FINAL DECISION

Essential Energy
Distribution Determination

2019 to 2024

Attachment 7
Corporate income tax

April 2019

AUSTRALIAN
ENERGY
REGULATOR

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Essential Energy for the 2019–2024 regulatory control period. It should be read with all other parts of the final decision.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The attachments have been numbered consistently with the equivalent attachments to our longer draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

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Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

Contents

Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Taxation Office
capex	capital expenditure
CESS	capital expenditure sharing scheme
disposals	asset disposals
distributor	distribution network service provider
DMIAM	demand management innovation allowance mechanism
DV	diminishing value
EBSS	efficiency benefit sharing scheme
Gamma	value of imputation credits
ITAA	Income Tax Assessment Act 1997
NER	National Electricity Rules
NSW	New South Wales
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RIN	regulatory information notice
SL	straight-line
TAB	tax asset base
Tax review	The 2018 review of the regulatory tax approach

7 Corporate income tax

Our determination of the annual revenue requirement includes the estimated cost of corporate income tax for Essential Energy's (Essential) 2019–24 regulatory control period.[1] Under the post-tax framework, a corporate income tax allowance is calculated as part of the building block assessment using our post-tax revenue model (PTRM). This attachment sets out our final decision on Essential's revised proposed corporate income tax allowance for the 2019–24 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 the estimated cost of corporate income tax is $79.9 million ($nominal) for Essential over the 2019–24 regulatory control period. This represents a reduction of $30.7 million (or 27.8 per cent) from Essential’s revised proposed cost of corporate income tax allowance of $110.6 million ($nominal).

The key reasons for this reduction are:

- we amended the PTRM to implement the findings in our final report on the review of the regulatory tax approach (the tax review), which concluded shortly before the submission of Essential's revised proposal (section 7.4.1). Specifically, for this final decision, we have applied the diminishing value (DV) method for tax depreciation to all new depreciable assets except for forecast capex associated with in-house software, equity raising costs and buildings. These changes have reduced the revised proposed corporate income tax allowance by about $16.6 million (or 15.0 per cent).
- we reduced Essential’s revised proposed return on equity (section 2.2 of the Overview). Our final decision on the forecast return on equity affects the amount of estimated taxable income. Therefore, it has contributed to the reduction on the revised proposed corporate income tax allowance by about $13.1 million (or 11.8 per cent).

For this final decision, we accept Essential's revised proposed:

- opening tax asset base (TAB) value as at 1 July 2019 of $6807.4 million (section 7.4.2)
- standard and remaining tax asset lives as at 1 July 2019 for the existing asset classes and determine a standard tax asset life of 5 years for the new 'In-house software' asset class that is subject to the straight-line (SL) method of tax depreciation (section 7.4.3)

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[1] NER, cl. 6.4.3(a)(4).

- value of imputation credits (gamma) of 0.585 (section 2.2 of the Overview).

Our final decision on the regulatory depreciation (attachment 4) affects the calculation of the estimated taxable income, which in turn impacts the corporate income tax allowance.

Table 7.1 sets out our final decision on the estimated cost of corporate income tax allowance for Essential over the 2019–24 regulatory control period.

Table 7.1 AER's final decision on Essential’s cost of corporate income tax allowance for the 2019–24 regulatory control period ($million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Tax payable	40.3	33.1	33.9	42.9	42.4	192.6
Less: value of imputation credits	23.6	19.4	19.8	25.1	24.8	112.7
Net corporate income tax allowance	**16.7**	**13.7**	**14.1**	**17.8**	**17.6**	**79.9**

Source: AER analysis.

7.2 Essential's revised proposal

Essential's revised proposed corporate income tax allowance is $110.6 million ($nominal) for the 2019–24 regulatory control period. Essential's revised proposal is based on the approach in the draft decision to estimate the corporate income tax allowance. Essential noted that the AER's tax review changes would apply to its final decision. It expected the changes would result in lower revenue requirements.[2]

Essential's revised proposal also adopted our draft decision changes on the tax treatment of the capital expenditure sharing scheme (CESS) and demand management innovation allowance mechanism (DMIAM) revenue adjustments.

Table 7.2 sets out Essential’s revised proposed roll forward of its TAB values over the 2014–19 regulatory control period.

[2] Essential Energy, *Revised regulatory proposal*, November 2018, p. 27.

Table 7.2 Essential’s revised proposed TAB roll forward ($million, nominal)

	2014–15	2015–16	2016–17	2017–18	2018–19[a]
Opening TAB	5340.8	5738.9	6031.4	6284.8	6489.6
Capital expenditure[b]	623.1	510.7	477.0	446.5	566.5
Less: tax depreciation	225.1	218.2	223.5	241.7	248.7
Closing TAB	5738.9	6031.4	6284.8	6489.6	6807.4

Source: Essential Energy, *Revised proposal - 8.1 Standard Control Service RFM*, December 2018.

(a) Based on estimated capex.

(b) Net of disposals.

Table 7.3 sets out Essential’s revised proposed corporate income tax allowance for the 2019–24 regulatory control period.

Table 7.3 Essential's revised proposed cost of corporate income tax allowance for the 2019–24 regulatory control period ($million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Tax payable	46.5	48.4	51.1	60.7	59.8	266.6
Less: value of imputation credits	27.2	28.3	29.9	35.5	35.0	156.0
Net corporate income tax allowance	**19.3**	**20.1**	**21.2**	**25.2**	**24.8**	**110.6**

Source: Essential Energy, *Revised Proposal - 8.1 Standard Control Service PTRM,* December 2018.

7.3 Assessment approach

We make an estimate of taxable income for each regulatory year as part of our determination of the annual revenue requirement for Essential’s 2019–24 regulatory control period. Our estimate is the taxable income a benchmark efficient entity would earn for providing standard control services if it operated Essential's network business.[3]

For this final decision, we have changed some aspects of our approach for calculating the estimated corporate income tax allowance since we made the draft decision in November 2018. In our draft decision, we noted that we had commenced a review into our regulatory tax approach. We also noted that we would apply any changes to our regulatory models arising from the tax review to the final decision for Essential's 2019–24 regulatory control period.

3 NER, cl. 6.5.3.

In December 2018, we released the final report of the tax review, which identified some required changes to our approach to estimating tax depreciation expenses in our regulatory models (PTRM and RFM).[4] The changes to our regulatory tax approach require amending our models to:[5]

- recognise immediate tax expensing of some capex forecast for a regulatory control period
- adopt the DV method for tax depreciation to all future capex except for a limited number of assets which must be depreciated using the SL depreciation method under the tax law.

In April 2019, we published a new version of the PTRM (version 4) which implements the changes to the tax depreciation approach. We have not yet amended the RFM because the tax review final report stated that the required changes to the tax depreciation approach would apply to new assets only. This means that only changes to the PTRM are required in the first regulatory control period when transitioning into the new tax approach. As such, the tax depreciation approach in the RFM remains the same as the draft decision for the purposes of this final decision.

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

Our approach for calculating a distributor's estimated cost of corporate income tax allowance is set out in our PTRM[6] and involves the following steps:[7]

1. We estimate the annual assessable income (taxable revenue) that would be earned by a benchmark efficient entity operating the distributor's business. This is the approved forecast revenues for the distribution business that we determined using the building block approach.[8]
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.[9]
    - Interest expense is a function of the size of the regulatory asset base (RAB), the benchmark gearing assumption (60 per cent) and the regulated cost of debt.

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4 AER, *Final report: Review of regulatory tax approach*, December 2018, pp. 6–20; The PTRM specifies the manner in which the estimated cost of corporate income tax is to be calculated. The RFM calculates the distributor's tax asset base which is an input to the PTRM for the calculation of the tax building block.

5 Capping of gas asset tax lives was also a finding from the final report, but does not require a model change.

6 AER, *Distribution PTRM (version 4)*, April 2019.

7 The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NER, cl. 6.4.2(b)(4).

8 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 revenue increments or decrements resulting from the CESS, efficiency benefit sharing scheme (EBSS) and DMIAM.

9 Our assessment approach for the opex building block is discussed in section 2.5 of the Overview.

- o Tax depreciation expense is calculated using a separate value for the TAB, and standard and remaining tax asset lives for taxation purposes. Previously, the PTRM applied the SL method for calculating tax depreciation for all assets. Consistent with the findings of the tax review, the new amended PTRM (version 4) applies the SL tax depreciation method for existing assets and the DV tax depreciation method[10] for all new assets except for in-house software, buildings and equity raising costs. The expenditure for these assets are to be depreciated using the SL method under the tax law. The new amended PTRM (version 4) also accounts for the value of certain forecast capex to be immediately expensed when estimating the benchmark tax expense. The value of immediately expensed capex is deducted from the net capex to be depreciated for tax purposes for the year in which it is forecast to be incurred,[11] and is then included in the total tax depreciation amount for that year.

Revenue increments or decrements resulting from CESS, EBSS and DMIAM may also be included in the benchmark tax expenses if they are also included in the taxable revenue.

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

How we assess the tax inputs to the PTRM

The estimated cost of corporate income tax allowance is an output of our PTRM. We therefore assess the distributor's proposed cost of corporate tax allowance by analysing the proposed inputs to the PTRM for calculating that allowance. While our assessment approach for most of the tax inputs has not changed since the draft decision, we have updated the value of gamma in this final decision to be consistent with the 2018 *Rate of return instrument*. In addition, our amended PTRM (version 4) requires two new set of inputs for the calculation of tax depreciation—the forecast

10 For more explanation of how we calculate depreciation using the DV method, please see: AER, *Distribution PTRM handbook*, April 2019, p. 22.

11 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.

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:

- **The opening TAB as at the commencement of the 2019–24 regulatory control period:** We consider that the roll forward of the opening TAB should be based on the approved opening TAB as at 1 July 2014 and Essential's actual capex incurred during the 2014–19 regulatory control period, and the final year (2013–14) of the previous regulatory control period.[12] Our assessment approach for this input has not changed since the draft decision.

  The roll forward of the opening TAB for 2014–19 is calculated in our RFM. We have not amended the RFM to implement the tax review. This is because 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 draft decision for the purposes of this final decision. Subsequent to this final decision we will make the relevant amendments to the RFM for changes from the tax review. The amended RFM will then be used for the purposes of the TAB roll forward for 2019–24 at the next reset.

  This opening TAB value is used to estimate forecast tax depreciation for the 2019–24 regulatory control 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. However, for all new assets forecast to be added to the TAB in the 2019–24 regulatory control period (with some exceptions discussed further below), we will apply the DV method of tax depreciation.

- **The remaining tax asset life for each asset class at the commencement of the 2019–24 regulatory control period**: Our standard method in the RFM for determining the remaining tax asset lives is the weighted average method. Our assessment approach for this input has not changed since the draft decision.

- **The standard tax asset life for each asset class:** Our assessment of Essential's proposed standard tax asset lives is guided by the effective life of depreciating assets determined by the Commissioner for Taxation. We consider that the standard tax asset lives for the majority of Essential's asset classes should be consistent with the ATO taxation ruling 2018/4 regarding the effective life of depreciating assets where possible.[13]

  While our assessment approach for this input has not changed since the draft decision, we also explain how we assess the standard tax asset lives for the in-house software, buildings and equity raising costs asset classes.

[12] 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.

[13] ATO, *Taxation Ruling 2018/4– Income tax: effective life of depreciating assets (applicable from 1 July 2018)*.

As discussed above, the new amended PTRM (version 4) applies the DV tax depreciation method for all new assets except for in-house software, buildings and equity raising costs. It provides designated asset classes for these assets to be depreciated using the SL method for tax purposes.[14] We note that the tax effective lives for in-house software, buildings and equity raising costs are not covered under the ATO taxation ruling 2018/4. Therefore, our assessment of the standard tax asset lives for these asset classes are guided by the *Income Tax Assessment Act 1997* (ITAA). Specifically, we consider that the standard tax asset life should be:

  - 40 years for buildings – 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.

- **The income tax rate:** The statutory income tax rate is 30 per cent per year. This is consistent with the rate applied in the draft decision.
- **The value of gamma:** The gamma input for Essential is 0.585 for this final decision. Our draft decision applied a gamma value of 0.5. Since then, we have published the *Rate of return instrument*, which requires us to use a gamma value of 0.585.[15] Refer to section 2.2 of the Overview for further discussion on this matter.
- **The size and treatment of any tax losses as at 1 July 2019:** Where a business has tax losses, we require the provision of this value to determine the appropriate estimated taxable income for a regulatory control period. If there is an amount of tax losses accumulated, the forecast taxable income for the regulatory control period will be reduced by this amount. Our assessment approach for this input has not changed since the draft decision. Essential does not have any accumulated tax losses as at the start of the 2019–24 regulatory control period.[16]
- **Forecast immediate expensing of capex:** The amended PTRM (version 4) requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2019–24 regulatory control period. For this final decision, our assessment of forecast immediate expensing of capex will be guided by the distributor's actual immediate expensing of capex from the previous regulatory control period. We will collect actual data relating to this expenditure in our annual reporting regulatory information notice (RIN) to further inform our decision on the amount of forecast immediate expensing of capex in future regulatory determinations.

14 Our assessment approach on new assets to be exempted from the DV method is discussed further below.

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

16 Essential Energy, *Revised Proposal - 8.1 Standard Control Service PTRM*, December 2018.

- **Diminishing value multiplier:** The amended PTRM (version 4) applies the following formula to calculate the tax depreciation under the DV method:[17]

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

  where:

  D_t is the tax depreciation in year t

  $D_0 = 0$

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

  $i = year\ 0$

  The PTRM provides an input section for the 'DV multiplier' in the above formula to be recorded for each year of the regulatory control period. This is labelled as the 'diminishing value multiplier' in the PTRM. We note that currently the DV multiplier is set at 200 per cent by the ATO. Our assessment approach for the standard tax asset life inputs are discussed above. The assessment approach for capex is discussed in section 2.4 of the Overview.

- **New assets to be exempted from the diminishing value method:** The amended PTRM (version 4) applies the DV method for tax depreciation purposes to all new depreciable assets except for certain assets. It provides for asset classes 47, 48, 49 and 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 allowance for equity raising costs should not be depreciated using the DV method. We note that section 40.880 of the ITAA and the ATO's taxation ruling 2011/6[18] 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.[19] Further, the distributor 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

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

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

19 The benchmark allowance for equity raising costs is determined within the PTRM.

97/25.[20] We note that this includes new buildings and structural improvements to existing buildings.[21] 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.

- o **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.[22] We note that this includes computer software, or the right to use computer software that the distributor acquires, develops or has someone else develop for the distributor's business use.[23] 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.

7.4 Reasons for final decision

We determine a cost of corporate income tax allowance of $79.9 million ($nominal) for Essential over the 2019–24 regulatory control period. This represents a reduction of $30.7 million (or 27.8 per cent) from Essential's revised proposal.

As discussed above, we applied the new amended PTRM (version 4) for this final decision to implement the changes to our regulatory tax approach identified in the tax review final report. These changes have reduced the revised proposed cost of corporate income tax allowance by $16.6 million (or 15.0 per cent).

We accept the revised proposed opening TAB as at 1 July 2019 of $6807.4 million ($nominal). We also accept the revised proposed standard and remaining tax asset lives as at 1 July 2019 for the existing asset classes. We determine a standard tax asset life of 5 years for the new 'In-house software' asset class that is subject to the SL method of tax depreciation. The reasons for our final decision are discussed below.

Discussed in other attachments, our final decision on Essential's revised proposed return on capital (attachment 2 and section 2.2 of the Overview) and the regulatory depreciation (attachment 4) building blocks affect total revenues, and therefore also impact the forecast corporate income tax allowance. We have accepted the revised proposed value of imputation credits (gamma) of 0.585 (section 2.2 of the Overview).

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[20] ATO, *Taxation Ruling 97/25*, July 2017.

[21] ITAA, section 43.20.

[22] ATO, *Taxation Ruling* 2016/3, October 2018.

[23] ITAA, section 995.1.

7.4.1 Implementation of the tax review

In the draft decision, we applied the existing PTRM (version 3) at the time to calculate the various components required to estimate Essential's cost of corporate income tax for the 2019–24 regulatory control period. We noted that we would apply any amended regulatory models arising from the tax review for the final decision. Essential calculated the corporate income tax allowance using version 3 of our PTRM for its revised proposal, which was submitted prior to the finalisation of the new PTRM (version 4).

We published the new amended PTRM (version 4) in April 2019 which implements the changes identified from the final report of the tax review.[24] Specifically, we made the following two changes which affect the calculation of tax depreciation in the PTRM:

- **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.[25]

We consulted with Essential on the PTRM changes and the required new inputs for implementing the new tax depreciation approach following the completion of the tax review. While Essential was not required to provide these inputs as part of its revised regulatory proposal, it has actively engaged with us in the lead up to this final decision in order to provide the relevant tax input requirements of the amended PTRM.

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

Forecast immediate expensing of capex

Certain capex (such as refurbishment capex) is able to be 'immediately expensed' under tax legislation. The amended PTRM (version 4) requires a forecast for immediately deductible capex to be provided for each asset class for each regulatory year of the 2019–24 regulatory control period.

Essential submitted that it has not forecast any of its capex as immediately deductible during the 2019–24 regulatory control period.[26] For this final decision, we accept Essential's submission because the proposed approach is consistent with its past tax practice. As discussed above, 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 regulatory determination for Essential.

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24 We have not yet amended the RFM to implement the new tax depreciation approach. This is because the final report of the tax review recommended that the required changes would apply to new assets only. This means that only changes to the PTRM are required in the first regulatory control period when transitioning into the new tax depreciation approach.

25 The buildings asset class may be classified as system or non-system assets in the PTRM.

26 Essential Energy, Email to AER: *Updated capex model*, dated 11 March 2019.

Assets exempt from the diminishing value method

In our draft decision, we used version 3 of the PTRM which applies the SL method to calculate tax depreciation for all asset classes. The amended PTRM (version 4) continues to apply the SL tax depreciation method to the opening TAB at 1 July 2019, but applies the DV method as the new regulatory benchmark for tax depreciation to all new capex.[27] 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.[28] In the PTRM, the benchmark allowance for equity raising costs is determined within the model and depreciated using the SL tax depreciation method as default. As part of our consultation on the new inputs for Essential's forecast capex, we asked Essential if it wishes to propose any relevant forecast capex to be exempted from the DV tax depreciation method.

In its response to our information request, Essential proposed that $62.0 million ($2018–19) of forecast capex associated with buildings and $121.5 million ($2018–19) of forecast capex associated with in-house software are to be exempted from the DV tax depreciation method.[29] It has provided us with the reallocation of the forecast capex related to these assets from the existing asset classes of 'Buildings' and 'IT systems' to the prescribed SL tax depreciation asset classes of 'Buildings' and 'In-house software' in the PTRM.

We accept Essential's proposed allocation of forecast capex for buildings and in-house software to be depreciated using the SL method for tax depreciation purposes. This is because the proposed forecast capex for:

- buildings satisfies the definition of a capital work under section 43.20 of the ITAA and in ATO taxation ruling 97/25[30]
- in-house software satisfies the definition under section 995.1 of the ITAA and ATO taxation ruling 2016/3.[31]

Therefore, these assets are not required to be depreciated using the DV method for tax purposes. The overall impact of our final decision to apply the DV tax depreciation method to new assets is to reduce Essential's revised proposed estimated corporate income tax allowance by $16.6 million ($nominal, or 15.0 per cent), all else being equal.

27 AER, *Final report: Review of regulatory tax approach*, December 2018, p. 76.
28 Asset classes 47, 48, 49 and 50 in the PTRM (version 4) provide for this.
29 Essential Energy, Email: *Updated capex model*, dated 8 February 2019.
30 ATO, *Taxation Ruling 97/25*, July 2017.
31 ATO, *Taxation Ruling 2016/3*, October 2018.

7.4.2 Opening tax asset base as at 1 July 2019

For this final decision, we accept Essential's revised proposed opening TAB value as at 1 July 2019 of $6807.4 million ($nominal). Table 7.2 sets out the roll forward of Essential's TAB values over the 2014–19 regulatory control period.

In our draft decision, we accepted Essential's proposed method to establish the opening TAB as at 1 July 2019. We also accepted the proposed opening TAB value, and noted that this opening TAB as at 1 July 2019 may be updated to reflect actual capex for 2017–18 and any updated 2018–19 capex estimates as part of the final decision.

In its revised proposal, Essential has adopted the same approach from the draft decision on the establishment of an opening TAB as at 1 July 2019. It has updated 2017–18 estimated capex with actuals reflecting the 2017–18 annual RIN and retained the 2018–19 capex estimates.[32] Essential's revised proposed opening TAB value is $73.6 million (or 1.1 per cent) lower than the value we determined in the draft decision. For the reasons discussed in attachment 2, we accept the 2017–18 actual capex in the revised proposal. We also accept the 2018–19 estimate of capex, and we will update this for actuals at the next revenue reset.

7.4.3 Standard and remaining tax asset lives as at 1 July 2019

For this final decision, we accept Essential's revised proposed standard and remaining tax asset lives as at 1 July 2019 for its existing asset classes. In addition, we determine a standard tax asset life of 5 years for the new 'In-house software' asset class.

In the draft decision, we accepted Essential's proposed standard tax asset lives, except for its 'Buildings'[33] and 'Capitalised property leases'[34] asset classes. We determined a standard tax asset life of 40 years and 8 years for these asset classes respectively. We also accepted Essential's proposal to use the RFM's weighted average remaining life approach to determine the remaining tax asset lives as at 1 July 2019.

Essential's revised proposal adopted the draft decision standard tax asset lives and updated the remaining tax asset lives as at 1 July 2019 to reflect the revised opening TAB value.

Discussed in section 7.4.1, as part of the implementation of the new tax depreciation approach, Essential proposed to reallocate forecast capex associated with buildings and in-house software into the prescribed SL tax depreciation asset classes in the

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32 Essential Energy, *Revised roll forward model*, January 2019.

33 Essential proposed a standard tax asset life of 100 years for its 'Buildings' asset class, but we considered that 40 years would be more appropriate and was consistent with tax rules.

34 Essential did not propose a standard tax asset life for its 'Capitalised property leases' asset class. In the draft decision, we considered that 8 years was appropriate which also reflected the standard asset life used for RAB depreciation purposes.

amended PTRM. The existing asset class for 'Buildings' has been moved to apply the SL tax depreciation method. Therefore we retain a standard tax asset life of 40 years as determined in our draft decision for this asset class. We note that this standard tax asset life is consistent with the number of years required to completely depreciate a capital works asset such as buildings under the ITAA.[35] We determine a standard tax asset life of 5 years for the new 'In-house software' asset class as this is consistent with the ITAA.[36] In its response to our information request, Essential agreed that both of these standard tax asset lives are appropriate for tax depreciation purposes.[37]

We also accept Essential's revised proposed remaining tax asset lives as at 1 July 2019 for tax depreciation purposes of its existing assets, which were calculated using the weighted average method. This is consistent with the approach accepted in our draft decision.

For the new ‘In-house software’ asset class we have not assigned a remaining tax asset life as there is no opening tax value for this asset class, only forecast capex is being allocated to it over the 2019–24 regulatory control period. We therefore record ‘n/a’ in the PTRM for this asset class.

Table 7.4 sets out our final decision on the standard and remaining tax asset lives as at 1 July 2019 for Essential. We are satisfied that the standard and remaining tax asset lives are appropriate for application over the 2019–24 regulatory control period. We are also satisfied 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.[38]

[35] ITAA, sections 43.15, 43.140, 43.210.

[36] ITAA, section 40.95(7).

[37] Essential Energy, Email: *Updated capex model*, dated 11 March 2019.

[38] NER, cl. 6.5.3.

Table 7.4 AER's final decision on Essential's standard and remaining tax asset lives as at 1 July 2019 (years)

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2019[a]
Sub-transmission lines and cables	47.5[b]	36.2
Distribution lines and cables	45.0[b]	32.8
Substations	40.0[b]	28.5
Transformers	40.0[b]	32.2
Low voltage lines and cables	45.0[b]	36.3
Customer metering and load control	25.0[b]	19.0
Communications	10.0[b]	7.2
Land	n/a	n/a
Easements	n/a	n/a
IT systems	4.0[b]	3.4
Furniture, fittings, plant and equipment	6.7[b]	5.0
Motor vehicles	15.0[b]	8.0
Land (non-system)	n/a	n/a
Other non-system assets	43.8[b]	32.7
Capitalised property leases	8.0[b]	n/a
Buildings	40.0[c]	88.3
In-house software	5.0[c]	n/a
Equity raising costs	5.0[c]	33.1

Source: AER analysis.

(a) Used for straight-line method of tax depreciation.

(b) Used for diminishing value method of tax depreciation.

(c) Used for straight-line method of tax depreciation.

n/a Not applicable. We have not assigned a standard tax asset life to the 'Land', 'Easements' and 'Land (non-system)' asset classes because the assets allocated to these asset classes are non-depreciating assets. There are no opening TAB values as at 1 July 2019 for the 'Capitalised property leases' and 'In-house software' asset classes. Therefore, no remaining tax asset lives are assigned to these asset classes.