained for the service provider reflecting tax rules. This TAB is affected by many of the same factors as the capital base, such as capex, although unlike the capital base value it is maintained at its historical cost with no indexation. The TAB is also affected by the depreciation rate/method and asset lives assigned for tax depreciation purposes.

A business that has tax expenses which are greater than its taxable revenue in a period would not be subject to pay tax and instead will generate a tax loss. A tax loss from the previous period(s) can be carried forward to offset against tax payable in the upcoming period.

7.4 Reasons for draft decision

Our draft decision on the estimated cost of corporate income tax is $22.7 million ($ nominal) for AGN over the 2023–28 period. This represents a decrease of $2.5 million from AGN's proposal of $25.1 million.

In its proposal, AGN did not include any tax loss at the start of the 2023–28 period. Consistent with the final decision PTRM for the 2023 half year extension period, we determine a forecast tax loss of $25.0 million ($2022–23) as at 1 July 2023 will be carried forward into the 2023–28 period for calculating the forecast tax building block.

We accept the opening TAB as at 1 July 2023 of $1288.8 million as proposed by AGN, subject to a minor change, since we accept AGN's approach for establishing the opening TAB.[39]

We are satisfied that AGN's proposed approach for determining the forecast immediate expensing of its capex over the 2023–28 period is reasonable. However, we amended the proposed amount of the forecast immediately expensed capex to $31.5 million ($2022–23) from $32.7 million, consistent with AGN's updated capex forecast model and our draft decision on the overall forecast capex (Attachment 5).[40]

39 The change impacts the proposed opening TAB value by less than $0.1 million.

40 AGN submitted updated forecast capex values which reduced total net capex by $0.8 million ($2022–23). AGN, Response to AER Information request #021, 25 October 2022.

We accept AGN's proposed standard tax asset lives for all of its existing asset classes. We also accept AGN's proposal to calculate forecast tax depreciation of its existing assets using the weighted average remaining life method. This method is a continuation of the approved approach used in the 2018–23 period and applies the approach as set out in our RFM.

As discussed in other attachments, our draft decision on AGN's proposed return on capital (Attachments 2, 3 and 5) and the regulatory depreciation (Attachment 4) building blocks affect total revenues, and therefore also impact the forecast corporate income tax amount.[41]

7.4.1 Implementation of the tax review

We published the latest version of the gas PTRM in April 2021. Specifically, the PTRM includes the following two components which affect the calculation of tax depreciation:

- **immediate expensing of capex –** we allow for certain capex to be immediately expensed when estimating the benchmark tax expense
- **diminishing value depreciation method –** we apply the diminishing value method for tax depreciation purposes to all new depreciable assets except for capex associated with in-house software, equity raising costs and buildings.

AGN has used our PTRM which implemented the changes identified from the final report of the tax review to estimate the corporate income tax for its proposal.[42] Our assessment of the tax inputs submitted by AGN are discussed below.

Forecast immediate expensing of capex

AGN proposed that $32.7 million ($2022–23) of forecast capex (7.3% of total capex)[43] will be immediately expensed for tax purposes for the 2023–28 period.[44]

We accept AGN's proposal to include all forecast capex for the 'Mains & services' asset class to be immediately expensed for tax purposes over the 2023–28 period. This is based on the same type of capex AGN used to calculate the value of its immediate expensing of actual capex for tax purposes during the 2018–22 period.[45] We consider it reasonable to expect that the same type of capex immediately expensed by AGN in the current period will also be expensed immediately for tax purposes during the 2023–28 period.

As discussed in Attachment 5, we have accepted AGN's proposed mains replacement forecast capex. However, we note that AGN has submitted updated forecast capex values in an information request after its September 2022 addendum PTRM submission.[46] Therefore, our draft decision is to make a corresponding adjustment to AGN's proposed amount of

---

41 NGR, r. 87A.

42 AGN, *AGN Revisions to Final Plan 2023-28_Attachment 1.5A GSR Response_Post Tax Revenue Model*, September 2022.

43 Compared with the proposed gross capex of $450.7 million ($2022–23).

44 AGN, *AGN Revisions to Final Plan 2023-28_Attachment 1.5A GSR Response_Post Tax Revenue Model*, September 2022.

45 AGN, *response to AER information request #009*, August 2022, p. 9

46 AGN submitted updated forecast capex values which reduced total net capex by $0.8 million ($2022–23). AGN, Response to AER Information request #021, 25 October 2022.

forecast immediate expensing capex to $31.5 million ($2022–23) for the 2023–28 period, consistent with AGN's updated capex forecast model and our draft decision on capex.[47]

We will continue to collect actual data relating to the immediate expensing of capex in our annual reporting RINs to further inform our decision for this type of expenditure in the next access arrangement for AGN.

Assets exempt from the diminishing value method

The gas PTRM continues to apply the straight-line tax depreciation method to the opening TAB at 1 July 2023, but applies the diminishing value method as the new regulatory benchmark for calculating tax depreciation to all new capex.[48] However, as discussed above, there are some exceptions to this approach under the tax law such as assets relating to in-house software, buildings and equity raising costs. In the PTRM, the benchmark equity raising costs are determined within the model and depreciated using the straight-line tax depreciation method.

AGN has not proposed any forecast capex that relates to the above categories which would be required to be depreciated using the straight-line method for tax depreciation purposes. As a result, all of AGN's assets acquired after 30 June 2023 are subject to the diminishing value method of tax depreciation. We accept AGN's proposal to not allocate any forecast capex to be depreciated under the straight-line method for tax depreciation.

Gas asset life caps

Our new regulatory tax approach applies a 20-year cap on the tax asset lives for certain new gas assets. This is consistent with the ATO's tax ruling which sets a statutory life cap of 20 years on certain classes of gas transmission and distribution assets.[49]

AGN's proposed standard tax asset lives for its gas pipeline assets (applying to the 'Mains & services' and 'Mains & services Albury' asset classes) over the 2023–28 period are capped at 20 years, reflecting our new regulatory tax approach. We therefore accept AGN's capped standard tax asset lives for its gas pipeline assets.

7.4.2 Opening tax asset base as at 1 July 2023

We accept the opening TAB as at 1 July 2023 of $1288.8 million as proposed by AGN. This is because AGN's proposed approach is based on our RFM and consistent with that previously approved for the 2018–23 period. However, we note AGN's proposed PTRM does not correctly reflect its RFM outputs for the opening TAB, and therefore we have amended it to be consistent with the RFM for this draft decision.

---

47 All else being equal, a reduction of immediately expensed capex will increase the forecast cost of corporate income tax (or in this case reduce the amount of forecast tax loss for AGN).

48 AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76.

49 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, p. 179. For transmission assets–compressor station assets, gas pipeline LNG station assets, pipelines– transmission, spur or lateral, regulators and underground gas storage asset. For distribution assets low pressure gas storage holders, pipelines (high, medium and low-pressure trunks, primary or secondary mains or services) and regulators.

We have reviewed the inputs to the TAB roll forward. We found all inputs were correct and reconciled with relevant data sources, such as historical data RINs and the 2018–23 decision models, with the exception of the value for the 2017 actual capex.[50] Using the resubmitted 2017 RIN we corrected the value of the actual capex for that year in the RFM. This increased the opening TAB as at 1 July 2023 by less than $0.1 million and therefore the proposed value did not change at one decimal place.

After the above change, we are satisfied with the 2018–22 and 2023 half year capex used to roll forward the TAB for the purposes of this draft decision. We note that the opening TAB as at 1 July 2023 may be updated to reflect any revisions for 2022 or 2023 half year capex estimates as part of the final decision.

We also note that while we have applied some accelerated depreciation for the capital base due to uncertainty of the future of gas networks going forward, we accept AGN's proposal not to apply a similar accelerated depreciation amount to the TAB. We consider that the shorter tax lives applied including the historical use of different tax depreciation methods and non-indexation of the TAB means the tax assets have been depreciated faster than the capital base. As such, the accelerated depreciation due to uncertainty about future of gas applied to the capital base is not likely to be material to the TAB in these circumstances.

Table 7.3 sets out our draft decision on the roll forward of AGN's TAB values over the 2018–23 period.

Table 7.3 AER's draft decision on AGN's TAB roll forward for 2018–23 period ($million, nominal)

	2018	2019	2020	2021	2022[a]	2023[b]
Opening TAB	698.6	766.2	849.4	956.0	1091.7	1245.7
Capital expenditure[c]	94.9	114.4	142.8	177.4	203.6	71.0
Less: tax depreciation	27.2	31.2	36.2	41.7	49.6	28.0
Closing TAB	**766.2**	**849.4**	**956.0**	**1091.7**	**1245.7**	**1288.8**

Source: AER analysis.

(a) Based on estimated capex. We expect to update the TAB roll forward with a revised capex estimate in the final decision.

(b) The half year period of 1 January to 30 June 2023. Based on estimated capex. We expect to update the TAB roll forward with a revised capex estimate in the final decision.

(c) Net of disposals.

7.4.3 Remaining tax asset lives

We accept AGN's proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2023. The proposed method is a continuation of the approved approach used in the 2018–23 period and applies the approach as set out in our RFM.

For this draft decision, we accept the proposed remaining tax asset lives as we have accepted the proposed roll forward of the TAB in the RFM. However, we will update the

50 We identified some other required input changes that affected the capital base roll forward (Attachment 2) but not the TAB roll forward.

remaining tax asset lives for the final decision for any changes to the estimated capex values in the RFM because they are used as inputs for calculating the remaining tax asset lives.

AGN's proposal PTRM did not include a remaining tax asset life for the 'Equity raising costs' asset class. We note the remaining life output in the proposed RFM was 0.5 year for this asset class, based on the weighted average remaining life method. Therefore, we have adopted the remaining tax asset life of 0.5 year for the 'Equity raising costs' asset class in our draft decision PTRM.

Table 7.4 sets out our draft decision on the remaining tax asset lives at 1 July 2023 for AGN. We are satisfied that the remaining tax asset lives are appropriate for application over the 2023–28 period. We are also satisfied that the remaining tax asset lives provide an estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.[51]

7.4.4 Standard tax asset lives

We accept AGN's proposed standard tax asset lives assigned to its existing asset classes for the 2023–28 period, because they are:

- broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2022/1, including the statutory cap on the effective life of 20 years for gas pipeline assets[52]
- for non-pipeline asset classes—consistent with the approved standard tax asset lives for the 2018–23 period.

Our draft decision on AGN's standard tax asset lives for each of its asset classes is set out in Table 7.4. We are satisfied that the standard tax asset lives are appropriate for application over the 2023–28 period. We are also satisfied that the standard tax asset lives provide an estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.[53]

---

51 NGR, r. 87A(1).

52 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022),* p. 179.

53 NGR, r. 87A(1).

Table 7.4 AER's draft decision on AGN's standard and remaining tax asset lives as at 1 July 2023 (years)

Asset class	Standard tax asset life[a]	Remaining tax asset life as at 1 July 2023[b]
Mains & services	20.0	40.0
Meters	15.0	10.5
Buildings	35.0	3.0
SCADA	10.0	7.8
Computer equipment	4.0	2.9
Other assets	15.0	10.3
Land	n/a	n/a
Mains & services Albury	20.0	39.1
Meters Albury	15.0	10.7
Buildings Albury	n/a	n/a
SCADA Albury	10.0	2.8
Computer equipment Albury	4.0	4.1
Other assets Albury	15.0	10.2
Land Albury	n/a	n/a
Equity raising costs[c]	5.0	0.5

Source: AER analysis.

(a) All new assets use the diminishing value method of tax depreciation.

(b) Used for straight-line method of tax depreciation.

(c) For this draft decision, the forecast capex determined for AGN does not meet a level to trigger any benchmark equity raising costs

n/a Not applicable. We have not assigned a standard tax asset life and remaining tax asset life to some asset classes because the assets allocated to them are non-depreciating assets. For the 'Buildings Albury' asset class, we have not allocated a standard or remaining tax life as there are no forecast capex or opening tax value allocated to the asset class.

7.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable as set out in Table 7.5.

Table 7.5 AGN's corporate income tax revisions

Revision	Amendment
Revision 7.1	Make all necessary amendments to reflect this draft decision on the proposed cost of corporate income tax for the 2023–28 access arrangement period.

Glossary

Term	Definition
AER	Australian Energy Regulator
AGN	Australian Gas Networks (Victoria and Albury)
ATO	Australian Tax Office
capex	Capital expenditure
ITAA	Income Tax Assessment Act 1997
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
opex	Operating expenditure
PTRM	Post-tax revenue model
RFM	Roll forward model
RIN	Regulatory Information Notice
TAB	Tax asset base