

Draft Decision

Roma to Brisbane Pipeline Access Arrangement 2022 to 2027

Attachment 7 Corporate income tax

November 2021

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Note

This attachment forms part of the AER's draft decision on the access arrangement that will apply to APT Petroleum Pipelines Pty Limited's (APTPPL) Roma to Brisbane Pipeline (RBP) for the 2022–2027 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

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7 Corporate income tax

Our determination of the total revenue for APTPPL includes the estimated cost of corporate income tax for the RBP for the 2022–27 access arrangement period (2022–27 period).¹ Under the post-tax framework, a corporate income tax amount is calculated as part of the building blocks assessment using our post-tax revenue model (PTRM). This amount allows APTPPL to recover the estimated cost of corporate income tax for the RBP during the 2022–27 period.

This attachment presents our assessment of APTPPL's proposed corporate income tax amount for the RBP for the 2022–27 period. It also presents our assessment of the proposed opening tax asset base (TAB), and the standard and remaining tax asset lives as at 1 July 2022 for the RBP that are used to estimate tax depreciation for the purpose of calculating tax expenses.

7.1 Draft decision

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

Our draft decision is to determine an estimated cost of corporate income tax of zero for the RBP over the 2022–27 period, consistent with APTPPL's proposal. This is due to APTPPL incurring a forecast tax loss over the 2022–27 period.³ We have determined that \$50.2 million (\$ nominal) in tax losses as at 30 June 2027 will be carried forward to the 2027–32 period where it can be used to offset future tax liabilities. The forecast tax loss arises because APTPPL's forecast tax expenses for the RBP are expected to exceed its revenue for tax assessment purposes over the 2022–27 period. This is largely driven by our draft decision to accept APTPPL's proposed approach to reduce the remaining tax asset life of the existing 'Original pipeline' asset class to two years and to merge the two pipelines asset classes.⁴ This has the effect of significantly increasing forecast tax depreciation.⁵ Implementation of our findings from the 2018 tax review, involving the introduction of immediate expensing of capital expenditure (capex) and diminishing value method of tax depreciation, have also resulted in an increase to forecast tax depreciation.⁶

¹ NGR, r. 76(c).

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

³ A forecast tax loss occurs when the forecast assessable income (taxable revenue) is lower than the forecast tax expense. In this event no tax is payable. Any residual amount of tax loss will be carried forward to future access arrangement periods to offset future tax liabilities until the tax loss is fully exhausted.

⁴ APTPPL also proposed a similar adjustment for the capital base which we have also accepted as discussed in section 4.4.1, Attachment 4 – Regulatory Depreciation of this draft decision: AER, *Draft decision, Roma to Brisbane Pipeline 2022–27, Attachment 4 – Regulatory depreciation*, November 2021.

⁵ Refer to section 7.4 for further details.

⁶ The third key finding from the 2018 tax review relates to capping tax lives for gas assets to 20 years. However, APTPPL has historically assigned tax asset lives of 20 years or less to its pipeline asset classes, hence this change does not affect APTPPL's Roma to Brisbane Gas Pipeline.

For our draft decision, we accept the proposed forecast immediately expensed capex for the RBP (section 7.4.1). We are satisfied that APTPPL's proposed approach for determining the forecast immediate expensing of its capex over the 2022–27 period is reasonable.

Further, we accept the proposed opening TAB as at 1 July 2022 for the RBP, since we accept APTPPL's approach for establishing the opening TAB including its actual and estimated capex over the 2017–22 period.

We accept APTPPL's proposed standard tax asset lives for all of its existing asset classes for the RBP, as they are broadly consistent with the tax asset lives prescribed by the Australian Taxation Office's (ATO) taxation ruling 2021/3, and/or are the same as the approved standard tax asset lives for the 2017–22 period (section 7.4.4).⁷

We also accept APTPPL's proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2022 for the RBP. This method is a continuation of the approved approach used in the 2017–22 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.

7.2 APTPPL's proposal

APTPPL proposed an estimated cost of corporate income tax of zero (\$ nominal) for the RBP for the 2022–27 period using our PTRM,⁸ with the following inputs:⁹

- an opening TAB as at 1 July 2022 of \$127.4 million (\$ nominal)
- an expected statutory income tax rate of 30 per cent per year
- a value of imputation credits (gamma) of 0.585
- immediately expensed capex amount of \$14.0 million (\$2021–22)
- the same standard tax asset lives for tax depreciation purposes of new assets for its existing asset classes in the 2022–27 period as approved for the 2017–22 access arrangement¹⁰
- the remaining tax asset lives which were calculated using a weighted average remaining life approach as contained in its proposed RFM.

⁷ ATO, *Taxation Ruling TR2021/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2021)*, p. 177.

⁸ Our published gas PTRM uses the diminishing value tax depreciation approach for all assets with the exception of in-house software, buildings and equity raising costs.

⁹ APTPPL, *Roma to Brisbane Pipeline 2022–27 – Updated Post-tax revenue model*, 30 September 2021.

¹⁰ We have accepted APTPPL's revision to assign 10 years for the standard tax life of the 'Communications' asset class as it aligns with the ATO Taxation Ruling 2021/3. APTPPL, Response to information request AER IR008, 3 September 2021, p. 4.

APTPPL proposed to reduce the remaining tax asset life of the ‘Original pipeline’ asset class (DN250 pipeline) to two years and merge this asset class with the ‘Pipelines’ asset class. This is consistent with its proposed adjustment for the capital base.¹¹ Accordingly, APTPPL calculated a new remaining tax asset life of 6.6 years for the consolidated ‘Pipelines’ asset class.¹²

Table 7.1 sets out APTPPL’s proposed TAB roll forward for the RBP over the 2017–22 period.

Table 7.1 APTPPL’s proposed tax asset base roll forward for the RBP over the 2017–22 period (\$million, nominal)

	2017–18	2018–19	2019–20	2020–21 ^a	2021–22 ^b
Opening TAB	122.7	122.8	130.4	124.9	125.7
Capital expenditure ^c	12.9	21.5	9.9	15.5	16.3
Less: tax depreciation	12.8	13.9	15.4	14.7	14.6
Closing TAB	122.8	130.4	124.9	125.7	127.4

Source: APTPPL, *Roma to Brisbane Pipeline 2022–27 – Updated transmission roll forward model*, 30 September 2021.

- (a) Based on actual (unaudited) capex.
- (b) Based on estimated capex.
- (c) As-commissioned, net of disposals.

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 APTPPL’s 2022–27 access arrangement period for the RBP.¹³ Our estimate is the taxable income a benchmark efficient entity would earn for providing reference services if it operated APTPPL’s business and is determined in accordance with the PTRM.

In April 2020, we published our first version of the RFM and PTRM for gas pipeline service providers under new provisions in the National Gas Rules (NGR).¹⁴ The gas models have been developed using our published electricity distribution and transmission regulatory models, which incorporates relevant findings from our final

¹¹ This is discussed in section 4.4.1, Attachment 4 – Regulatory Depreciation of this draft decision: AER, *Draft decision, Roma to Brisbane Pipeline 2022–27, Attachment 4 – Regulatory depreciation*, November 2021.

¹² APTPPL’s proposed approach used the weighted average (by opening TAB value) of the reduced remaining tax asset life of the ‘Original pipeline’ (2 years) and the (pre-merged) remaining tax asset life of the ‘Pipelines’ asset class (10.6 years).

¹³ NGR, r. 87A(1).

¹⁴ NGR, r. 75A.

report on the tax review.¹⁵ They also incorporate several amendments to account for gas specific requirements. Gas pipeline service providers are required to use the gas models for the purposes of their access arrangement proposals.¹⁶

In April 2021, we published a new version 2 of the PTRM that applies the same regulatory tax approach as version 1, and implements the changes set out in our final position paper on the treatment of inflation under the regulatory framework.¹⁷

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 PTRM¹⁸ and involves the following steps:¹⁹

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.²⁰
2. We then estimate the benchmark tax expenses such as operating expenditure (opex), interest expense and tax depreciation in the following ways:
 - operating expense is set equal to the opex building block²¹
 - 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 TAB that is separate to the capital base, and standard and/or remaining tax asset lives for taxation purposes. Previously, APTPPL's access arrangements for the RBP applied the straight-line method for calculating tax depreciation for all assets. Consistent with the findings of the tax review, the published gas PTRM applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method²² for all assets acquired after 30 June 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 Australian tax law. The PTRM also accounts for

¹⁵ 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.

¹⁶ NGR, r. 75A.

¹⁷ AER, *Final position: Regulatory treatment of inflation*, December 2020, pp. 6–8.

¹⁸ AER, *Transmission PTRM*, April 2021.

¹⁹ The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NGR, r. 75B(2)(e).

²⁰ The total revenue for tax purposes is the sum of the building blocks including return on capital, return of capital, operating expenditure and cost of corporate taxation (and any capital contributions if applicable). It may also include other revenue adjustments, but the assessment of whether they should give rise to a cost of corporate tax will occur on a case-by-case basis.

²¹ Our assessment approach for the opex building block is discussed in Attachment 6 of the draft decision.

²² For more explanation of how we calculate depreciation using the diminishing value method, please see: AER, *Transmission PTRM handbook*, April 2021, pp. 23–24.

the value of certain forecast capex to be immediately expensed when estimating the benchmark tax expense. The value of immediately expensed capex is deducted from the net capex being depreciated for tax purposes for the year in which it is forecast to be commissioned.²³ The immediately expensed amount is then included in the total tax depreciation amount for the relevant year.

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

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

How we assess the tax inputs to the PTRM

The estimated cost of corporate income tax is an output of the PTRM. We therefore assess the gas pipeline service provider's proposed cost of corporate income tax by analysing the proposed inputs to the PTRM for calculating that cost. While our assessment approach for most of the tax inputs remain largely the same as the determination for the current (2017–22) period, our gas PTRM requires two new sets of inputs for the calculation of tax depreciation—the forecast immediate expensing of certain capex and the assets to be exempted from the diminishing value method of tax depreciation.

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

- **Opening TAB as at the commencement of the 2022–27 period:** We consider that the roll forward of the opening TAB should be based on the approved opening TAB as at 1 July 2017 and APTPPL's actual capex incurred for the RBP during the 2017–22 period, and the final year (2016–17) of the previous access arrangement period.²⁴ We do not adjust the TAB value for immediate expensing of past capex in

²³ 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.

²⁴ 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.

the roll forward process. This is consistent with our 2017–22 access arrangement that the benchmark efficient entity at the time will not immediately expense any capex during that period.

The roll forward of the opening TAB for the 2017–22 period is calculated in APTPPL’s RFM for the RBP. 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.²⁵ We expect that this RFM will be used for the purposes of the TAB roll forward for 2022–27 at the next reset.

The opening TAB value is used to estimate forecast tax depreciation for the 2022–27 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.²⁶ However, for all assets forecast to be added to the TAB in the 2022–27 period (with some exceptions discussed further below), we will apply the diminishing value method of tax depreciation.

- **Standard tax asset life for each asset class:** Our assessment of a gas pipeline service provider's proposed standard tax asset lives is generally guided by the effective life for depreciating assets determined by the Commissioner of Taxation. The ATO sets a statutory life cap of 20 years on certain classes of gas transmission and distribution assets.²⁷ We consider that the standard tax asset lives for APTPPL’s asset classes for the RBP should be consistent with the ATO taxation ruling 2021/3 regarding the effective life of depreciating assets where possible.²⁸

As discussed above, the PTRM applies the diminishing value tax depreciation method for all new assets except for in-house software, buildings and capital works, and equity raising costs. It provides for these assets to be depreciated using the straight-line method for tax purposes.²⁹ The tax effective lives for in-house software, buildings and capital works, and equity raising costs are not covered under the ATO taxation ruling 2021/3. Therefore, our assessment of the standard tax asset lives for these asset classes are guided by the *Income Tax Assessment*

²⁵ See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/gas-financial-models-roll-forward-and-revenue-2020>.

²⁶ The tax review final report stated that the required changes to the tax depreciation approach would apply to new assets only. Therefore, the straight-line approach to tax depreciation that applied for Roma to Brisbane Gas Pipeline’s 2017–22 access arrangement remains appropriate for use in the roll forward of the TAB to 1 July 2022.

²⁷ ATO, *Taxation Ruling TR2021/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2021)*, p. 177. 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.

²⁸ ATO, *Taxation Ruling TR2021/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2021)*, p. 177.

²⁹ 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 capital works assets such as buildings for tax purposes when applying sections 43.15, 43.140 and 43.210 of the ITAA.
- 5 years for in-house software – This is consistent with section 40.95(7) of the ITAA.
- 5 years for equity raising costs – This is consistent with section 40.880 of the ITAA.
- **Income tax rate:** The statutory income tax rate is 30 per cent per annum for businesses of the size we regulate, which was adopted in APTPPL’s RBP proposal.
- **Value of gamma:** The gamma input for APTPPL is 0.585 for this RBP 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 APTPPL’s RBP proposal.³⁰ Refer to section 4.2 of the Overview of this draft decision for further discussion on this matter.
- **Size and treatment of any tax losses as at 1 July 2022:** Where a business has tax losses under our benchmark approach, we require the provision of this value to determine the appropriate estimated taxable income for an access arrangement period. Any tax losses accumulated at the end of the current 2017–22 access arrangement are to be carried over to the start of the 2022–27 access arrangement, which will offset any forecast taxable income for that period. Consistent with the final decision PTRM for the 2017–22 period, our draft decision determines an accumulated tax loss of \$1.7 million (\$2021–22) is to be carried forward at the start of the 2022–27 period for APTPPL’s RBP.
- **Forecast immediate expensing of capex:** The PTRM requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2022–27 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.³¹ We will collect actual data relating to this expenditure in our annual reporting Regulatory Information Notices (RIN) to further inform our decision on the amount of forecast immediate expensing of capex in future access arrangements. Benchmarking may also be considered going forward.³²

³⁰ AER, *Rate of return instrument*, December 2018, p. 19.

³¹ 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.

³² 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 diminishing value method:³³

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

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

We consider that the benchmark equity raising costs should not be depreciated using the diminishing value method. Section 40.880 of the ITAA and the ATO's taxation ruling 2011/6³⁴ 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.³⁵ Further, the gas pipeline service provider may propose capex associated with buildings and in-house software to be exempted from the diminishing value method of tax depreciation in the PTRM if the proposal satisfies the following requirements:

- **Buildings:** We consider that capex for buildings may be exempted from the diminishing value method in the PTRM, consistent with sections 43.15, 43.140 and 43.210 of the ITAA. However, such capex must be consistent with the definition of a capital work under section 43.20 of the ITAA and in

³³ This formula shows how the tax depreciation for capex in a particular year is calculated under the DV method in the PTRM.

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

³⁵ The benchmark amount for equity raising costs is determined within the PTRM.

ATO taxation ruling 97/25.³⁶ This includes new buildings and structural improvements to existing buildings.³⁷ 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. APTPPL did not propose this type of capex for the RBP for the 2022–27 period.

- **In-house software:** We consider that capex for in-house software may be exempted from the diminishing value method in the PTRM, consistent with section 40.72 of the ITAA. However, such capex must be consistent with the definition of in-house software under section 995.1 of the ITAA and in ATO taxation ruling 2016/3.³⁸ 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.³⁹ However, capex associated with other IT assets such as computer hardware is not consistent with the definition of in-house software, and therefore is required to be depreciated using the diminishing value method in the PTRM. APTPPL did not propose this type of capex for the RBP for the 2022–27 period.

In assessing APTPPL's RBP proposal, we have had regard to the National Gas Objective (NGO) and the revenue and pricing principles.⁴⁰ 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.⁴¹

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

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

³⁷ ITAA, section 43.20.

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

³⁹ ITAA, section 995.1.

⁴⁰ 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.

⁴¹ NGR, r. 74(2).

- gamma—the expected proportion of company tax that is returned to investors through the utilisation of imputation credits—which is offset against the corporate income tax payable.

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

The pre-tax revenues depend on all the building block components. Any factor that affects revenue will therefore affect pre-tax revenues. Higher pre-tax revenues can increase the tax payable.⁴² Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.⁴³

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

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

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

7.4 Reasons for draft decision

⁴² In fact, there is an iterative relationship between tax and revenues. That is, revenues lead to tax, being applied, which increases revenues and leads to slightly more tax and so on. The PTRM is therefore set up to run an iterative process until the revenue and corporate tax amounts become stable.

⁴³ 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 determine a cost of corporate income tax of zero for APTPPL's RBP over the 2022–27 period, consistent with APTPPL's proposal. APTPPL's updated proposal carried forward an accumulated tax loss of \$1.7 million (\$2021–22) to the start of the 2022–27 period, consistent with the approved forecast tax loss determined in the final decision PTRM for the 2017–22 period.⁴⁴ As a result, we forecast a tax loss of \$15.0 million (\$nominal) in 2022–23, increasing to \$50.2 million by the end of 2026–27.

This is primarily due to our draft decision to accept APTPPL's proposed approach to reduce the remaining tax asset life of the existing 'Original pipeline' asset class to two years and to merge the two pipelines asset classes. This has the effect of significantly increasing forecast tax depreciation.⁴⁵ To a lesser extent, the implementation of our tax review findings has also contributed to a higher forecast tax depreciation.⁴⁶

We accept the proposed opening TAB as at 1 July 2022 for the RBP, since we accept APTPPL's approach for establishing the opening TAB including its actual and estimated capex over the 2017–22 period.

Further, we accept APTPPL's forecast immediately expensed capex of \$13.9 million (\$2021–22) based on our draft decision on forecast capex (Attachment 5).⁴⁷

We accept APTPPL's proposed standard tax asset lives for all of its existing asset classes.

We also accept APTPPL's proposal to calculate forecast tax depreciation of its existing assets using the weighted average remaining life method. This method is a continuation of the approved approach used in the 2017–22 period and applies the approach as set out in our RFM.

Discussed in other attachments and the Overview, our draft decision on APTPPL'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.⁴⁸

7.4.1 Implementation of the tax review

⁴⁴ APTPPL's initial proposal in July 2021 did not include this tax loss carried forward. In its response to our information request, APTPPL has confirmed that the approved forecast tax loss determined for the 2017–22 period should be carried forward into the 2022–27 period. This has been updated in its revised PTRM in September 2021. APTPPL, Response to information request AER IR005, 11 August 2021, pp. 4–5; APTPPL, *Roma to Brisbane Pipeline 2022–27 – Updated Post-tax revenue model*, 30 September 2021.

⁴⁵ If we did not accept APTPPL's proposal to reduce both the remaining capital base and tax asset life for the 'Original pipeline' asset class to two years and to consolidate the two pipeline assets, the forecast tax loss would reduce to \$13.0 million as at 30 June 2027.

⁴⁶ Holding all else constant, the implementation of the tax review findings (diminishing value method depreciation and immediately expensed capex) resulted in a \$12.0 million increase in tax depreciation over the 2022–27 period.

⁴⁷ APTPPL proposed immediately expensed capex of \$14.0 million. Our draft decision made a minor adjustment to forecast capex, resulting in a slight decrease to the immediately expensed capex.

⁴⁸ NGR, r. 87A.

We published the first version of the gas PTRM in April 2020.⁴⁹ Specifically, the PTRM includes the following two components which affect the calculation of tax depreciation:

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

APTPPL 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.⁵⁰ Our assessment of the tax inputs submitted by APTPPL are discussed below.

Forecast immediate expensing of capex

APTPPL proposed that \$14.0 million (\$2021–22) of forecast capex (47.8 per cent of total capex)⁵¹ will be immediately expensed for tax purposes in the 2022–27 period.⁵²

APTPPL initially proposed immediately expensed capex of \$15.8 million (\$2021–22) associated with several forecast capex programs over the 2022–27 period.⁵³ In its response to our information request, APTPPL advised that the battery charger projects of \$0.2 million should also be immediately expensed.⁵⁴ Subsequently, APTPPL submitted its updated proposed PTRM which included the immediate expensing of the battery charger capex. It also made a further update to reduce the immediately expensed capex for the ‘Group IT’ asset class by \$2.1 million.⁵⁵

Our draft decision is to accept APTPPL’s updated proposed immediate expensing amount for the RBP, subject to some minor adjustments. While we have accepted the forecast capex for these programs discussed in Attachment 5, the minor adjustments made to the proposed capex also need to be reflected in the immediately expensed capex. Our draft decision approves the immediately expensed capex of \$13.9 million. We are satisfied that APTPPL’s proposed approach for determining the forecast immediate expensing of its capex over the 2022–27 period is reasonable.

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

⁴⁹ Consistent with APTPPL’s proposal, our draft decision uses version 2 of the PTRM which was published in April 2021. This version applies the same regulatory tax approach as version 1, and implements the changes set out in our 2020 final position paper on the treatment of inflation.

⁵⁰ APTPPL, *Roma to Brisbane Pipeline 2022–27, Attachment 3 – Post-tax revenue model*, 1 July 2021.

⁵¹ Compared with the proposed gross capex of \$29.3 million (\$2021–22).

⁵² APTPPL, *Roma to Brisbane Pipeline 2022–27 – Updated Post-tax revenue model*, 30 September 2021.

⁵³ APTPPL, *Roma to Brisbane Pipeline 2022–27, Attachment 3 – Post-tax revenue model*, 1 July 2021.

⁵⁴ APTPPL, Response to information request AER IR005, 03 September 2021, pp. 6–7.

⁵⁵ APTPPL *Roma to Brisbane Pipeline 2022–27 – Updated Post-tax revenue model*, 30 September 2021.

Assets exempt from the diminishing value method

The gas PTRM continues to apply the straight-line tax depreciation method to the opening TAB at 1 July 2022, but applies the diminishing value method as the new regulatory benchmark for calculating tax depreciation to all new capex.⁵⁶ However, as discussed above, there are some exceptions to this approach under the tax law such as assets relating to in-house software, buildings and equity raising costs. In the PTRM, the benchmark equity raising costs are determined within the model and depreciated using the straight-line tax depreciation method.

APTPPL has not proposed any forecast capex that relates to the above categories and which would be required to be depreciated using the straight-line method for tax depreciation purposes. As a result, all of APTPPL's assets acquired after 30 June 2022 are subject to the diminishing value method of tax depreciation. We accept APTPPL's proposal for the RBP and have not allocated any forecast capex to be depreciated under the straight-line method for tax depreciation.

Gas asset life caps

Our new regulatory tax approach applies a 20-year cap on the tax asset lives for certain new gas assets. This is consistent with ATO's tax ruling which sets a statutory life cap of 20 years on certain classes of gas transmission and distribution assets.⁵⁷

We note that APTPPL has historically capped its standard tax asset lives for its gas pipeline assets at 20 years. APTPPL has proposed to continue this in the 2022–27 period for the RBP, reflecting our new regulatory tax approach. We therefore accept APTPPL's capped standard tax asset lives for its gas pipeline assets.

7.4.2 Opening tax asset base as at 1 July 2022

We accept APTPPL's proposed opening TAB of \$127.4 million (\$nominal) as at 1 July 2022 for the RBP, since we accept APTPPL's proposed method to establish the opening TAB as at 1 July 2022. This is because APTPPL's proposed approach is based on our RFM and consistent with that previously approved for the 2017–22 period.

We have reviewed the inputs to the TAB roll forward, where we found that they were correct and reconciled with relevant data sources, such as historical data RINs and the 2017–22 decision models.⁵⁸

⁵⁶ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76.

⁵⁷ ATO, *Taxation Ruling TR2021/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2021)*, p. 177. 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.

⁵⁸ Based on APTPPL's proposed RFM submitted in July 2021. We identified some required input changes that affected the capital base roll forward (Attachment 2) but not the TAB roll forward.

APTPL submitted an updated proposed RFM, which reflected our suggested input adjustments for the capital base roll forward and included further updates to the capex inputs for 2018–21.⁵⁹ APTPL reduced the 2018–19 and 2019–20 capex values for the ‘Original pipeline’ asset class by \$0.9 million to remove BRAEMAR 2 customer connection, which was incorrectly identified as expansion or extension of the pipeline. It also updated the 2020–21 estimated capex with actual (unaudited) capex.

For the reasons discussed in our assessment of the opening capital base (Attachment 2), we are satisfied with adopting these capex updates for the purposes of this draft decision. We note that the opening TAB as at 1 July 2022 may be updated to reflect actual audited capex for 2020–21 and any revised 2021–22 capex estimates as part of the final decision.

Table 7.2 sets out our draft decision on the roll forward of APTPL’s TAB values over the 2017–22 period for the RBP.

Table 7.2 AER’s draft decision on APTPL’s RBP TAB roll forward for the 2017–22 period (\$million, nominal)

	2017–18	2018–19	2019–20	2020–21 ^a	2021–22 ^b
Opening TAB	122.7	122.8	130.4	124.9	125.7
Capital expenditure ^c	12.9	21.5	9.9	15.5	16.3
Less: tax depreciation	12.8	13.9	15.4	14.7	14.6
Closing TAB	122.8	130.4	124.9	125.7	127.4

Source: AER analysis.

- (a) Based on actual (unaudited) capex. We will review this against the reporting of actual (audited) capex and may update the TAB roll forward for any changes in the final decision.
- (b) Based on estimated capex. We expect to update the TAB roll forward with a revised capex estimate in the final decision, and true-up the TAB for actual capex at the next reset.
- (c) As-commissioned, net of disposals.

7.4.3 Remaining tax asset lives

We accept APTPL’s proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2022 for the RBP. The proposed method is a continuation of the approved approach used in the 2017–22 period and applies the approach as set out in our RFM.

⁵⁹ APTPL, *Roma to Brisbane Pipeline 2022–27 – Updated transmission roll forward model*, 30 September 2021.

APTPPL's proposed RFM initially omitted the 2012–17 actual capex in the calculation of the remaining tax asset lives.⁶⁰ In an information request,⁶¹ we proposed amending the RFM to also include this capex, consistent with the approach described in our RFM handbook for gas transmission businesses.⁶² APTPPL's updated proposed RFM reflected this amendment.⁶³ For this draft decision, we have further amended this calculation in the RFM to reflect the correct nominal weighted average cost of capital (WACC) values for 2017–22.⁶⁴

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.⁶⁵

We accept APTPPL's proposed approach to reduce the remaining tax asset life for the 'Original pipelines' asset class to two years and to merge this asset class with the 'Pipelines' asset class. This is consistent with our draft decision on the remaining asset lives for the capital base.⁶⁶ For our draft decision, we determine a remaining tax asset life as at 1 July 2022 for the 'Pipelines' asset class of 6.6 years consistent with the life proposed by APTPPL for the RBP.⁶⁷

Table 7.3 sets out our draft decision on the remaining tax asset lives at 1 July 2022 for the RBP. We are satisfied that the remaining tax asset lives are appropriate for application over the 2022–27 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.⁶⁸

7.4.4 Standard tax asset lives

We accept APTPPL's proposed standard tax asset lives assigned to its existing asset classes for the RBP for the 2022–27 period, because they are:

⁶⁰ Similarly APTPPL's proposed RFM also initially omitted this capex in the calculation of the remaining asset lives for the capital base. APTPPL, *RBP – Attachment 2 – RFM*, 01 July 2021.

⁶¹ We also proposed a similar amendment to the remaining asset lives for the capital base. AER, *Information request #008*, 17 August 2021, pp.2–4.

⁶² AER, *Gas transmission network service providers – Roll forward model handbook*, April 2020, pp 36, 37, 40.

⁶³ APTPPL's updated proposed RFM also reflected our similar proposed amendment to the remaining asset lives for the capital base. APTPPL, *RBP – Transmission roll forward model*, 30 September 2021.

⁶⁴ AER, *Draft decision, Roma to Brisbane Pipeline 2022–27, Roll forward model*, November 2021.

⁶⁵ At the time of this draft decision, the roll forward of APTPPL's TAB includes actual (unaudited capex) and estimated capex values for 2020–21 and 2021–22 respectively. We will update the 2020–21 capex for any changes to actual audited capex, and may update the 2021–22 capex estimate 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 APTPPL's remaining tax asset lives as at 1 July 2022 using the method approved in this draft decision.

⁶⁶ This is discussed in section 4.4.1, Attachment 4 of this draft decision: AER, *Draft decision, Roma to Brisbane Pipeline 2022–27, Attachment 4 – Regulatory depreciation*, November 2021.

⁶⁷ Our draft decision remaining asset life is slightly different to APTPPL's proposed life but is consistent to 1 decimal place.

⁶⁸ NGR, r. 87A(1).

- broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2021/3⁶⁹
- largely the same as the approved standard tax asset lives for the 2017–22 period⁷⁰
- consistent with the statutory cap on the effective life of 20 years for gas pipeline assets under the ITAA.⁷¹

Our draft decision on APTPPL's standard tax asset lives for each of its asset classes for the RBP is set out in Table 7.3. We are satisfied that the standard tax asset lives are appropriate for application over the 2022–27 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.⁷²

Table 7.3 AER's draft decision on APTPPL's RBP standard and remaining tax asset lives as at 1 July 2022 (years)

Asset class	Standard tax asset life ^a	Remaining tax asset life as at 1 July 2022 ^b
Pipelines	20.0	6.6
Compressors	20.0	11.5
Regulators and meters	n/a	13.1
Easements	n/a	n/a
Communications	10.0	20.0
Capitalised AA costs	5.0	1.0
Group IT	5.0	4.1
SIB capex	5.0	4.0
Equity raising costs ^c	n/a	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) For this draft decision, the forecast capex determined for APTPPL does not meet a level to trigger any benchmark equity raising costs
- n/a Not applicable. We have not assigned a standard tax asset life and remaining tax asset life to some asset classes because they have zero capex forecast or because the assets allocated to them are non-depreciating assets.

⁶⁹ ATO, *Taxation Ruling TR2021/3 – Income tax: effective life of depreciating assets* (applicable from 1 July 2021).

⁷⁰ We have accepted APTPPL's revision to assign 10 years for the standard tax life of the 'Communications' asset class as it aligns with the ATO Taxation Ruling 2021/3. APTPPL, Response to information request AER IR008, 03 September 2021, p. 4.

⁷¹ APTPPL has historically capped its standard tax asset lives of its pipeline assets to 20 years.

⁷² NGR, r. 87A(1).

A. Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
APTPPL	APT Petroleum Pipelines Pty Limited
ATO	Australian Tax Office
Capex	Capital expenditure
Gamma	Value of Imputation Credits
IT	Information technology
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
RBP	Roma to Brisbane Pipeline
RFM	Roll forward model
RIN	Regulatory Information Notice
TAB	Tax asset base