FINAL DECISION

AusNet Services
Distribution Determination
2021 to 2026

Attachment 7
Corporate income tax

April 2021

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the Australian Energy Regulator (AER)'s final decision on the distribution determination that will apply to AusNet Services for the 2021–26 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

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

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7 Corporate income tax

Our distribution determination includes the estimated cost of corporate income tax for AusNet Services' 2021–26 regulatory control period. 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 attachment sets out our final decision on AusNet Services' revised proposed cost of corporate income tax for the 2021–26 regulatory control period. It presents our assessment of the inputs required in the PTRM for the calculation of the cost of corporate income tax.

7.1 Final decision

Our final decision on AusNet Services' estimated cost of corporate income tax is zero over the 2021–26 regulatory control period. This is consistent with AusNet Services' revised proposal and our draft decision.

We expect AusNet Services to incur a forecast tax loss over the 2021–26 regulatory control period.[1] We have determined that $328.6 million in tax losses as at 30 June 2026 will be carried forward to the 2026–31 regulatory control period where it can be used to offset future tax liabilities. The forecast tax loss arises because of AusNet Services' forecast tax expenses will exceed its revenue for tax assessment purposes over the 2021–26 regulatory control period. This 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.

For this final decision, we have:

- reduced the forecast immediately expensed capex for tax purposes from $769.6 million to $768.1 million ($2020–21)[2]
- accepted the revised proposed opening tax asset base (TAB) value as at 1 July 2021 of $3682.7 million[3]
- accepted AusNet Services' revised proposal on the standard tax asset lives for all of its asset classes, consistent with our draft decision

[1] A forecast tax loss occurs when the forecast taxable income is lower than the forecast tax expense. In this event no tax is payable. Any residual amount of tax loss will be carried forward over to future regulatory control periods to offset future taxable income until the tax loss is fully exhausted.

[2] All else equal, a lower immediately expensed capex amount will increase the cost of corporate income tax because it reduces the tax expense.

[3] Subject to minor input updates for equity raising costs, weighted average cost of capital and depreciation for the 2021 half year. These changes are minor and do not have a material impact on the TAB (less than $0.01 million).

- updated AusNet Services' remaining tax asset lives as at 1 July 2021 to reflect our minor amendments to the opening TAB value
- accepted AusNet Services' revised proposal to change the tax treatment for large embedded generators by directly charging for the tax cost associated with their connections
- amended the tax treatment for gifted assets to be consistent with a recent ruling by the Full Federal Court of Australia made after the draft decision.[4]

In the draft decision, we made the following changes to AusNet Services' modelling of its cost of corporate income tax:[5]

- We revised the opening TAB as at 1 July 2021 to correct for some minor input errors in the roll forward model (RFM) for historical capex over 2016–20 regulatory control period. We also reflected AusNet Services' RAB reallocation of 'Distribution system assets' and 'Subtransmission' asset classes into the new 'Secondary systems (pre 2016)' and 'Accelerated Depr - Distr assets (Other)' asset classes and the existing 'Accelerated Depr - Distr assets (Contingent Project 3)' asset class to the TAB for these asset classes.[6]
- We revised AusNet Services' forecast immediate expensing of capex by applying an approach that is informed by AusNet Services' current immediate expensing rate.[7]
- We accepted AusNet Services' proposed standard tax asset lives. We also determined standard tax asset lives of 40 years and 5 years respectively for the two new asset classes of 'Buildings - capital works'[8] and 'In-house software'[9] that are subject to the straight-line method of tax depreciation.[10]
- While we accepted AusNet Services' proposed approach to calculating its remaining tax asset lives as at 1 July 2021, we updated these lives to reflect our adjustments to the opening TAB value. We also determined a remaining tax asset life of 2 years for the asset class of 'Accelerated depr - distr assets (contingent project 3)' and 'Accelerated depr - distr assets (other)', and determined a remaining

4 Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169*, 21 October 2020.

5 AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 4–5.

6 AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 17–19.

7 AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 15–16.

8 This is consistent with the number of years required to completely depreciate a capital works asset such as buildings under the Income Tax Assessment Act 1997 (ITAA), ss. 43.15, 43.140 and 43.210.

9 This is consistent with the ITAA, s. 40.95(7).

10 AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, p. 21.

tax asset life of 9.3 years for the asset class of 'Non-network leasehold land & buildings - 1 July 2021'.[11]

AusNet Services' revised proposal adopted the changes required by the draft decision in full.[12]

Opening tax asset base as at 1 July 2021

For this final decision, we accept AusNet Services' revised proposed opening TAB value as at 1 July 2021 of $3682.7 million ($ nominal).[13] This is $50.9 million (or 1.4 per cent) lower than the value of $3733.7 million determined in our draft decision.

In our draft decision, we accepted AusNet Services' proposed method to establish the opening TAB as at 1 July 2021. However, we amended some of the proposed inputs used for the TAB roll forward—specifically, we made adjustments for actual and estimated capex and a reallocation for accelerated tax depreciation. We noted that the opening TAB may be updated as part of the final decision to reflect:

- any revised 2020 capex estimates
- any revised capex estimates for the six month period between 1 January to 30 June 2021.

AusNet Services' revised proposal adopted our draft decision changes, and also provided the revised estimate of capex for 2020 and the half year period of 1 January to 30 June 2021.[14]

For the reasons discussed in attachment 2, we accept the updated 2020 and 2021 half year capex estimate for this final decision. The capex estimate for 2020 is lower and the capex estimate for 2021 half year is higher compared to what we approved in our draft decision, reflecting more recent data. We will update the 2020 and the six month period estimated capex for actuals at the next revenue reset (2026–31).

Table 7.1 sets out our final decision on the roll forward of AusNet Services' TAB values over the 2016–21 period.

Table 7.1 AER's final decision on AusNet Services' TAB roll forward for the 2016–21 period ($ million, nominal)

	2016	2017	2018	2019	2020[a]	2021[b]
Opening TAB	2191.8	2403.8	2649.8	2942.3	3240.1	3506.5

11 AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 19–21.

12 AusNet Services, *EDPR 2022–26 Revised Regulatory Proposal,* December 2020, pp. 130–132.

13 Subject to minor input updates for equity raising costs, weighted average cost of capital and depreciation for the 2021 half year. These changes are minor and do not have a material impact on the TAB (less than $0.01 million).

14 AusNet Services, *EDPR 2022–26 Revised Regulatory Proposal,* December 2020, p. 131.

	2016	2017	2018	2019	2020[a]	2021[b]
Capital expenditure[c]	311.7	358.2	411.9	418.7	408.8	231.4
Less: tax depreciation	99.6	112.2	119.4	120.9	142.4	82.9
Closing TAB	**2403.8**	**2649.8**	**2942.3**	**3240.1**	**3506.5**	**3682.7**

Source: AER analysis.

(a) Based on estimated capex.

(b) The half year period of 1 January to 30 June 2021. Based on estimated capex.

(c) Net of disposals.

Forecast immediate expensing of capex

For this final decision, we determine that forecast capex of $768.1 million ($2020–21) is to be immediately expensed for tax purposes in the 2021–26 regulatory control period.

In our draft decision, we amended AusNet Services' approach to forecast its immediately expensed capex. AusNet Services' proposed forecast immediate expensing of capex over the 2021–26 regulatory control period was based on a simple average of the actual immediately expensed capex claimed over 2015–2019. The proposed approach provided an immediate expensing amount that was disproportionate to overall forecast capex, as it resulted in a fixed amount irrespective of total forecast capex. We did not agree with this approach and instead considered that the forecast immediate expensing amount should be based on the rate of immediate expensing of capex relative to actual capex. We expected that the same proportion of capex would also be deducted immediately by AusNet Services for its annual tax returns during the 2021–26 regulatory control period.

AusNet Services' revised proposal adopted our draft decision approach to calculate its immediate expensing of forecast capex for tax purposes in the 2021–26 regulatory control period.[15] However, AusNet Services updated its forecast immediate expensing amount to $769.6 million ($2020–21, or 43.7 per cent of total capex),[16] which reflected its revised proposal overall forecast capex.[17]

As discussed in attachment 5, we have reduced AusNet Services' proposed forecast capex by 3 per cent.[18] Consistent with the approach adopted in the draft decision and revised proposal, we need to adjust the amount of immediate expensing of capex to reflect the overall substitute estimate of forecast capex. Our final decision therefore reduces the immediately expensed capex for tax purposes to $768.1 million ($2020–21).

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15 AusNet Services, *EDPR 2022–26 Revised Regulatory Proposal,* December 2020, pp. 136–137.

16 Compared with the proposed gross capex of $1761.6 million ($2020–21).

17 AusNet Services, *EDPR 2022–26 Revised Proposal – PTRM Model (2022–26),* December 2020.

18 AER, *Final decision: AusNet Services distribution determination 2021 to 2026, attachment 5 – Capital Expenditure*, April 2021, p. 5.

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.

Treatment of gifted assets

For this final decision, we have changed the tax treatment of gifted assets for AusNet Services. We have therefore excluded the value of gifted assets from the cash flow modelling in the PTRM for the purposes of calculating the corporate income tax building block.

In our draft decision, we applied the usual treatment as adopted by the Australian Taxation Office where gifted assets (along with cash customer contributions) were included as assessable income in the cash flow modelling in the PTRM.

On 21 October 2020, the Full Federal Court of Australia published its determination on the tax treatment of customer contributions.[19] The determination:

- Confirmed an earlier Court ruling that cash contributions were ordinary income and should be treated as assessable income for tax purposes.
- Overturned an earlier Court ruling and determined that while a gifted asset was a 'non-cash business benefit' there was effectively nil income for tax purposes.

We consider the Court's ruling on gifted assets require us to change the tax treatment in our cash flow modelling in the PTRM. As such, the cost of construction of these assets has to be removed from AusNet Services' revised proposed gross capex and customer contributions.[20] While this results in no change to net capex, this tax treatment change results in a decrease to the cost of corporate income tax building block. AusNet Services submitted its revised gross capex and customer contributions in response to our information request to exclude the value of gifted assets.[21] The impact of this change in approach for gifted assets will increase AusNet Services' forecast tax loss, all else being equal.

We have assessed AusNet Services' revisions and are satisfied that it implements the Court's ruling on the tax treatment of gifted assets.

Tax treatment for embedded generators

AusNet Services' revised proposal submitted that large embedded generators connecting to its distribution network should now be charged directly for the tax costs associated with their connection.[22] Currently, these tax costs are borne by all

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19 Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169*, 21 October 2020.

20 Any associated rebates would remain being included in net capex and therefore treated as a tax depreciating asset.

21 AusNet Services, *Response to AER Information Request #084*, 10 March 2021.

22 AusNet Services, *EDPR 2022–26 Revised Regulatory Proposal,* 03 December 2020, pp. 140–141.

customers using standard control services. For the reasons discussed in attachment 18, we accept AusNet Services' revised proposal to change the tax treatment for large embedded generator connections because it has consulted on this change from the initial proposal. For AusNet Services' final decision PTRM we have therefore excluded the capex for these connections from the input sections for both gross capex and capital contributions. This change will lower the calculated revenue for tax assessment, and as a result increases the size of AusNet Services' forecast tax loss at 30 June 2026.

Standard and remaining tax asset lives

For this final decision, we accept AusNet Services' revised proposed standard tax asset lives for all of its asset classes. They are consistent with our draft decision, and we confirm our position that the standard asset lives are broadly consistent with the values prescribed by the Commissioner for taxation in the Australian Tax Office ruling 2020/3 and the Income Tax Assessment Act 1997 (ITAA).

We also accept AusNet Services' revised proposed approach to calculate the remaining tax asset lives as at 1 July 2021 for tax depreciation purposes of its existing assets, which were calculated using the weighted average method.[23] This is consistent with the approach accepted in our draft decision. However, we have updated the remaining tax asset lives as at 1 July 2021 to reflect the amendments we made to the opening TAB values as at 1 July 2021.[24]

Table 7.2 sets out our final decision on the standard and remaining tax asset lives as at 1 July 2021 for AusNet Services. We are satisfied that the standard and remaining tax asset lives are appropriate for application over the 2021–26 regulatory control period. We are also satisfied that the standard and 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.[25]

Table 7.2 AER's final decision on AusNet Services' standard and remaining tax asset lives (years)

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2021[b]
Subtransmission	43.0	36.1
Distribution system assets	46.0	34.9

23 The proposed method is a continuation of the approved approach used in the 2016–20 regulatory control period and applies the approach as set out in our RFM.

24 The estimates of 2020 and 2021 capex are used to calculate the weighted average remaining tax asset lives in the RFM. Therefore, for this final decision we have recalculated AusNet Services' remaining tax asset lives as at 1 July 2021 reflecting the updates for the estimates of 2020 and 2021 capex, using the method approved in the draft decision.

25 National Electricity Rules, cl. 6.5.3.

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2021[b]
SCADA/Network control	10.0	8.3
Non-network general assets - IT	4.0	3.2
Non-network general assets - Other	12.0	7.2
Land	n/a	n/a
Secondary systems (pre 2016)	n/a	5.3
Accelerated depr - Distr assets (contingent project 3)	n/a	2.0
Accelerated depr - Distr assets (other)	n/a	2.0
Non-network leasehold land & buildings – 1 July 2021	n/a	9.3
Non-network leasehold land & buildings – 2021–22	23.7	n/a
Non-network leasehold land & buildings – 2025–26	5.0	n/a
Buildings - capital works	40.0[a]	n/a
In-house software	5.0[a]	n/a
Equity raising costs	5.0[a]	3.1

Source: AER analysis.

(a) These are the only asset classes used for the straight-line method of tax depreciation for new assets. All 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 'Land' asset class because the assets allocated to it are non-depreciating assets. We have not assigned a standard tax asset life to the 'Secondary systems (pre 2016)', 'Accelerated depr - Distr assets (contingent project 3)', 'Accelerated depr - Distr assets (other)' and 'Non-network leasehold land & buildings - 1 July 2021' and asset classes, because there are no new capex being allocated to these asset classes in the future. We also have not assigned a remaining tax asset life to the 'Non-network leasehold land & buildings – 2021–22', 'Non-network leasehold land & buildings – 2025–26', 'Buildings - capital works' and 'In-house software' asset classes because they have no opening TAB values as at 1 July 2021.

7.2 Assessment approach

We did not change our assessment approach for the cost of corporate income tax from our draft decision. Attachment 7 (section 7.3) of our draft decision details that approach.[26]

[26] AER, *Draft decision: AusNet Services distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 7–14.

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
ITAA	Income Tax Assessment Act 1997
PTRM	post-tax revenue model
RFM	roll forward model
TAB	tax asset base