Draft Decision

AusNet Gas Services
Access Arrangement 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 7
Corporate income tax

December 2022

AUSTRALIAN
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Note

This attachment forms part of the AER’s draft decision on the access arrangement that will apply to AusNet Gas Services (AusNet) 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

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7 Corporate income tax

Our determination of the total revenue for AusNet 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 AusNet to recover the estimated cost of corporate income tax for the 2023–28 period.

This attachment presents our assessment of AusNet'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 AusNet's proposed approach to calculate its forecast cost of corporate income tax. AusNet 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 $32.9 million ($ nominal) for AusNet over the 2023–28 period. This decision represents a decrease of $18.2 million (35.7%) from AusNet's proposal of $51.1 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 the regulatory depreciation (Attachment 4) which, in turn, decreased AusNet'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 $8.6 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 AusNet's proposed forecast immediately expensed capex of $13.3 million. This is because we consider AusNet's approach of immediately expensing overheads over the 2023–28 period is reasonable and consistent with its historical treatment.

We determine an opening TAB as at 1 July 2023 of $1048.8 million for AusNet. This is $5.2 million higher than the amount proposed by AusNet. While we accept AusNet'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 period), we have:

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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 AusNet has proposed for its 'Transmission pipelines', 'Distribution pipelines', 'Service pipes', 'Cathodic protection' and 'Supply regulators/Valve stations' asset classes.

- updated AusNet's proposed final year asset adjustment for capitalised leases to the TAB to be consistent with the adjustment for the capital base[4]
- included $6.1 million ($ nominal) of reported expenditure as capex in 2021, 2022 and 2023 half year extension period for Software as a Service (SaaS) related costs to be included in the TAB for the 2018–23 period to reflect our approach to mid-period changes in accounting standards. This is consistent with our treatment for the capital base.[5]

We accept AusNet'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 accept the creation of new asset classes for 'Capitalised leases 1 July 2023' and 'Cathodic protection - post 1998', and the proposed standard tax asset life of 20 years for this asset class.[7] However, we do not accept the creation of new asset classes for 'Transmission pipelines - post 1998', 'Distribution pipelines - post 1998' and 'Service pipes - post 1998' associated with asset reallocations in the final year adjustment. We are not satisfied that these asset classes are required for the purposes of assigning shorter asset lives.[8]

We also accept AusNet'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 roll forward model (RFM). However, we have amended the calculation of tax remaining lives for the 'Transmission pipelines', 'Distribution pipelines', 'Service pipes', 'Cathodic protection' asset classes, due to our decision on the final year adjustments for asset reallocations. We have also revised the tax remaining life for the capitalised leases to be consistent with its capital base remaining life of 6.6 years, which reflects the average remaining lease terms for AusNet's existing leases (section 7.4.3).

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.

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4 Our assessment for the final year asset adjustment for capitalised leases is discussed in Attachment 2 of this draft decision.

5 Costs related to SaaS are considered capital expenditure for the 2018–23 period and will only begin being treated as operating expenditure from the start of the 2023–28 period. Details of our approach is further discussed in Attachments 2 and 8.

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

7 We have not assigned a standard tax asset life for 'Capitalised leases 1 July 2023' asset class because there will be no forecast capex for this asset class going forward.

8 Please see section 4.4.2 of attachment 4 of this draft decision for details.

7.2 AusNet's proposal

AusNet proposed an estimated cost of corporate income tax of $51.1 million ($ nominal) for the 2023–28 period using our PTRM,[9] and with the following inputs:

- an opening TAB value as at 1 July 2023 of $1043.7 million ($ 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. AusNet has separately calculated the remaining lives for the new asset classes of 'Capitalised leases 1 July 2023', 'Transmission pipelines – post 1998', 'Distribution pipelines – post 1998', 'Service pipes – post 1998' and 'Cathodic protection – post 1998'. These asset classes generally reflect reallocations of existing assets from broader asset groupings or new treatment.
- for the existing asset classes of 'Transmission pipelines', 'Distribution pipelines', 'Service pipes', 'Cathodic protection' and 'Supply regulators/Valve stations', AusNet proposed to apply the 20 year cap to the standard tax asset lives. For all other asset classes, AusNet 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.
- for the new asset classes of 'Transmission pipelines – post 1998', 'Distribution pipelines – post 1998', 'Service pipes – post 1998' and 'Cathodic protection – post 1998' the 20 year cap to the standard asset lives have also been applied. For the new asset class of 'Capitalised leases 1 July 2023', AusNet did not propose a standard tax asset life as there is no forecast capex allocated to this class.

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

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

	2018	2019	2020	2021	2022[a]	2023[b]
Opening TAB	707.3	763.5	815.6	868.7	941.0	1000.7
Capital expenditure[c]	101.5	102.5	98.7	110.2	102.4	60.7
Less: tax depreciation	45.4	50.3	45.7	37.9	42.7	22.5
Closing TAB	**763.5**	**815.6**	**868.7**	**941.0**	**1000.7**	**1043.7**

Source: AusNet, *ASG - GAAR 2018-23 RFM (5.5 Years)*, 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.

9 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 7.2 sets out AusNet's proposed cost of corporate income tax for the 2023–28 period.

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

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
Tax payable	27.7	22.9	22.2	24.2	26.2	123.2
Less: value of imputation credits	16.2	13.4	13.0	14.1	15.3	72.1
Net corporate income tax	**11.5**	**9.5**	**9.2**	**10.0**	**10.9**	**51.1**

Source: AusNet, *ASG – GAAR 2024-28 PTRM*, 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 AusNet.[10] Our estimate is the taxable income a benchmark efficient entity would earn for providing reference services if it operated AusNet'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.[11] 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.[12] They also incorporate several 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.[13]

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.[14]

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[15] and involves the following steps:[16]

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

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10 NGR, r. 87A(1).

11 NGR, r. 75A.

12 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.

13 NGR, r. 75A.

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

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

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

the approved forecast revenues for the gas pipeline service provider that we determined using the building block approach.[17]

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[18]
   - 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, AusNet'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[19] 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 forecast to be commissioned.[20] 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.

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17 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.

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

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

20 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.

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 AusNet's actual capex incurred during the 2018–23 period, and the final year (2017) of the previous access arrangement period.[21] 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 review.[22] 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.[23] 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

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21 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.

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

23 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 AusNet's 2018–22 access arrangement and extension period remains appropriate for use in the roll forward of the TAB to 1 July 2023.

assets.[24] We consider that the standard tax asset lives for AusNet should be consistent with the ATO taxation ruling 2022/1 regarding the effective life of depreciating assets where possible.[25]

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.[26] 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.[27]

- **Income tax rate:** The statutory income tax rate is 30% per annum for businesses of the size we regulate, which was adopted in AusNet's proposal.
- **Value of gamma:** The gamma input for AusNet 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 AusNet's proposal.[28] 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 $8.6 million ($2022–23) is to be carried forward at the start of the 2023–28 period for AusNet.

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24 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.

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

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

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

28 AER, *Rate of return instrument*, December 2018, p. 19.

- **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.[29] 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:[30]

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

  where:

  D_t is the tax depreciation in year t

  $D_0 = 0$

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

  $i = year\ 0$

  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[31] 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.[32] Further, the gas pipeline service provider may propose

29 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.

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

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

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

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.[33] This includes new buildings and structural improvements to existing buildings.[34] 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. AusNet 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.[35] 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.[36] However, capex associated with other IT assets such as computer hardware is not consistent with the definition of in-house software, and therefore is required to be depreciated using the diminishing value method in the PTRM. AusNet did not propose this type of capex for the 2023–28 period.

In assessing AusNet's proposal, we have had regard to the National Gas Objective (NGO) and the revenue and pricing principles.[37] 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.[38]

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

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

34 ITAA, section 43.20.

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

36 ITAA, section 995.1.

37 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.

38 NGR, r. 74(2).

- 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.[39] Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.[40]

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 $32.9 million ($ nominal) for AusNet over the 2023–28 period. This represents a decrease of $18.2 million from AusNet's proposal of $51.1 million.

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[39] 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.

[40] 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.

In its proposal, AusNet 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 $8.6 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 determine an opening TAB as at 1 July 2023 of $1048.8 million for AusNet. We accept AusNet's approach for establishing the opening TAB. However, we have updated AusNet's proposed final year asset adjustment for capitalised leases and included SaaS expenditures as capex additions to the TAB to be consistent with our treatment for the capital base.[41]

We accept AusNet's proposed forecast immediately expensed capex of $13.3 million. This is because we consider AusNet's approach of immediately expensing overheads over the 2023–28 period is reasonable and consistent with its historical treatment.

We accept AusNet's proposed standard tax asset lives for all of its existing asset classes. However, we partly accept AusNet's proposal to create new asset classes and standard asset lives for tax depreciation of certain new assets (section 7.4.2and 7.4.4). We also accept AusNet'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 AusNet'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.[42]

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.

AusNet 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.[43] Our assessment of the tax inputs submitted by AusNet are discussed below.

Forecast immediate expensing of capex

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[41] Our assessment for the final year asset adjustment for capitalised leases is discussed in Attachment 2 of this draft decision. Our assessment of the treatment of SaaS expenditures is discussed in Attachments 2 and 8.

[42] NGR, r. 87A.

[43] AusNet, *ASG - GAAR 2024-28 PTRM*, September 2022.

AusNet proposed that $13.3 million ($2022–23) of forecast capex (2.6% of total capex)[44] will be immediately expensed for tax purposes for the 2023–28 period.[45]

We accept AusNet's proposed method of immediately expensing overheads for tax purposes, as this is consistent with the immediately expensed capex amounts reported in its annual RINs over the current period. We consider it reasonable to expect that the same type of capex immediately expensed by AusNet in the current period will also be expensed immediately during the 2023–28 period.

As discussed in Attachment 5, we have accepted AusNet's proposed forecast capex for the 2023–28 period. Our draft decision is to therefore also accept the proposed amount of forecast immediate expensing of capex.

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 AusNet.

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.[46] 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.

In its proposal, AusNet submitted that $1.5 million ($2022–23) of forecast capex associated with equity raising costs are to be exempted from the diminishing value tax depreciation method. We accept this exemption, while approving a lower equity raising cost amount of $0.02 million.

We therefore allocate the forecast benchmark equity raising costs to be depreciated using the straight-line method for tax depreciation purposes. This is because equity raising costs satisfy the definition under section 40.880 of the ITAA and in ATO Taxation Ruling 2011/6.[47]

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.[48]

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44 Compared with the proposed gross capex of $505.9 million ($2022–23).

45 AusNet, *ASG - GAAR 2024-28 PTRM*, September 2022.

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

47 ATO, *Taxation Ruling 2011/6*, July 2016

48 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.

AusNet's proposed standard tax asset lives for its gas pipeline assets (applying to the 'Transmission pipelines', 'Distribution pipelines', 'Service pipes', 'Cathodic protection', 'Supply regulators/Valve stations' and 'Cathodic protection – post 1998' asset classes) over the 2023–28 period are capped at 20 years, reflecting our new regulatory tax approach. We therefore accept AusNet'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 AusNet's proposed method to establish the opening TAB as at 1 July 2023. This is because AusNet's proposed approach is based on our RFM and consistent with that previously approved for the 2018–23 period. Based on the proposed approach, we have determined AusNet's opening TAB value as at 1 July 2023 of $1048.8 million ($nominal). This represents an increase of $5.2 million compared to AusNet's proposal.

We have reviewed the inputs to the TAB roll forward. We found the inputs were correct and reconciled with relevant data sources, such as historical data RINs and the 2018–23 decision models. However, we have updated AusNet's proposed final year asset adjustment for capitalised leases to the TAB to be consistent with the adjustment for the capital base.[49] This is because the capital base adjustment of $5.3 million ($2022–23) represents the present value of its existing leases as at 30 June 2023, which we consider is also applicable for tax purposes.

For the reasons discussed in Attachments 2 and 8, we do not approve of AusNet's approach to mid-period changes in capitalisation. AusNet proposed to reclassify SaaS expenditures for 2021, 2022 and 2023 half year extension period as opex which was previously treated as capex. As discussed in Attachment 8, our draft decision approach is to maintain the current capitalisation treatment consistent with the basis approved in the 2018–23 period, and allocate capex and opex costs accordingly. We will then apply the new capitalisation changes from the start of the 2023–28 period. AusNet has indicated it has no concerns with our approach.[50] As a result, we have reinstated SaaS related capex of $3.1 million, $2.5 million and $0.4 million ($ nominal) for 2021, 2022 and 2023 half year period respectively to the 'Other – IT' asset class to be rolled into the TAB over the 2018–23 period.

We have removed the proposed 'Transmission pipelines – post 1998', 'Distribution pipelines – post 1998', 'Service pipes – post 1998' new asset classes and reallocated the amounts to their respective original 'Transmission pipelines', 'Distribution pipelines' and 'Service pipes' asset classes. This is consistent with our decision on the capital base to reject these new asset classes with shorter lives. However, we accept the reallocation of $6.3 million ($2022–23) from the 'Cathodic protection' asset class to 'Cathodic protection – post 1998' asset class, with the same tax standard life of 20 years.

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.

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49 Our assessment for the final year asset adjustment for capitalised leases is discussed in Attachment 2 of this draft decision.

50 AusNet, *Response to information request #017*, October 2022, p. 4.

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 AusNet'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 AusNet's TAB values over the 2018–23 period.

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

	2018	2019	2020	2021	2022[a]	2023[b]
Opening TAB	707.3	763.5	815.6	868.7	944.1	1005.6
Capital expenditure[c]	101.5	102.5	98.7	113.3	104.9	61.1
Less: tax depreciation	45.4	50.3	45.7	37.9	43.4	23.2
Closing TAB	**763.5**	**815.6**	**868.7**	**944.1**	**1005.6**	**1048.8**

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 AusNet'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.

However, we have updated the remaining tax asset lives to reflect our amendments to the TAB roll forward as discussed in section 7.4.2. We will update the 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.

We do not accept AusNet's proposed tax remaining life of 6.2 years for the 'Capitalised leases 1 July 2023' asset class. We have instead determined a remaining tax asset life of 6.6 years based on the average remaining lease terms for AusNet's existing leases (and therefore reflecting the economic lives) included in the capital base as a final year asset adjustment. We are satisfied that this approach is consistent with the ATO guidance on determining the effective life of an asset for tax purposes.[51]

We also accept the proposed remaining tax asset life of 20.7 years for the new 'Cathodic protection - post 1998' asset class. This is because the original 'Cathodic protection' asset class had a remaining life of 20.7 years calculated under the weighted average method, and

[51] ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022),* p. 9; ITAA 1997, section 40.105.

the value of the tax assets for this asset class at 1 July 2023 has been reallocated to the new asset class.

Table 7.4 sets out our draft decision on the remaining tax asset lives at 1 July 2023 for AusNet. 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.[52]

7.4.4 Standard tax asset lives

We accept AusNet'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[53]
- for non-pipeline asset classes—consistent with approved standard tax asset lives for the 2018–23 period.

We accept AusNet's proposal to create a new 'Capitalised Leases 1 July 2023' asset class to account for the change in accounting standards (AASB 16) requiring certain lease costs to be capitalised.[54] However, consistent with AusNet's proposal we have not assigned a standard tax asset life for this asset class because there is no forecast capex allocated to this asset class in the 2023–28 period.

We accept AusNet's proposal to create a new 'Cathodic protection - post 1998' asset class for the 2023–28 period. This is because we consider the progressive adoption of plastic mains reduces the need for cathodic protections. Our draft decision is to assign a standard tax asset life of 20 years for this asset class, consistent with AusNet's proposal and the 20 year asset life cap.

However, we do not accept the creation of new asset classes for 'Transmission pipelines - post 1998', 'Distribution pipelines - post 1998' and 'Service pipes - post 1998'. For the reasons discussed in Attachment 4, we are not satisfied that these asset classes are required for the purposes of assigning shorter asset lives for accelerated depreciation of these assets in the capital base. Therefore, these asset classes are also not required for tax purposes and so no standard tax asset lives are required for approval.

Our draft decision on AusNet'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

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52 NGR, r. 87A(1).

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

54 For example, such as property, office equipment and motor vehicles.

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.[55]

Table 7.4 AER's draft decision on AusNet'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]
Transmission pipelines	20.0	26.3
Distribution pipelines	20.0	33.6
Service pipes	20.0	36.7
Supply regulators/Valve stations	20.0	30.9
Meters	15.0	12.1
SCADA and remote control	10.0	8.0
Other - IT	4.0	3.0
Other - non-IT	4.0	3.5
Buildings	35.0	12.2
Land	n/a	n/a
Capitalised leases 1 July 2023	n/a	6.6
Cathodic protection - post 1998	20.0	20.7
Equity raising costs	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.

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 or there is no forecast capex 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 AusNet'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.

55 NGR, r. 87A(1).

Glossary

Term	Definition
2018 tax review	2018 review of the regulatory tax approach
AER	Australian Energy Regulator
ATO	Australian Tax Office
AusNet	AusNet Gas Services
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
SaaS	Software as a Service
TAB	Tax asset base