



**DRAFT DECISION**

**AusNet Services**  
**Transmission Determination**  
**2022 to 2027**

**Attachment 7**  
**Corporate income tax**

June 2021

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## Note

This attachment forms part of the AER's draft decision on AusNet Services' 2022–27 transmission determination. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset 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 benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management innovation allowance mechanism

Attachment 12 – Pricing methodology

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## 7 Corporate income tax

Our revenue determination includes the estimated cost of corporate income tax for AusNet Services' 2022–27 regulatory control period.<sup>1</sup> Under the post-tax framework, the cost of corporate income tax is calculated as part of the building block assessment using our post-tax revenue model (PTRM). This amount allows AusNet Services to recover the costs associated with the estimated corporate income tax payable during the 2022–27 regulatory control period.

This attachment presents our assessment of AusNet Services' proposed cost of corporate income tax for the 2022–27 regulatory control period. It also presents our assessment of its proposed opening tax asset base (TAB), and its proposed standard and remaining tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

### 7.1 Draft decision

Our draft decision on the estimated cost of corporate income tax is \$11.2 million over the 2022–27 regulatory control period. This decision represents an increase of \$10.1 million from AusNet Services' proposal of \$1.1 million. The key reasons for the increase are:

- increase to the rate of return on equity (attachment 3)<sup>2</sup>
- reduction to the forecast immediately expensed capex (section 7.4.1)<sup>3</sup>
- reduction to the proposed opening TAB as at 1 April 2022 (section 7.4.2)<sup>4</sup>
- reallocation of some forecast capex which meets the requirements of sections 43.15, 43.140 and 43.210 of the *Income Tax Assessment Act 1997* (ITAA) from the existing 'Premises' asset class into a new asset class labelled 'Buildings - capital works', which depreciates using the straight-line method rather than the diminishing value method for tax purposes (section 7.4.3).<sup>5</sup>

Our draft decision on the forecast tax amount for the 2022–27 regulatory control period is significantly lower than that forecast for the 2017–22 regulatory control period. This

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<sup>1</sup> NER, cl. 6A.5.4(a)(4).

<sup>2</sup> All else being equal, a higher rate of return on equity will increase the cost of corporate income tax because it increases the return on equity, a component of the taxable income.

<sup>3</sup> All else being equal, a lower immediately expensed capex amount will increase the cost of corporate income tax because it reduces the tax expense.

<sup>4</sup> All else being equal, a lower opening TAB value will reduce the tax depreciation, a component of the tax expense, and increase the cost of corporate income tax.

<sup>5</sup> All else being equal, the reallocation of capex from an asset class subject to diminishing value tax depreciation to straight-line tax depreciation reduces the tax depreciation in the short term (first 5 years of the asset's life). This increases the taxable income and therefore the cost of corporate income tax. In this case, the forecast capex to be allocated is around \$4 million over 5 years. Therefore, the impact of the reallocation is a relatively small amount of around \$0.1 million.

change is mostly due to the implementation of our findings from the 2018 *Review of the regulatory tax approach*, where the introduction of immediate expensing of capital expenditure (capex) and diminishing value method of tax depreciation have resulted in a significant increase of forecast tax depreciation.

We accept AusNet Services' proposed standard tax asset lives for all existing asset classes for the 2022–27 regulatory control period. These proposed standard tax asset lives are the same as the approved standard tax asset lives for the 2017–22 regulatory control period and are broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in Australian Tax Office (ATO) Taxation Ruling 2020/3.

In addition to the existing asset classes, AusNet Services proposed 14 new asset classes for the 2022–27 regulatory control period.<sup>6</sup> We accept AusNet Services' proposed new asset classes and associated standard tax asset lives, with the exception of the proposed standard tax asset lives for new asset classes for future insulators and instrument transformers (section 7.4.3).

We also accept AusNet Services' proposed weighted average method to calculate the remaining tax asset lives as at 1 April 2022. This method is a continuation of the approved approach used in the 2017–22 regulatory control period and applies the approach as set out in our roll forward model (RFM). In accepting the weighted average method, we have updated AusNet Services' proposed remaining tax asset lives to reflect our adjustments to its opening TAB value as at 1 April 2022 (section 7.4.2). Further, we accept AusNet Services' proposed remaining tax asset lives for its new asset classes associated with capitalised leases, and the accelerated depreciation of insulators and instrument transformers that are to be decommissioned. However, we do not accept the proposed remaining tax asset lives for the new asset classes associated with the accelerated depreciation of other existing insulators and instrument transformers (section 7.4.4).

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 attachment 1.

Table 7.1 sets out our draft decision on the estimated cost of corporate income tax for AusNet Services over the 2022–27 regulatory control period.

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<sup>6</sup> These asset classes included one new asset class using the straight-line method of tax depreciation for in-house software and six new asset classes associated with the proposed accelerated depreciation of insulators and instrument transformers. The remaining seven asset classes are used to record the residual value of existing capitalised leases and the forecast capitalised value of leases for the 2022–27 regulatory control period.

**Table 7.1 AER's draft decision on AusNet Services' cost of corporate income tax for the 2022–27 regulatory control period (\$million, nominal)**

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Tax payable	7.8	3.6	4.0	6.1	5.5	27.0
Less: value of imputation credits	4.6	2.1	2.3	3.6	3.2	15.8
<b>Net cost of corporate income tax</b>	<b>3.2</b>	<b>1.5</b>	<b>1.7</b>	<b>2.5</b>	<b>2.3</b>	<b>11.2</b>

Source: AER analysis.

## 7.2 AusNet Services' proposal

AusNet Services proposed an estimated cost of corporate income tax of \$1.1 million (\$nominal) for the 2022–27 regulatory control period using our PTRM,<sup>7</sup> and with the following inputs:<sup>8</sup>

- an opening TAB value as at 1 April 2022 of \$2843.6 million (\$nominal)
- an expected statutory income tax rate of 30 per cent per year
- a value of imputation credits (gamma) of 0.585
- application of version 4 of the PTRM released in April 2019 which applies the diminishing value method for tax depreciation to all new depreciable assets except for forecast capital expenditure (capex) associated with buildings,<sup>9</sup> and recognises the immediate expensing of certain capex for tax purposes.
- immediately expensed capex amount of \$42.4 million (\$2020–21)
- remaining tax asset lives of assets in existence as at 30 March 2022 calculated using a weighted average remaining life approach as set out in our RFM
- the same standard tax asset lives for tax depreciation purposes of new assets for its existing asset classes in the 2022–27 regulatory control period as approved for the 2017–22 transmission determination
- 14 new asset classes and associated tax asset lives related to in-house software, accelerated depreciation and capitalised leases for the 2022–27 regulatory control period.

Table 7.2 sets out AusNet Services' proposed cost of corporate income tax for the 2022–27 regulatory control period.

<sup>7</sup> This model now 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.

<sup>8</sup> AusNet Services, *Revenue Proposal 2023–27, Post Tax Revenue Model - Revised*, February 2021.

<sup>9</sup> All assets acquired prior to 1 April 2022 will continue to be depreciated using the straight-line depreciation method for regulatory tax purposes, until these assets are fully depreciated.

**Table 7.2 AusNet Services' proposed cost of corporate income tax for the 2022–27 regulatory control period (\$million, nominal)**

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Tax payable	2.8	0.0	0.0	0.0	0.0	2.8
Less: value of imputation credits	1.6	0.0	0.0	0.0	0.0	1.6
<b>Net cost of corporate income tax</b>	<b>1.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>1.1</b>

Source: AusNet Services, *Revenue proposal 2022–27, Post Tax Revenue Model Revised*, February 2021.

### 7.3 Assessment approach

We make an estimate of taxable income for each regulatory year as part of our determination of the annual building block revenue requirement for AusNet Services' 2022–27 regulatory control period.<sup>10</sup> Our estimate is the taxable income that a benchmark efficient entity would earn for providing prescribed services if it operated AusNet Services' business and is determined in accordance with the PTRM. Our draft decision used version 5 of the PTRM, which was published after AusNet Services submitted its revenue proposal.<sup>11</sup> This new version of the PTRM gives effect to the changes set out in the AER's final position paper on the treatment of inflation in its regulatory framework.<sup>12</sup>

In May 2018, we commenced a review of our regulatory tax approach (tax review). We released the final report of the tax review in December 2018, which identified some required changes to our approach to estimating tax depreciation expenses in our regulatory models (PTRM and RFM).<sup>13</sup> The changes to our regulatory tax approach require amending our models to:<sup>14</sup>

- recognise immediate tax expensing of some capex forecast for a regulatory control period
- adopt the diminishing value (DV) method for tax depreciation to all future capex except for a limited number of assets which must be depreciated using the straight-line depreciation method under the tax law.<sup>15</sup>

The above changes to the regulatory tax approach was implemented in version 4 of the PTRM, which AusNet Services used for its revenue proposal. In April 2021, we

<sup>10</sup> NER, cl. 6A.6.4

<sup>11</sup> AER, *Electricity transmission network service providers: Post-tax revenue model (version 5)*, 7 April 2021.

<sup>12</sup> AER, *Final position: Regulatory treatment of inflation*, 17 December 2020, pp. 6–8.

<sup>13</sup> 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 TNSP's tax asset base which is an input to the PTRM for the calculation of the tax building block.

<sup>14</sup> Capping of gas asset tax lives was also a finding from the final report, but does not require a model change.

<sup>15</sup> We will continue to apply straight-line tax depreciation for assets acquired prior to 1 July 2022 for the 2022–27 regulatory control period and until they are fully depreciated.



published a new version of the PTRM (version 5), after the submission of AusNet Services' revenue proposal. This new version of the PTRM applies the same regulatory tax approach as version 4 but implements the changes set out in the AER's final position paper on the treatment of inflation in its regulatory framework.<sup>16</sup> Accordingly, our draft decision used version 5 of the PTRM to forecast AusNet Services' cost of corporate income tax over the 2022–27 regulatory control period.<sup>17</sup>

Our tax review final report stated that the required changes to the tax depreciation approach would only apply to new assets created in future regulatory control periods.<sup>18</sup> The 2022–27 regulatory control period is the first period for AusNet Services after the release of the tax review final report. Therefore, only changes to the PTRM were required when adopting the new tax approach. As such, no immediate change to the TAB roll forward would be required until the subsequent regulatory control period.<sup>19</sup>

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

Our approach for calculating a transmission network service provider's (TNSP's) estimated cost of corporate income tax is set out in our PTRM<sup>20</sup> and involves the following steps:<sup>21</sup>

1. we estimate the annual assessable income (taxable revenue) that would be earned by a benchmark efficient entity operating the TNSP's business. This is the approved forecast revenues for the transmission business that we determined using the building block approach.<sup>22</sup>
2. we then estimate the benchmark tax expenses such as operating expenditure (opex), interest expense, tax depreciation in the following ways:
  - operating expense is set equal to the opex building block<sup>23</sup>

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<sup>16</sup> The changes to the regulatory treatment of inflation does not have a direct impact on the cost of corporate income tax. See AER, *Final position: Regulatory treatment of inflation*, 17 December 2020, pp. 6–8.

<sup>17</sup> AER, *Electricity transmission network service providers: Post-tax revenue model (version 5)*, 7 April 2021.

<sup>18</sup> AER, *Final report, Review of regulatory tax approach*, December 2018, p. 73.

AER, *Explanatory statement, Electricity transmission and distribution network service providers Proposed amendments to the roll forward models (Distribution - version 3) (Transmission - version 4), Appendix A*, April 2020.

<sup>19</sup> In this case, the diminishing value method and the immediate expensing of certain capex did not apply for AusNet Services' TAB roll forward for the 2017–22 regulatory control period. The changes to the regulatory tax approach under version 4 of the RFM will apply in the subsequent reset to roll forward the TAB for AusNet Services during the 2022–27 regulatory control period.

<sup>20</sup> AER, *Transmission PTRM (version 5)*, April 2021.

<sup>21</sup> The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NER, cl. 6A.5.3(b)(4).

<sup>22</sup> 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. It may also include other revenue adjustments, but the assessment of whether they should give rise to a tax cost will occur on a case by case basis.

<sup>23</sup> Our assessment approach for the opex building block is discussed in attachment 6 of the draft decision.

- interest expense is a function of the size of the regulatory asset base (RAB), the benchmark gearing assumption (60 per cent) and the regulated cost of debt
- tax depreciation expense is calculated using a separate value for the TAB, and standard and remaining tax asset lives for taxation purposes. Previously, the PTRM applied the straight-line method for calculating tax depreciation for all assets. Consistent with the findings of the tax review, the PTRM (version 5) applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method<sup>24</sup> for all assets acquired after 30 March 2022 except for in-house software, buildings and equity raising costs. The expenditure for these assets are to be depreciated using the straight-line method under the tax law. The PTRM (version 5) 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 incurred.<sup>25</sup> 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 tax cost 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 TNSP's business by subtracting the benchmark estimates of tax expenses (step 2) from the approved forecast revenues for the transmission business (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 cost of corporate income tax and is included as a separate building block in determining the TNSP's annual building block revenue requirement.

### ***How we assess the tax inputs to the PTRM***

The estimated cost of corporate income tax is an output of our PTRM. We therefore assess the TNSP's proposed cost of corporate 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 2017–22 regulatory

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<sup>24</sup> For more explanation of how we calculate depreciation using the diminishing value method, please see: AER, *Transmission PTRM handbook*, April 2019, pp. 22–23.

<sup>25</sup> 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.

control period, our amended PTRM (version 5) 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:

- **the opening TAB as at the commencement of the 2022–27 regulatory control period:** We consider that the roll forward of the opening TAB should be based on the approved opening TAB as at 1 April 2017 and AusNet Services' actual capex incurred during the 2017–22 regulatory control period, and the final year (2016–17) of the previous regulatory control period.<sup>26</sup> As noted above, we do not adjust the TAB value for immediate expensing of past capex in the roll forward process over the 2017–22 period. This is consistent with our final report for the tax review and our 2017–22 transmission determination which applied straight-line tax depreciation to capex commissioned during that period as prescribed in the PTRM.

The roll forward of the opening TAB for 2017–22 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 determination for the purposes of this draft decision. We have published the amended RFM (version 4) implementing the findings of the tax review.<sup>27</sup> We expect that the approach set out in this version of the RFM will be used for the purposes of the TAB roll forward for 2022–27 at the next reset.

The opening TAB value at 1 April 2022 is used to estimate forecast tax depreciation for the 2022–27 regulatory control 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. However, for all new assets forecast to be added to the TAB in the 2022–27 regulatory control period (with some exceptions discussed further below), we will apply the diminishing value method of tax depreciation.

- **the standard tax asset life for each asset class:** Our assessment of a TNSP's proposed standard tax asset lives is generally guided by the effective life of depreciating assets determined by the Commissioner for Taxation. We consider that the standard tax asset lives for the majority of AusNet Services' asset classes should be consistent with the ATO Taxation Ruling 2020/3 regarding the effective life of depreciating assets where possible.<sup>28</sup>

As discussed above, the PTRM (version 5) applies the diminishing value tax depreciation method for all new assets except for in-house software, buildings and

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<sup>26</sup> 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 reset.

<sup>27</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-roll-forward-models-transmission-and-distribution-2020-amendment/final-decision>.

<sup>28</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2020)*.

equity raising costs. It provides designated asset classes for these assets to be depreciated using the straight-line method for tax purposes.<sup>29</sup> We note that the tax effective lives for in-house software, buildings and equity raising costs are not covered under the ATO Taxation Ruling 2020/3. Therefore, our assessment of the standard tax asset lives for these asset classes are guided by the ITAA. Specifically, we consider that the standard tax asset life should be:

- 40 years for buildings – This is consistent with the number of years required to completely depreciate a capital works asset 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 subsection 40.95(7) of the ITAA
  - 5 years for equity raising costs – This is consistent with section 40.880 of the ITAA.
- **the income tax rate:** The statutory income tax rate is 30 per cent per year, which was adopted in AusNet Services' proposal.
  - **the value of gamma:** The gamma input for AusNet Services is 0.585 for this draft decision. This is consistent with the 2018 *Rate of return instrument*, which requires us to use a gamma value of 0.585, and adopted in AusNet Services' proposal.<sup>30</sup> Refer to attachment 3 for further discussion on this matter.
  - **the size and treatment of any tax losses as at 1 April 2022:** Where a business has tax losses, we require the provision of this value to determine the appropriate estimated taxable income for a regulatory control period. If there is an amount of tax losses accumulated, the forecast taxable income for the regulatory control period will be reduced by this amount. AusNet Services does not have any accumulated tax losses as at the start of the 2022–27 regulatory control period.<sup>31</sup>
  - **forecast immediate expensing of capex:** The PTRM (version 5) requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2022–27 regulatory control period. Our assessment of forecast immediate expensing of capex will be guided by the TNSP's actual immediate expensing of capex from the previous regulatory control period.<sup>32</sup> We will collect actual data relating to this expenditure in our annual regulatory accounts to further inform our decision on the amount of forecast immediate expensing of capex in future regulatory determinations. Benchmarking may also be considered going forward.<sup>33</sup>

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<sup>29</sup> Our assessment approach on new assets to be exempted from the DV method is discussed in detail below.

<sup>30</sup> AER, *Rate of return instrument*, December 2018, p. 19.

<sup>31</sup> AusNet Services, *Revenue Proposal 2023–27, Post Tax Revenue Model Revised*, February 2021.

<sup>32</sup> 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.

<sup>33</sup> AER, *Final report, Review of regulatory tax approach*, December 2018, pp. 66–67.

- **diminishing value multiplier:** The PTRM (version 5) applies the DV method of tax depreciation and provides an input section for the 'diminishing value multiplier' to be recorded for each year of the regulatory control period. We note that currently the diminishing value multiplier is set at 200 per cent by the ATO.
- **new assets to be exempted from the diminishing value method:** The PTRM (version 5) applies the diminishing value method for tax depreciation purposes to all new depreciable assets except for certain assets. It provides for 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 cost for equity raising costs should not be depreciated using the diminishing value method. We note that section 40.880 of the ITAA and the ATO's Taxation Ruling 2011/6<sup>34</sup> 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.<sup>35</sup> Further, the TNSP 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.<sup>36</sup> We note that this includes new buildings and structural improvements to existing buildings.<sup>37</sup> 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
- **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.<sup>38</sup> We note that this includes computer software, or the right to use computer software that the TNSP acquires, develops or has someone else develop for the TNSP's business use.<sup>39</sup> However, capex associated with other IT assets such as computer hardware is not consistent

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<sup>34</sup> ATO, *Taxation Ruling 2011/6*, July 2016.

<sup>35</sup> The benchmark cost for equity raising costs is determined within the PTRM.

<sup>36</sup> ATO, *Taxation Ruling 97/25*, July 2017.

<sup>37</sup> ITAA, section 43.20.

<sup>38</sup> ATO, *Taxation Ruling 2016/3*, October 2018.

<sup>39</sup> ITAA, section 995.1.

with the definition of in-house software, and therefore is required to be depreciated using the diminishing value method in the PTRM.

### 7.3.1 Interrelationships

The cost of corporate income tax building block feeds directly into the annual building block revenue requirement. This cost 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 cost of corporate income tax.

Of these factors, the corporate tax rate is set externally by the Government. The higher the tax rate the higher the required cost of corporate income 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.<sup>40</sup> Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.<sup>41</sup>

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 RAB funded through debt. It also depends on the allowed return on debt and the size of the RAB
- general expenses – these expenses generally will match the opex including any revenue adjustments, but the assessment of whether they should be treated as a tax expense occurs on a case by case basis

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<sup>40</sup> 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 the cost of corporate income tax become stable.

<sup>41</sup> 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 cost of corporate income tax in proportion to the company tax rate.



- tax depreciation – a separate TAB is maintained for the TNSP reflecting tax rules. This TAB is affected by many of the same factors as the RAB, such as capex, although unlike the RAB 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 generate a tax loss. A tax loss can be carried forward to offset against tax payable in the future.

## 7.4 Reasons for draft decision

Our draft decision on the estimated cost of corporate income tax is \$11.2 million over the 2022–27 regulatory control period. This represents an increase of \$10.1 million from AusNet Services' proposal of \$1.1 million. The key drivers of this increase are discussed in the following sections.

### 7.4.1 Implementation of the tax review

The amended PTRM (version 5) provides for two new inputs which affect the calculation of tax depreciation compared to the current 2017–22 regulatory control period:

- **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.<sup>42</sup>

Our assessment of the new tax inputs submitted by AusNet Services are discussed below.

#### Forecast immediate expensing of capex

AusNet Services proposed that \$42.4 million (\$2021–22) of forecast capex (5.1 per cent of total capex)<sup>43</sup> will be immediately expensed for tax purposes in the 2022–27 regulatory control period.<sup>44</sup>

We accept AusNet Services' proposed method to calculate its forecast immediate expensing of capex. AusNet Services has set the forecast immediate expensing capex equal to the forecast amount of capitalised overheads.<sup>45</sup> This is the same approach it used to calculate the value of immediate expensing capex included in its income tax

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<sup>42</sup> The buildings asset class may be classified as system or non-system assets in the PTRM.

<sup>43</sup> Compared with the proposed gross capex of \$833.4 million (\$2021–22) on an as-commissioned basis.

<sup>44</sup> AusNet Services, *Revenue Proposal 2023–27, Post Tax Revenue Model - Revised*, February 2021.

<sup>45</sup> AusNet Services, *2023–27 Regulatory Proposal*, 29 October 2020, p. 225.

returns since 2018–19.<sup>46</sup> We consider it reasonable to expect that the same type of capex will also be deducted immediately by AusNet Services for its annual tax returns during the 2022–27 regulatory control period.

As discussed in attachment 5, we have reduced AusNet Services' proposed forecast capex by 5.5 per cent.<sup>47</sup> This includes a reduction of forecast capitalised overheads by \$0.4 million (\$2021–22).<sup>48</sup> Our draft decision is to therefore reduce the proposed amount of forecast immediate expensing capex to reflect our draft decision on the overall forecast capex. This resulted in a reduction of the forecast immediately expensed capex to \$41.9 million from \$42.4 million (\$2021–22) for the 2022–27 regulatory control period.<sup>49</sup>

We will collect actual data relating to the immediately expensing of capex in our annual reporting regulatory information notices to further inform our decision for this type of expenditure in the next regulatory determination for AusNet Services.

### **Assets exempt from the diminishing value method**

The PTRM (version 5) applies the straight-line tax depreciation method to the opening TAB at 1 April 2022, but applies the diminishing value method as the regulatory benchmark for tax depreciation to all new capex.<sup>50</sup> However, as discussed above, there are some exceptions to this approach under the tax law such as assets relating to in-house software, buildings (capital works) and equity raising costs.<sup>51</sup> In the PTRM, the benchmark equity raising costs is determined within the model and depreciated using the straight-line tax depreciation method as default.

In its proposal, AusNet Services submitted that \$67.1 million (\$2021–22) of forecast capex associated with in-house software are to be exempted from the diminishing value tax depreciation method. In response to our information request, AusNet Services further identified that \$4.2 million (\$2021–22) million of forecast capex associated with buildings should be reallocated from the existing 'Premises' asset class to the prescribed 'Buildings – capital works' straight-line tax depreciation asset class in the PTRM.

We accept AusNet Services' proposed allocation of forecast capex for in-house software and buildings (capital works) to be depreciated using the straight-line method for tax depreciation purposes, while approving a lower capex amount of \$66.4 million

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<sup>46</sup> AusNet Services, *Regulatory Information Notice – Basis of Preparation 2023-27 Transmission Revenue Reset*, October 2020, p. 11.

<sup>47</sup> The 5.5 per cent reduction is calculated for capex recognised on an as-incurred basis. The corresponding reduction for capex recognised on an as-commissioned basis is 5.3 per cent, which is used to calculate the tax depreciation.

<sup>48</sup> Please see section 5.3 of attachment 5 of this draft decision for details.

<sup>49</sup> All else 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 AusNet Services).

<sup>50</sup> AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76.

<sup>51</sup> Asset classes 47, 48, 49 and 50 in the PTRM (version 5) provide for this.



and \$4.2 million (\$2021–22) respectively. This is because the proposed forecast capex for:

- in-house software satisfies the definition under section 995.1 of the ITAA and in ATO Taxation Ruling 2016/3<sup>52</sup>
- buildings satisfies the definition of a capital work under section 43.20 of the ITAA and in ATO Taxation Ruling 97/25.<sup>53</sup>

Therefore, these assets are not required to be depreciated using the diminishing value method for tax purposes.

## 7.4.2 Opening tax asset base as at 1 April 2022

We accept AusNet Services' proposed method to establish the opening TAB as at 1 April 2022. Based on the proposed approach, we have determined AusNet Services' opening TAB value as at 1 April 2022 of \$2842.8 million (\$nominal). This represents a decrease of \$0.9 million (or less than 0.1 per cent) compared to its proposal.

We have reviewed the inputs to the TAB roll forward and found that they were mostly correct and reconcile with relevant data sources such as annual regulatory accounts and the 2017–22 decision models. However, we made the following amendments to AusNet Services' proposed inputs to the RFM which explains the difference in our draft decision opening TAB value and that proposed by AusNet Services:

- amended the proposed tax value of the final year adjustment (end of period) consistent with our draft decision for the RAB roll forward as discussed in attachment 2. This resulted in an increase to the final year adjustment for the value of 'growth assets' rolled into the opening TAB by \$2.7 million based on the additional information provided by AusNet Services<sup>54</sup>
- removed the proposed annual capex entries for capitalised leases in respect of the 'Lease L&B 2019-20 < 20 years rem life', 'Lease L&B 2019-20 > 20 years rem life' and 'Lease L&B 2020-21' asset classes over the 2019–21 period. Consistent with our draft decision on the RAB roll forward, we do not accept AusNet Services' proposal to add the value of its capitalised leases in this manner. For the reasons discussed in attachment 2, we recorded the residual value of the capitalised leases for each respective asset class as a single value as at 30 March 2022 (end of current period). Further, we amended the calculation for the residual tax value of 2019–20 capitalised leases to account for asset disposals for that year. This reduced the opening TAB value by \$4.7 million. In its response to our information request, AusNet Services agreed with this approach.<sup>55</sup>

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<sup>52</sup> ATO, *Taxation Ruling 2016/3*, October 2018.

<sup>53</sup> ATO, *Taxation Ruling 97/25*, July 2017.

<sup>54</sup> AusNet Services, *Response to AER IR#010*, 22 February 2021.

<sup>55</sup> AusNet Services, *email response to AER Information request #006*, 19 January 2021.

Table 7.3 sets out our draft decision on the roll forward of AusNet Services' TAB values over the 2017–22 regulatory control period.<sup>56</sup>

**Table 7.3 AER's draft decision on AusNet Services' TAB roll forward for the 2017–22 regulatory control period (\$million, nominal)**

	2017–18	2018–19	2019–20	2020–21 <sup>a</sup>	2021–22 <sup>a</sup>
Opening TAB	2418.2	2403.1	2392.3	2447.0	2543.2
Capital expenditure <sup>b</sup>	105.0	116.0	177.5	219.7	144.9
Less: tax depreciation	120.1	126.9	122.8	123.4	134.8
Final year adjustments (capitalised leases)					42.7
Growth assets adjustments <sup>c</sup>					246.7
<b>Closing TAB</b>					<b>2842.8</b>

Source: AER analysis.

(a) Based on estimated capex.

(b) As-commissioned, net of disposals.

(c) Roll-in of 'growth assets' at 1 April 2022, and true-up for difference between actual and forecast growth assets rolled in at the 2017–22 determination.

### 7.4.3 Standard tax asset lives

We accept AusNet Services' proposed standard tax asset lives for its existing asset classes because they are:

- broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2020/3<sup>57</sup>
- the same as the approved standard tax asset lives for the 2017–22 regulatory control period.

In addition to the existing asset classes approved for the 2017–22 transmission determination, AusNet Services proposed 14 new asset classes for the 2022–27 regulatory control period. These included one new asset class using the straight-line method of tax depreciation for in-house software, six new asset classes related to the accelerated depreciation of insulators and instrument transformers, with the remaining seven new asset classes related to capitalised leases.

Table 7.4 sets out the list of new asset classes proposed by AusNet Services and the types of assets it proposed to allocate to each class.

<sup>56</sup> We note that the opening TAB as at 1 April 2022 may be updated to reflect actual capex for 2020–21 and any revised 2021–22 capex estimate as part of the final decision.

<sup>57</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets* (applicable from 1 July 2020).

**Table 7.4 New asset classes proposed by AusNet Services for the 2022–27 regulatory control period**

Asset class	Category
In-house software	Straight-line tax depreciation of IT assets
Insulators - Already decommissioned	Removed assets for accelerated depreciation
Insulators - Decommission 2022-2027	Assets (to be removed) for accelerated depreciation
Instrument transformers - Already decommissioned	Removed assets for accelerated depreciation
Instrument transformers - Decommission 2022-2027	Assets (to be removed) for accelerated depreciation
Insulators/Polymeric insulators	Existing assets for accelerated depreciation
Instrument transformers	Existing assets for accelerated depreciation
Lease L&B 2019-20 < 20 years rem life	Residual value of existing capitalised leases
Lease L&B 2019-20 > 20 years rem life	Residual value of existing capitalised leases
Lease L&B 2020-21	Residual value of existing capitalised leases
Lease L&B 2022-23	Forecast value of capitalised leases
Lease L&B 2023-24	Forecast value of capitalised leases
Lease L&B 2025-26	Forecast value of capitalised leases
Lease L&B 2026-27	Forecast value of capitalised leases

Source: AER analysis.

Note: AusNet Services' proposed PTRM included two asset classes labelled 'Lease L&B 2021-22' and 'Lease L&B 2024-25'. However, it did not allocate any forecast values nor assign asset lives to these asset classes. For this draft decision, we have removed these asset classes from the PTRM.

Our draft decision is to accept the addition of all proposed new asset classes, with the exception of the 'Instrument transformers' asset class. For the reasons discussed in attachment 4, we do not accept AusNet Services' proposal to shorten the standard asset life of future instrument transformers in a new asset class. We therefore removed this asset class from the PTRM and no standard tax asset life is needed.

While we accept AusNet Services' proposal to shorten the RAB standard life of future polymeric insulators in a new asset class, we have assigned a different standard life of 35 years reflecting the economic life of the assets for the reasons discussed in attachment 4. As a result, we assign a standard tax asset life of 35 years for the 'Polymeric insulators' asset class. We consider this approach of applying a standard tax asset life that reflects the economic life of the assets is consistent with the ATO's guidance on determining the effective life of an asset.<sup>58</sup>

<sup>58</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets*, p. 9; ITAA 1997, s 40.105.

In relation to AusNet Services' proposed standard tax asset lives for its new asset classes related to future capitalised leases ('Lease L&B 2022-23', Lease L&B 2023-24', 'Lease L&B 2025-26' and Lease 'L&B 2026-27') we accept them because they are consistent with the RAB standard lives, which reflect the economic lives of these assets. We are satisfied that this approach is consistent with the ATO's guidance on determining the effective life of an asset.<sup>59</sup>

Discussed in section 7.4.1, as part of the implementation of the new tax depreciation approach, we accept AusNet Services' proposal to reallocate forecast capex associated with buildings (capital works) and in-house software to the prescribed straight-line tax depreciation asset classes in the PTRM. As a consequence, we accept the proposal to assign the standard tax asset lives of:

- 40 years for buildings (capital works), as this is consistent with the number of years required to completely depreciate a capital works asset such as buildings under the ITAA<sup>60</sup>
- 5 years for in-house software, as this is consistent with the ITAA.<sup>61</sup>

Table 7.5 sets out our draft decision on the standard tax asset lives for AusNet Services. We are satisfied that the standard tax asset lives are appropriate for application over the 2022–27 regulatory control 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.<sup>62</sup>

#### 7.4.4 Remaining tax asset lives

We accept AusNet Services' proposed weighted average method to calculate the remaining tax asset lives as at 1 April 2022 for its existing asset classes. The proposed method is a continuation of the approved approach used in the 2017–22 regulatory control period and applies the approach as set out in our RFM.

In accepting the weighted average method, we have updated AusNet Services' proposed remaining tax asset lives to reflect our adjustments to AusNet Services' opening TAB value as at 1 April 2022 (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.<sup>63</sup>

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<sup>59</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets*, p. 9; ITAA 1997, s 40.105.

<sup>60</sup> ITAA, s 43.15, 43.140, 43.210.

<sup>61</sup> ITAA, s 40.95(7).

<sup>62</sup> NER, cl. 6A.6.4.

<sup>63</sup> At the time of this draft decision, the roll forward of AusNet Services' TAB includes estimated capex values for 2020–21 and 2021–22. We will update the 2020–21 estimated capex value with the actual value for the final decision, and may further update the estimate of 2021–22 capex. The capex values are used to calculate the weighted average remaining tax asset lives in the RFM. Therefore, for the final decision we will recalculate AusNet Services' remaining tax asset lives as at 1 April 2022 using the method approved in this draft decision.

For the new asset classes of 'In-house software', 'Buildings - capital works', 'Lease L&B 2022-23', 'Lease L&B 2023-24', 'Lease L&B 2025-26' and 'Lease L&B 2026-27', we have not assigned remaining tax asset lives as there are no opening tax values for these asset classes, and only forecast capex is being allocated to these asset classes over the 2022–27 regulatory control period. We therefore record 'n/a' in the PTRM for these asset classes.

For the new asset classes of 'Lease L&B 2019-20 < 20 years rem life', 'Lease L&B 2019-20 > 20 years rem life' and 'Lease L&B 2020-21' related to existing capitalised leases, we accept the proposed remaining tax asset life of 8.1 years, 46.0 years and 9.7 years respectively. These remaining tax asset lives were calculated based on the expected remaining lease terms and therefore reflect the economic lives of the capitalised leases. We are satisfied that this approach is consistent with the ATO's guidance on determining the effective life of an asset.<sup>64</sup>

For the new asset classes of 'Insulators - Already decommissioned', 'Insulators - Decommission 2022-2027', 'Instrument transformers - Already decommissioned', 'Instrument transformers - Decommission 2022-2027' related to removed (or expected to be removed) assets, we accept the proposed remaining tax asset life of 1.0 years, 5.0 years, 1.0 years and 5.0 years respectively. They are consistent with the asset lives assigned for these asset classes for regulatory depreciation purposes, reflecting the economic lives of these assets.<sup>65</sup> We are satisfied that this approach is consistent with the ATO's guidance on determining the effective life of an asset.<sup>66</sup>

For the reasons discussed in attachment 4, we do not accept AusNet Services' proposal to:

- shorten the remaining asset life of other existing instrument transformers. We therefore removed this asset class from the PTRM and no remaining tax asset life is needed
- assign a remaining tax asset life of 18.1 years for the accelerated depreciation of insulators because we have limited the accelerated depreciation of insulators to those of polymeric material. We therefore re-calculated a remaining tax asset life of 13.4 years based on the reduced scope of assets allocated to this asset class.

Table 7.5 sets out our draft decision on the remaining tax asset lives at 1 April 2022 for AusNet Services. We are satisfied that the remaining tax asset lives are appropriate for application over the 2022–27 regulatory control 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.<sup>67</sup>

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<sup>64</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets*, p. 9; ITAA 1997, Section 40.105.

<sup>65</sup> Please see section 4.4.2 of attachment 4 of this draft decision for details.

<sup>66</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets*, p. 9; ITAA 1997, s 40.105.

<sup>67</sup> NER, cl. 6A.6.4.

**Table 7.5 AER's draft decision on AusNet Services' standard and remaining tax asset lives as at 1 April 2022 (years)**

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 April 2022 <sup>b</sup>
Secondary	12.5	8.1
Switchgear	40.0	29.5
Transformers	40.0	28.6
Reactive	40.0	24.0
Towers and conductor	47.5	24.7
Establishment	40.0	31.1
Communications	12.5	9.2
Inventory	n/a	n/a
IT	3.5	2.7
Vehicles	8.0	6.5
Other (non-network)	10.0	5.3
Premises	20.0	17.2
Land	n/a	n/a
Easements	n/a	n/a
Polymeric insulators	35.0	13.4
Insulators - Already decommissioned	1.0	1.0
Insulators - Decommission 2022-2027	5.0	5.0
Instrument transformers - Already decommissioned	1.0	1.0
Instrument transformers - Decommission 2022-2027	5.0	5.0
Lease L&B 2019-20 < 20 years rem life	n/a	8.1
Lease L&B 2019-20 > 20 years rem life	n/a	46.0
Lease L&B 2020-21	n/a	9.7
Lease L&B 2022-23	25.0	n/a
Lease L&B 2023-24	19.0	n/a
Lease L&B 2025-26	31.8	n/a
Lease L&B 2026-27	15.4	n/a
Buildings - capital works	40.0 <sup>a</sup>	n/a
In-house software	5.0 <sup>a</sup>	n/a

Source: AER analysis.

- (a) These are the only asset classes used for the straight-line method of tax depreciation for new assets. All other new assets for other asset classes used 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 the 'Inventory', 'Land' and 'Easements' asset classes because the assets allocated to it are non-depreciating assets. We have not assigned a standard tax asset life to the 'Lease L&B 2019-20 < 20 years rem life', 'Lease L&B 2019-20 > 20 years rem life' and 'Lease L&B 2020-21' asset classes because there is no forecast capex allocated to these classes. We also have not assigned a remaining tax asset life to the 'Lease L&B 2022-23', 'Lease L&B 2023-24', 'Lease L&B 2025-26', 'Lease L&B 2026-27', 'Buildings - capital works' and 'In house software' asset classes because they have no opening TAB values as at 1 April 2022.

## Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Taxation Office
capex	capital expenditure
DV	diminishing value
ITAA	<i>Income Tax Assessment Act 1997</i>
NER	national electricity rules
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
TAB	tax asset base
TNSP	transmission network service provider