



**DRAFT DECISION**  
**Evoenergy**  
**Access Arrangement**

**2021 to 2026**

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

November 2020

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## Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to Evoenergy for the 2021–26 access arrangement period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Services covered by the access arrangement

Attachment 2 – Capital base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency carryover mechanism

Attachment 9 – Reference tariff setting

Attachment 10 – Reference tariff variation mechanism

Attachment 11 – Non-tariff components

Attachment 12 – Demand

Attachment 13 – Capital expenditure sharing scheme

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## 7 Corporate income tax

Our determination of the total revenue for Evoenergy includes the estimated cost of corporate income tax for Evoenergy's 2021–26 access arrangement period.<sup>1</sup> 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 Evoenergy to recover the estimated cost of corporate income tax during the 2021–26 period.

This attachment presents our assessment of Evoenergy's proposed corporate income tax amount for the 2021–26 access arrangement period. It also presents our assessment of its proposed opening tax asset base (TAB), and the standard and remaining tax asset lives as at 1 July 2021 that it used to estimate tax depreciation for the purpose of calculating tax expenses.

### 7.1 Draft decision

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

We determine an estimated cost of corporate income tax of \$1.4 million (\$ nominal) for Evoenergy in the 2021–26 access arrangement period. This represents a small decrease of \$0.1 million (or 3.8 per cent) compared to Evoenergy's proposal of \$1.5 million (\$ nominal). The key reason for this difference is due to our reduction to the return on capital, which is influenced by our adjustments on other building block components (Attachments 2, 3 and 5).

Further, we determine an opening TAB value as at 1 July 2021 of \$260.3 million (\$ nominal) for Evoenergy. While we accept Evoenergy's proposed method to establish the opening TAB, we reduced the proposed opening TAB value by about \$0.2 million (or 0.1 per cent) due to minor corrections to 2014–15 actual capital expenditure (capex).

We accept Evoenergy'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 Tax Office's (ATO) taxation ruling 2020/3 (section 7.4.4).<sup>3</sup> As discussed in Attachment 4, we created three new asset classes for pipeline assets located in the NSW region of Evoenergy's gas network.<sup>4</sup> We have applied the same standard tax

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<sup>1</sup> National Gas Rules (NGR), r. 76(c).

<sup>2</sup> AER, *Final report: Review of regulatory tax approach*, December 2018.

<sup>3</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2020)*, p. 181.

<sup>4</sup> These are presented as 'HP Mains – MSW', 'MP Mains – NSW' and 'MP Services – NSW' in the draft decision PTRM.

asset life of 20 years to these new asset classes as that of the existing pipeline asset classes for tax depreciation purposes.

We also accept Evoenergy’s proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2021. This method is a continuation of the approved approach used in the 2016–21 access arrangement period and applies the approach as set out in our roll forward model (RFM).

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

Table 7.1 sets out our draft decision on Evoenergy’s estimated cost of corporate income tax for the 2021–26 access arrangement period.

**Table 7.1 AER's draft decision on Evoenergy's cost of corporate income tax for the 2021–26 regulatory control period (\$ million, nominal)**

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Tax payable	0.8	0.7	0.6	0.6	0.7	3.5
Less: value of imputation credits	0.5	0.4	0.4	0.4	0.4	2.0
<b>Net corporate income tax</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>1.4</b>

Source: AER analysis.

## 7.2 Evoenergy’s proposal

Evoenergy proposed an estimated cost of corporate income tax of \$1.5 million (\$ nominal) for the 2021–26 access arrangement period using our PTRM,<sup>5</sup> with the following inputs:<sup>6</sup>

- an opening TAB as at 1 July 2021 of \$260.5 million (\$ nominal)
- an expected statutory income tax rate of 30 per cent per year
- a value of imputation credits (gamma) of 0.585
- remaining tax asset lives in existence as at 30 June 2021 calculated using a weighted average remaining life approach as set out in our RFM
- for the asset classes of ‘HP Mains’, ‘HP Services’, ‘MP Mains’, ‘MP Services’ and ‘TRS & DRS - Valves & Regulators’, Evoenergy proposed to apply the 20 year cap as the standard tax asset lives. For all other asset classes, Evoenergy applied the

<sup>5</sup> Our published gas model uses the diminishing value (DV) tax depreciation approach for all assets with the exception of in-house software, buildings and equity raising costs.

<sup>6</sup> Evoenergy, *2021–26 Access Arrangement Proposal – Appendix 4.2 – PTRM*, June 2020.

same standard tax asset lives for its existing asset classes in the 2021–26 period as approved for the 2016–21 period.

Table 7.2 sets out Evoenergy's proposed TAB roll forward over the 2016–21 period.

**Table 7.2 Evoenergy's proposed TAB roll forward for the 2016–21 access arrangement period (\$ million, nominal)**

	2015–16 <sup>a</sup>	2016–17	2017–18	2018–19	2019–20 <sup>b</sup>	2020–21 <sup>b</sup>
Opening TAB	231.7	238.0	245.8	248.7	252.6	256.9
Capital expenditure <sup>c</sup>	17.1	19.2	13.3	13.9	14.8	14.8
Less: tax depreciation	10.8	11.4	10.4	10.0	10.5	11.2
<b>Closing TAB</b>	<b>238.0</b>	<b>245.8</b>	<b>248.7</b>	<b>252.6</b>	<b>256.9</b>	<b>260.5</b>

Source: Evoenergy, *Appendix 4.1 RFM*, June 2020.

- (a) The 2015–16 capex is included in the roll forward period as it was an interval of delay.
- (b) Based on estimated capex.
- (c) Net of disposals.

Table 7.3 sets out Evoenergy's proposed cost of corporate income tax for the 2021–26 period.

**Table 7.3 Evoenergy's proposed cost of corporate income tax for the 2021–26 access arrangement period (\$ million, nominal)**

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Tax payable	0.9	0.7	0.6	0.6	0.7	3.6
Less: value of imputation credits	0.6	0.4	0.4	0.4	0.4	2.1
<b>Net corporate income tax</b>	<b>0.4</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>1.5</b>

Source: Evoenergy, *Appendix 4.2 PTRM*, June 2020.

## 7.3 Assessment approach

We make an estimate of taxable income for each regulatory year of the access arrangement period as part of our determination of the total revenue requirement for Evoenergy's 2021–26 access arrangement period.<sup>7</sup> Our estimate is the taxable income a benchmark efficient entity would earn for providing reference services if it operated Evoenergy's business.

In April 2020, we published our first version of the RFMs and PTRMs for gas pipeline service providers under new provisions in the NGR. The gas models have been

<sup>7</sup> NGR, r. 87A(1).

developed using our published electricity distribution and transmission regulatory models, which incorporates relevant findings from our final report on the tax review.<sup>8</sup> They also incorporate several amendments to account for gas specific requirements. Gas distribution businesses are required to use the gas models for the purposes of their access arrangement proposal.<sup>9</sup>

### ***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<sup>10</sup> and involves the following steps:<sup>11</sup>

1. We estimate the annual assessable income (taxable revenue) that would be earned by a benchmark efficient entity operating the gas pipeline service provider's business. This is the approved forecast revenues for the gas pipeline service provider that we determined using the building block approach.<sup>12</sup> It includes capital contributions where these are subject to taxation.
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>13</sup>
  - interest expense is a function of the size of the capital base, 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/or remaining tax asset lives for taxation purposes. Previously, Evoenergy's access arrangements applied the straight-line (SL) method for calculating tax depreciation for all assets. Consistent with the findings of the tax review, the published gas PTRM applies the SL tax depreciation method for existing assets and the DV tax depreciation method<sup>14</sup> for all assets acquired after 30 June 2021 except for in-house software, buildings and equity raising costs. The expenditure for these assets are to be depreciated using the SL method under Australian tax law. The PTRM also accounts for the value of certain forecast capex to be

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<sup>8</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 gas pipeline service provider's tax asset base which is an input to the PTRM for the calculation of the tax building block.

<sup>9</sup> NGR, r. 75A.

<sup>10</sup> AER, *Distribution PTRM*, April 2020.

<sup>11</sup> The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NGR, r. 75B(2)(e).

<sup>12</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, and any capital contributions. 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.

<sup>13</sup> Our assessment approach for the opex building block is discussed in Attachment 6 of the draft decision.

<sup>14</sup> For more explanation of how we calculate depreciation using the DV method, please see: AER, *Distribution PTRM handbook*, April 2019, pp. 22–23.



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>15</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 amount occurs on a case by case basis.

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

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

The estimated cost of corporate income tax is an output of the PTRM. We therefore assess the gas pipeline service provider's proposed cost of corporate income tax by analysing the proposed inputs to the PTRM for calculating that cost. While our assessment approach for most of the tax inputs remain largely the same as the determination for the current (2016–21) access arrangement 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 DV 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 2021–26 access arrangement period:** We consider that the roll forward of the opening TAB should be based on the approved opening TAB as at 1 July 2015 and Evoenergy's actual capex incurred during the 2016–21 access arrangement period, the interval of delay year of 2015–16 and the final year (2014–15) of the previous access arrangement period.<sup>16</sup> We do not adjust the TAB value for (if any) immediate expensing of past

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<sup>15</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.

<sup>16</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.

capex in the roll forward process. This is consistent with our 2016–21 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 2016–21 period is calculated in Evoenergy’s 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 new gas RFM to implement the findings of the tax review.<sup>17</sup> We expect that this RFM will continue to be used for the purposes of the TAB roll forward for 2021–26 at the next reset.

This opening TAB value is used to estimate forecast tax depreciation for the 2021–26 access arrangement period, including new assets to be added to the TAB over this period. We will continue to apply the SL method of tax depreciation for the opening TAB value.<sup>18</sup> However, for all assets forecast to be added to the TAB in the 2021–26 access arrangement period (with some exceptions discussed further below), we will apply the DV 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 for Taxation. The ATO sets a statutory life cap of 20 years on certain classes of gas transmission and distribution assets.<sup>19</sup> We consider that the standard tax asset lives for Evoenergy’s asset classes should be consistent with the ATO taxation ruling 2020/3 regarding the effective life of depreciating assets where possible.<sup>20</sup>

As discussed above, the PTRM applies the DV tax depreciation method for all new assets except for in-house software, buildings and capital works, and equity raising costs. It provides designated asset classes for these assets to be depreciated using the SL method for tax purposes.<sup>21</sup> The tax effective lives for in-house software, buildings and capital works, 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 *Income Tax Assessment*

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<sup>17</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/gas-financial-models-roll-forward-and-revenue-2020>.

<sup>18</sup> The tax review final report stated that the required changes to the tax depreciation approach would apply to new assets only. Therefore, the SL approach to tax depreciation that applied for Evoenergy’s 2016–21 access arrangement remains appropriate for use in the roll forward of the TAB to 1 July 2021.

<sup>19</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2020)*, p. 181. 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.

<sup>20</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2020)*, p. 181.

<sup>21</sup> Our assessment approach on new assets to be exempted from the DV method is discussed in detail below.

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 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 section 40.95(7) of the ITAA
  - 5 years for equity raising costs – This is consistent with section 40.880 of the ITAA.
- **Income tax rate:** The statutory income tax rate is 30 per cent per year for the businesses of the size we regulate, which was adopted in Evoenergy's proposal.
  - **Value of gamma:** The gamma input for Evoenergy 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 was adopted in Evoenergy's proposal.<sup>22</sup> Refer to section 4.2 of the Overview for this draft decision for further discussion on this matter.
  - **Size and treatment of any tax losses as at 1 July 2021:** 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. If there is an amount of tax losses accumulated, the forecast taxable income for the period will be reduced by this amount. Evoenergy does not have any accumulated tax losses as at the start of the 2021–26 period.<sup>23</sup>
  - **Forecast immediate expensing of capex:** The PTRM requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2021–26 access arrangement 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.<sup>24</sup> We will collect actual data relating to this expenditure in our annual reporting Regulatory Information Notices (RINs) to further inform our decision on the amount of forecast immediate expensing of capex in future access arrangements. Benchmarking may also be considered going forward.<sup>25</sup>

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<sup>22</sup> AER, *Rate of return instrument*, December 2018, p. 19.

<sup>23</sup> Evoenergy, *Appendix 4.2 PTRM*, June 2020.

<sup>24</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>25</sup> AER, *Final report, Review of regulatory tax approach*, December 2018, pp. 66–67.

- **Diminishing value multiplier:** The PTRM applies the following formula to calculate the tax depreciation under the DV method:<sup>26</sup>

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

where:

$D_t$  is the tax depreciation in year  $t$

$D_0 = 0$

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

$i = \text{year } 0$

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 per cent 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 DV 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 SL method for tax purposes rather than the DV 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 DV method. Section 40.880 of the ITAA and the ATO's taxation ruling 2011/6<sup>27</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 SL method for calculating the tax depreciation for equity raising costs, consistent with the ITAA and ATO's requirements.<sup>28</sup> Further, the gas pipeline service provider may propose capex associated with buildings and in-house software to be exempted from the DV 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 DV 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

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<sup>26</sup> This formula shows how the tax depreciation for capex in a particular year is calculated under the DV method in the PTRM.

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

<sup>28</sup> The benchmark amount for equity raising costs is determined within the PTRM.

97/25.<sup>29</sup> This includes new buildings and structural improvements to existing buildings.<sup>30</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 DV method in the PTRM. Evoenergy did not propose this type of capex for the 2021–26 access arrangement period.

- **In-house software:** We consider that capex for in-house software may be exempted from the DV 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>31</sup> 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.<sup>32</sup> 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 DV method in the PTRM. Evoenergy did not propose this type of capex for the 2021–26 access arrangement period.

In assessing Evoenergy's proposal, we have had regard to the National Gas Objective (NGO) and the revenue and pricing principles.<sup>33</sup> 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.<sup>34</sup>

### 7.3.1 Interrelationships

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

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

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<sup>29</sup> ATO, *Taxation Ruling 97/25*, July 2017.

<sup>30</sup> ITAA, section 43.20.

<sup>31</sup> ATO, *Taxation Ruling 2016/3*, October 2018.

<sup>32</sup> ITAA, section 995.1.

<sup>33</sup> 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.

<sup>34</sup> NGR, r. 74(2).

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.<sup>35</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>36</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 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 separate TAB 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 generate a tax loss. A tax loss from the previous period(s) can be carried forward to offset against tax payable in the current period.

## 7.4 Reasons for draft decision

We determine a cost of corporate income tax of \$1.4 million (\$ nominal) for Evoenergy over the 2021–26 access arrangement period. This represents a reduction of \$0.1 million (or 3.8 per cent) from Evoenergy’s proposal as a result of applying our tax review findings.

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<sup>35</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 tax amounts become stable.

<sup>36</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 corporate tax amount in proportion to the company tax rate.

We accept Evoenergy's proposed method to establish the opening TAB as at 1 July 2021. However, we have made a slight reduction to Evoenergy's proposed opening TAB value as at 1 July 2021 to \$260.3 million—a reduction of \$0.2 million (or 0.1 per cent).

We accept Evoenergy's proposed standard tax asset lives for all of its existing asset classes. This includes updating the 2021–26 standard tax asset lives for certain asset classes<sup>37</sup> to be capped at 20 years, which is consistent with the findings of our 2018 tax review.<sup>38</sup> As discussed in Attachment 4, we created three new asset classes for pipeline assets located in the NSW region of Evoenergy's gas network.<sup>39</sup> We have applied the same standard tax asset life of 20 years to these new asset classes as that of the existing pipeline asset classes for tax depreciation purposes.

We also accept Evoenergy's proposed approach to calculating the remaining tax asset lives as at 1 July 2021 for all asset classes, because they are calculated based on the weighted average method as set out in our RFM.

Discussed in other attachments and the Overview, our draft decision on Evoenergy'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.<sup>40</sup>

### 7.4.1 Implementation of the tax review

We published the new gas PTRM in April 2019. 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 DV method for tax depreciation purposes to all new depreciable assets except for capex associated with in-house software, equity raising costs and buildings.<sup>41</sup>

Evoenergy 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.<sup>42</sup> Our assessment of the tax inputs submitted by Evoenergy are discussed below.

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<sup>37</sup> These asset classes are: HP Mains', 'HP Services', 'MP Mains', 'MP Services' and 'TRS & DRS - Valves & Regulators'.

<sup>38</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2020)*, p. 181.

<sup>39</sup> These are presented as 'HP Mains – MSW', 'MP Mains – NSW' and 'MP Services – NSW' in the draft decision PTRM.

<sup>40</sup> NGR, r. 87A.

<sup>41</sup> The buildings asset class may be classified as system or non-system assets in the PTRM.

<sup>42</sup> Evoenergy, *Appendix 4.2 PTRM*, June 2020.

### ***Forecast immediate expensing of capex***

Evoenergy did not propose any forecast capex to be immediately expensed for tax purposes in the 2021–26 access arrangement period.<sup>43</sup> Evoenergy submitted that it does not expect to immediately expense any capex during the 2021–26 period.<sup>44</sup>

For this draft decision, we accept Evoenergy’s submission that it has no forecast for immediate expensing of capex for the 2021–26 access arrangement period. We will collect actual data relating to this expenditure in our annual reporting RINs to further inform our decision on the amount of forecast immediate expensing of capex in the next access arrangement for Evoenergy.

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

The new gas PTRM continues to apply the SL tax depreciation method to the opening TAB at 1 July 2021, but applies the DV method as the new regulatory benchmark for tax depreciation to all new capex.<sup>45</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 and equity raising costs. In the PTRM, the benchmark equity raising costs is determined within the model and depreciated using the SL tax depreciation method as default.

Evoenergy has not proposed any forecast capex that are to be depreciated using the SL method for tax depreciation purposes. As a result, all of Evoenergy’s assets are subject to the DV method of tax depreciation.

We accept Evoenergy’s proposal as it is consistent with its historical approach.

### ***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 ATO’s tax ruling which sets a statutory life cap of 20 years on certain classes of gas transmission and distribution assets.<sup>46</sup>

Evoenergy’s proposed standard tax asset lives for its gas pipeline assets over the 2021–26 access arrangement period are capped at 20 years, reflecting our new regulatory tax approach. We therefore accept Evoenergy’s capped standard tax asset lives for its gas pipeline assets.

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<sup>43</sup> Evoenergy, *Appendix 4.2 PTRM*, June 2020

<sup>44</sup> Evoenergy, *RIN 1 Written response*, June 2020, p. 25.

<sup>45</sup> AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76.

<sup>46</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2020)*, p. 181. 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.



## 7.4.2 Opening tax asset base as at 1 July 2021

We accept Evoenergy's proposed method to establish the opening TAB as at 1 July 2021. This is because Evoenergy's proposed approach is based on our RFM consistent with that previously approved for the 2016–21 access arrangement.

We determine an opening TAB value as at 1 July 2021 of \$260.3 million (\$ nominal) for Evoenergy. This represents a reduction of \$0.2 million compared to Evoenergy's proposed value of \$260.5 million. 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 reporting RINs and the 2016–21 decision models. However, we have made minor adjustments to 2014–15 actual capex added to the TAB to reflect the historical annual reporting RIN, which affected the opening TAB value for 1 July 2015. Evoenergy has confirmed that it does not have any concerns with this amendment.<sup>47</sup>

We note that the opening TAB as at 1 July 2021 may be updated to reflect actual capex for 2019–20 and any revised 2020–21 capex estimates as part of the final decision.

Table 7.4 sets out our draft decision on the roll forward of Evoenergy's TAB values over the 2016–21 period.

**Table 7.4 AER's draft decision on Evoenergy's TAB roll forward for the 2016–21 access arrangement period (\$ million, nominal)**

	2015–16 <sup>a</sup>	2016–17	2017–18	2018–19	2019–20 <sup>b</sup>	2020–21 <sup>c</sup>
Opening TAB	231.4	237.7	245.5	248.4	252.4	256.6
Capital expenditure <sup>c</sup>	17.1	19.2	13.3	13.9	14.8	14.8
Less: tax depreciation	10.8	11.4	10.4	9.9	10.5	11.2
<b>Closing TAB</b>	<b>237.7</b>	<b>245.5</b>	<b>248.4</b>	<b>252.4</b>	<b>256.6</b>	<b>260.3</b>

Source: AER analysis.

- (a) The 2015–16 capex is included in the roll forward period as it was an interval of delay.
- (b) Based on estimated capex. We expect to update the TAB roll forward for actual capex in the final decision.
- (c) Based on estimated capex. We expect to update the TAB roll forward with a revised capex estimate in the final decision.
- (d) Net of disposals.

## 7.4.3 Remaining tax asset lives

We accept Evoenergy's proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2021. The proposed method is a continuation of the

<sup>47</sup> Evoenergy, *Response to AER information request 002 – question 1*, August 2020.

approved approach used in the 2016–21 access arrangement period and applies the approach as set out in our RFM.

In accepting the weighted average method, we have updated Evoenergy's proposed remaining tax asset lives to reflect our adjustments to Evoenergy's opening TAB value as at 1 July 2021 (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>48</sup>

Table 7.5 sets out our draft decision on the remaining tax asset lives at 1 July 2021 for Evoenergy. We are satisfied that the remaining tax asset lives are appropriate for application over the 2021–26 access arrangement 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>49</sup>

#### 7.4.4 Standard tax asset lives

We accept Evoenergy's proposed standard tax asset lives assigned to its existing asset classes for the 2021–26 access arrangement period because they are:

- broadly consistent with the tax asset lives prescribed by the Commissioner for Taxation in ATO taxation ruling 2020/3<sup>50</sup>
- for non-pipeline asset classes—the same as the approved standard tax asset lives for the 2016–21 access arrangement period
- consistent with the statutory cap on the effective life of 20 years for gas pipeline assets under the ITAA.

As discussed in Attachment 4, we created three new asset classes for pipeline assets located in the NSW region of Evoenergy's gas network.<sup>51</sup> We have applied the same standard tax asset life of 20 years to these new asset classes as that of the existing pipeline asset classes for tax depreciation purposes.

Our draft decision on Evoenergy's standard tax asset lives for each of its asset classes is set out in Table 7.5. We are satisfied that the standard tax asset lives are appropriate for application over the 2021–26 access arrangement period. We are also satisfied that the standard tax asset lives provide an estimate of the tax depreciation

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<sup>48</sup> At the time of this draft decision, the roll forward of Evoenergy's TAB includes estimated capex values for 2019–20 and 2020–21. We will update the 2019–20 capex with actuals, and may update the 2020–21 estimates for the final decision. 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 Evoenergy's remaining tax asset lives as at 1 July 2021 using the method approved in this draft decision.

<sup>49</sup> NGR, r. 87A(1).

<sup>50</sup> ATO, *Taxation Ruling TR2020/3 – Income tax: effective life of depreciating assets* (applicable from 1 July 2020).

<sup>51</sup> These are presented as 'HP Mains – MSW', 'MP Mains – NSW' and 'MP Services – NSW' in the draft decision PTRM.

amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.<sup>52</sup>

**Table 7.5 AER's draft decision on Evoenergy's standard and remaining tax asset lives as at 1 July 2021 (years)**

Asset class	Standard tax asset life <sup>a</sup>	Remaining tax asset lives as at 1 July 2020 <sup>b</sup>
HP mains - ACT <sup>c</sup>	20.0	39.7
HP services	20.0	24.1
MP mains - ACT <sup>c</sup>	20.0	26.9
MP services - ACT <sup>c</sup>	20.0	23.7
TRS & DRS – valves & regulators	20.0	33.8
Contract meters	15.0	14.5
Tariff meters	15.0	11.4
Regulatory costs	5.0	n/a
IT system	5.0	n/a
Land and easement	n/a	n/a
HP Mains - NSW	20.0	n/a
MP Mains - NSW	20.0	n/a
MP Services - NSW	20.0	n/a

Source: AER analysis.

- (a) All new assets use the diminishing value method of tax depreciation.
  - (b) Used for straight-line method of tax depreciation.
  - (c) We have renamed these asset classes to reflect pipeline assets located in the ACT region of Evoenergy's gas network as discussed in Attachment 4.
- n/a Not applicable. We have not assigned a standard tax asset life and remaining tax asset life to the 'Land and easement' asset class because the assets allocated to it are non-depreciating assets. We also have not assigned a remaining tax asset life to the 'HP Mains – NSW', 'MP Mains – NSW' and 'MP Services – NSW' asset classes because they have no opening TAB values as at 1 July 2021.

<sup>52</sup> NGR, r. 87A(1).

## 7.5 Revisions

We require the following revisions to make the access arrangement proposal acceptable as set out in Table 7.6:

**Table 7.6** Evoenergy’s corporate income tax revisions

Revision	Amendment
<b>Revision 7.1</b>	Make all necessary amendments to reflect this draft decision on the proposed cost of corporate income tax for the 2021–26 access arrangement period.
<b>Revision 7.2</b>	Make all necessary amendments to reflect this draft decision on the opening tax asset base as at 1 July 2021, as set out in Table 7.4.

## Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Tax Office
Capex	Capital expenditure
DV	Diminishing value
Gamma	Value of Imputation Credits
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
SL	Straight-line
TAB	Tax asset base