



**FINAL DECISION**  
**Evoenergy**  
**Distribution Determination**

**2019 to 2024**

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

April 2019

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## Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Evoenergy 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 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 12 – Classification of services

Attachment 13 – Control mechanisms

Attachment 15 – Alternative control services

Attachment A – Negotiated framework

Attachment B – Pricing methodology

# Contents

<b>Note</b> .....	<b>7-2</b>
<b>Contents</b> .....	<b>7-3</b>
<b>Shortened forms</b> .....	<b>7-4</b>
<b>7 Corporate income tax</b> .....	<b>7-5</b>
<b>7.1 Final decision</b> .....	<b>7-5</b>
<b>7.2 Evoenergy's revised proposal</b> .....	<b>7-7</b>
<b>7.3 Assessment approach</b> .....	<b>7-8</b>
<b>7.4 Reasons for final decision</b> .....	<b>7-14</b>
7.4.1 Implementation of the tax review .....	7-15
7.4.2 Opening tax asset base as at 1 July 2019 .....	7-17
7.4.3 Standard and remaining tax asset lives as at 1 July 2019 .....	7-17

## 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 method for calculating depreciation
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 Evoenergy's distribution and transmission (dual function assets)<sup>1</sup> networks for the 2019–24 regulatory control period.<sup>2</sup> 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 Evoenergy'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 \$8.0 million and \$4.7 million (\$ nominal) for Evoenergy over the 2019–24 regulatory control period for its distribution and transmission networks respectively. This represents reductions of \$24.0 million (or 75.1 per cent) and \$4.8 million (or 50.6 per cent) on Evoenergy's revised proposed values for its distribution and transmission networks respectively.

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 after the submission of Evoenergy's revised proposal (section 7.4.1). Specifically, for this final decision, we have recognised immediately expensed capital expenditure (capex) for the calculation of tax depreciation. We also applied the diminishing value (DV) method for tax depreciation to all new depreciable assets except for forecast capex associated with equity raising costs. These changes have reduced the revised proposed corporate income tax allowances by about \$14.3 million (or 44.7 per cent) and \$1.0 million (or 10.5 per cent) for Evoenergy's distribution and transmission networks respectively.
- we reduced Evoenergy'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 reductions on the revised proposed corporate income tax allowances by about \$5.9 million (or 18.3 per cent) and \$1.2 million (or 12.9 per cent) for Evoenergy's distribution and transmission networks respectively.
- we increased the value of imputation credits (gamma) to 0.585 from Evoenergy's revised proposal of 0.4 (section 2.2 of the Overview). This has reduced the revised proposed corporate income tax allowances by about \$4.3 million (or 13.5 per cent)

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<sup>1</sup> Evoenergy's dual function assets are high voltage assets which support the broader NSW/ACT transmission network owned and operated by TransGrid. We apply transmission pricing to these assets. See: AER, *Framework and approach ActewAGL Regulatory control period commencing 1 July 2019*, July 2017, p. 13.

<sup>2</sup> NER, cl. 6.4.3(a)(4).

and \$2.5 million (or 26.8 per cent) for Evoenergy's distribution and transmission networks respectively.

We accept Evoenergy's approach for establishing the opening TAB. We also accept the revised proposed total opening tax asset base (TAB) values as at 1 July 2019 of \$744.0 million and \$163.3 million for Evoenergy's distribution and transmission networks respectively. As discussed in attachment 2, we have updated the revised proposed opening TAB values for a number of asset classes to reflect our amendments to Evoenergy's actual capex value for 2017–18 in the RFM. While these amendments affect the opening TAB values at the asset class level, they do not result in a material change to the total opening TAB values (section 7.4.2).

As a consequence of amending the actual capex value for 2017–18, we have updated Evoenergy's remaining tax asset lives as at 1 July 2019. We accept Evoenergy's revised proposed standard tax asset lives, which are consistent with our draft decision, subject to a change for the 'Buildings' asset class (section 7.4.3).

Our final decisions on the regulatory depreciation (attachment 4) and forecast capital expenditure (attachment 5) affect the calculation of the estimated taxable income, which in turn impacts the corporate income tax allowance.

Table 7.1 and Table 7.2 set out our final decision on the estimated cost of corporate income tax allowance for Evoenergy over the 2019–24 regulatory control period for its distribution and transmission networks respectively.

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

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Tax payable	4.2	4.5	3.7	3.5	3.3	19.2
Less: value of imputation credits	2.5	2.6	2.2	2.0	1.9	11.2
<b>Net corporate income tax allowance</b>	<b>1.8</b>	<b>1.9</b>	<b>1.5</b>	<b>1.4</b>	<b>1.4</b>	<b>8.0</b>

Source: AER analysis.

**Table 7.2 AER's final decision on Evoenergy's cost of corporate income tax allowance for the 2019–24 regulatory control period (\$million, nominal) – transmission**

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Tax payable	3.5	6.2	0.5	0.5	0.6	11.3
Less: value of imputation credits	2.1	3.6	0.3	0.3	0.4	6.6
<b>Net corporate income tax allowance</b>	<b>1.5</b>	<b>2.6</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>4.7</b>

Source: AER analysis.

## 7.2 Evoenergy's revised proposal

Evoenergy's revised proposed corporate income tax allowances are \$32.0 million and \$9.5 million for the 2019–24 regulatory control period for its distribution and transmission networks respectively. Evoenergy noted that the revised proposal is based on the approach in the draft decision to estimate the corporate income tax allowance. Evoenergy also noted the AER's tax review and its intent to engage further with the AER in the consultation process.<sup>3</sup>

Table 7.3 and Table 7.4 set out Evoenergy's revised proposed roll forward of its TAB values over the 2014–19 regulatory control period for its distribution and transmission networks respectively.

**Table 7.3 Evoenergy's revised proposed TAB roll forward (\$million, nominal) – distribution**

	2014–15	2015–16	2016–17	2017–18	2018–19 <sup>a</sup>
Opening TAB	608.6	644.5	667.7	684.2	719.3
Capital expenditure <sup>b</sup>	67.3	58.1	53.8	71.0	63.0
Less: tax depreciation	31.4	34.8	37.3	36.0	38.2
Closing TAB	644.5	667.7	684.2	719.3	744.0

Source: Evoenergy, *Revised proposal RFM – distribution*, November 2018.

(a) Based on estimated capex.

(b) Net of disposals.

**Table 7.4 Evoenergy's revised proposed TAB roll forward (\$million, nominal) – transmission**

	2014–15	2015–16	2016–17	2017–18	2018–19 <sup>a</sup>
Opening TAB	137.1	143.1	146.4	148.3	154.8
Capital expenditure <sup>b</sup>	11.8	9.8	8.9	13.4	15.9
Less: tax depreciation	5.8	6.5	7.0	6.9	7.5
Closing TAB	143.1	146.4	148.3	154.8	163.3

Source: Evoenergy, *Revised proposal RFM – transmission*, November 2018.

(a) Based on estimated capex.

(b) Net of disposals.

<sup>3</sup> Evoenergy, *Revised regulatory proposal*, November 2018, p. 69.



Table 7.5 and Table 7.6 set out Evoenergy's revised proposed corporate income tax allowance for the 2019–24 regulatory control period for its distribution and transmission networks respectively.

**Table 7.5 Evoenergy's revised proposed cost of corporate income tax allowance for the 2019–24 regulatory control period – distribution (\$million, nominal)**

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Tax payable	9.5	10.5	10.4	11.2	11.6	53.3
Less: value of imputation credits	3.8	4.2	4.2	4.5	4.7	21.3
<b>Net corporate income tax allowance</b>	<b>5.7</b>	<b>6.3</b>	<b>6.3</b>	<b>6.7</b>	<b>7.0</b>	<b>32.0</b>

Source: Evoenergy, *Revised proposed PTRM – distribution*, November 2018.

**Table 7.6 Evoenergy's revised proposed cost of corporate income tax allowance for the 2019–24 regulatory control period – transmission (\$million, nominal)**

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Tax payable	4.2	7.1	1.4	1.5	1.6	15.8
Less: value of imputation credits	1.7	2.9	0.6	0.6	0.6	6.3
<b>Net corporate income tax allowance</b>	<b>2.5</b>	<b>4.3</b>	<b>0.8</b>	<b>0.9</b>	<b>1.0</b>	<b>9.5</b>

Source: Evoenergy, *Revised proposed PTRM – transmission*, November 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 Evoenergy's 2019–24 regulatory control period.<sup>4</sup> Our estimate is the taxable income a benchmark efficient entity would earn for providing standard control services if it operated Evoenergy's electricity network business.

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 September 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 Evoenergy's 2019–24 regulatory control period.

<sup>4</sup> 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).<sup>5</sup> The changes to our regulatory tax approach require amending our models to:<sup>6</sup>

- 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 straight-line (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<sup>7</sup> and involves the following steps:<sup>8</sup>

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.<sup>9</sup>
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 block.<sup>10</sup>
  - 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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<sup>5</sup> 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.

<sup>6</sup> Capping of gas asset tax lives was also a finding from the final report, but does not require a model change.

<sup>7</sup> AER, *Distribution PTRM (version 4)*, April 2019.

<sup>8</sup> 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).

<sup>9</sup> The total revenue for tax purposes is the sum of the building blocks including return on capital, return of capital, operating expenditure and cost of corporate taxation, and any capital contributions. It may also include revenue increments or decrements resulting from the capital expenditure sharing scheme (CESS), efficiency benefit sharing scheme (EBSS) and demand management innovation allowance mechanism (DMIAM).

<sup>10</sup> Our assessment approach for the opex building block is discussed in attachment 6.

- 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<sup>11</sup> 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,<sup>12</sup> 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 sets of inputs for the calculation of tax depreciation—the forecast

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<sup>11</sup> For more explanation of how we calculate depreciation using the DV method, please see: AER, *Distribution PTRM handbook*, April 2019, p. 22.

<sup>12</sup> That is, the net capex to be added to the TAB for tax depreciation purposes is the amount of gross capex, less disposals, less the immediately deductible capex.

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 Evoenergy's actual capex incurred during the 2014–19 regulatory control period, and the final year (2013–14) of the previous regulatory control period.<sup>13</sup> 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 Evoenergy'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 Evoenergy's asset classes should be consistent with the ATO taxation ruling 2018/4 regarding the effective life of depreciating assets where possible.<sup>14</sup>

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. As discussed above, the new amended PTRM (version 4) applies the DV tax depreciation

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<sup>13</sup> The tax depreciation is therefore recalculated based on actual capex. The same tax depreciation approach of using actual capex applies to the roll forward of the TAB at the next reset.

<sup>14</sup> ATO, *Taxation Ruling 2018/4– Income tax: effective life of depreciating assets (applicable from 1 July 2018)*.

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.<sup>15</sup> We note that the tax effective lives for in-house software, buildings and equity raising costs are not covered under the ATO taxation ruling 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.
- We assess Evoenergy’s proposed standard tax asset lives against the effective life of depreciating assets determined by the Commissioner for Taxation.<sup>16</sup> Our assessment approach for this input has not changed since the draft decision.
  - **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 Evoenergy 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.<sup>17</sup> 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. Evoenergy does not have any accumulated tax losses as at the start of the 2019–24 regulatory control period.<sup>18</sup>
  - **Forecast immediate expensing of capex:** The amended PTRM (version 4) requires a forecast for immediately deductible capex to be provided for each regulatory year for 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

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<sup>15</sup> Our assessment approach on new assets to be exempted from the DV method is discussed in detail below.

<sup>16</sup> ATO, *Taxation Ruling 2018/4– Income tax: effective life of depreciating assets (applicable from 1 July 2018)*.

<sup>17</sup> AER, *Rate of return instrument*, December 2018, p. 19.

<sup>18</sup> Evoenergy, *Regulatory proposal 2019–24 Attachment 9: Corporate income tax*, January 2018, pp. 4–5, Table 9.5 and Table 9.6.

reporting regulatory information notice (RIN) to further inform our decision on the amount of forecast immediate expensing of capex in future regulatory determinations.

- **Diminishing value multiplier:** The amended PTRM (version 4) applies the following formula to calculate the tax depreciation under the DV method:<sup>19</sup>

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

where:

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

$D_0 = 0$

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

$i = \text{year } 0$

The PTRM provides an input section for the 'DV multiplier' in the above formula to be recorded for each year of the 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 tax standard asset life inputs are discussed above. The assessment approach for capex is discussed in attachment 5.

- **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<sup>20</sup> require that businesses claim deductions on equity raising costs in equal proportions over a five-year period. Therefore, in the PTRM, we apply the SL method for calculating the tax depreciation for equity raising costs, consistent with the ITAA and ATO's requirements.<sup>21</sup> 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

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<sup>19</sup> This formula shows how the tax depreciation for capex in a particular year is calculated under the DV method in the PTRM.

<sup>20</sup> ATO, *Taxation Ruling 2011/6*, July 2016.

<sup>21</sup> The benchmark allowance for equity raising costs is determined within the PTRM.



of the ITAA. However, such capex must be consistent with the definition of a capital work under section 43.20 of the ITAA and in ATO taxation ruling 97/25.<sup>22</sup> We note that this includes new buildings and structural improvements to existing buildings.<sup>23</sup> However, capex on separate assets within a building such as air-conditioning units, transformers and converters are not consistent with the definition of a capital work, and therefore are required to be depreciated using the DV method in the PTRM.

- **In-house software:** We consider that capex for in-house software may be exempted from the DV method in the PTRM, consistent with section 40.72 of the ITAA. However, such capex must be consistent with the definition of in-house software under section 995.1 of the ITAA and in ATO taxation ruling 2016/3.<sup>24</sup> 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.<sup>25</sup> However, capex associated with other IT assets such as computer hardware is not consistent with the definition of in-house software, and therefore is not required to be depreciated using the DV method in the PTRM.

## 7.4 Reasons for final decision

We determine costs of corporate income tax allowances of \$8.0 million and \$4.7 million (\$nominal) for Evoenergy over the 2019–24 regulatory control period for its distribution and transmission networks respectively. These represent reductions of \$24.0 million (or 75.1 per cent) and \$4.8 million (or 50.6 per cent) from Evoenergy's revised proposal for its distribution and transmission networks respectively.

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 corporate income tax allowances by about \$14.3 million (or 44.7 per cent) and \$1.0 million (or 10.5 per cent) for Evoenergy's distribution and transmission networks respectively.

We accept the revised proposed total opening tax asset base (TAB) values as at 1 July 2019 for Evoenergy's distribution and transmission networks. We also accept Evoenergy's revised proposed standard tax asset lives, which are consistent with our draft decision, subject to a change for the 'Buildings' asset class. We have updated Evoenergy's remaining tax asset lives as at 1 July 2019 to reflect our amendments to Evoenergy's actual capex for 2017–18 in the RFM (attachment 2). The reasons for our final decision are discussed below.

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<sup>22</sup> ATO, *Taxation Ruling 97/25*, July 2017.

<sup>23</sup> ITAA, section 43.20.

<sup>24</sup> ATO, *Taxation Ruling 2016/3*, October 2018.

<sup>25</sup> ITAA, section 995.1.

Discussed in other attachments and the overview, our final decision on Evoenergy's revised proposed return on capital (attachments 2, 5, 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.

Our final decision to increase the value of imputation credits (gamma) to 0.585 from the revised proposed value of 0.40 further reduced the estimated corporate income tax allowance for the 2019–24 regulatory control period (section 2.2 of the Overview).

### 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 Evoenergy'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. Evoenergy calculated the corporate income tax allowance using version 3 of our PTRM for its revised proposal, which was submitted prior to the final report of the tax review.

We published the new amended PTRM (version 4) in April 2019 which implements the changes identified from the final report of the tax review.<sup>26</sup> 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.<sup>27</sup>

We consulted with Evoenergy on the PTRM changes and the required new inputs for implementing the new tax depreciation approach following the completion of the tax review. While Evoenergy 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 Evoenergy 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.

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<sup>26</sup> 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.

<sup>27</sup> The buildings asset class may be classified as system or non-system assets in the PTRM.



Evoenergy submitted that \$45.4 million (\$2018–19, or 14.2 per cent)<sup>28</sup> of its forecast capex will be immediately expensed for tax purposes in the 2019–24 regulatory control period for its distribution network only. Evoenergy stated that its approach to determining the categories of immediately expensed forecast capex is consistent with the approach it uses for tax purposes.<sup>29</sup>

For this final decision, we accept Evoenergy's proposed approach for determining the forecast immediate expensing of capex for the 2019–24 regulatory control period. The proposed capex to be immediately expensed are mainly associated with replacement capex. In particular, we note that pole replacement capex account for the majority of this capex. This is largely consistent with the historical immediately expensed capex information Evoenergy provided to us during the tax review. Therefore, we consider that Evoenergy's proposed approach is reasonable because it 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 Evoenergy.

Our final decision to recognise immediately deductible capex has reduced the revised proposed estimated corporate income tax allowance by about \$9.9 million (\$nominal, or 30.9 per cent) for Evoenergy's distribution network, all else being equal.<sup>30</sup>

### ***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.<sup>31</sup> However, as discussed above, there are some exceptions to this approach under the tax law such as assets relating to in-house software, buildings and equity raising costs.<sup>32</sup> 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 Evoenergy's forecast capex, we asked Evoenergy 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, Evoenergy did not propose any forecast capex associated with buildings or in-house software to be exempted from the DV tax depreciation method.<sup>33</sup> We accept this proposal for the final decision.

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<sup>28</sup> Compared with the revised proposed capex.

<sup>29</sup> Evoenergy, *Response to AER email: Implementation of the tax review - Evoenergy*, dated 15 February 2019.

<sup>30</sup> This is using Evoenergy's revised proposal inputs.

<sup>31</sup> AER, *Final report: Review of regulatory tax approach*, December 2018, p. 76.

<sup>32</sup> Asset classes 47, 48, 49 and 50 in the PTRM (version 4) provide for this.

<sup>33</sup> Evoenergy, *Response to AER email: Implementation of the tax review - Evoenergy*, 24 January 2019. We note that Evoenergy has allocated some forecast capex to its existing 'Buildings' asset class. This forecast capex is

The overall impact of our final decision to apply the DV tax depreciation method to new assets is to reduce Evoenergy's revised proposed estimated corporate income tax allowances by about \$4.4 million (or 13.8 per cent) and \$1.0 million (or 10.5 per cent) for its distribution and transmission networks respectively (\$nominal), all else being equal.

### 7.4.2 Opening tax asset base as at 1 July 2019

We accept the revised proposed opening TAB values as at 1 July 2019 of \$744.0 million and \$163.3 million (\$ nominal) for Evoenergy's distribution and transmission networks respectively. Table 7.3 and Table 7.4 set out our final decision on the roll forward of Evoenergy's TAB values over the 2014–19 regulatory control period for its distribution and transmission networks respectively.

In our draft decision, we accepted Evoenergy's proposed method to establish the opening TAB as at 1 July 2019. However, we made changes to some of the proposed inputs in the RFMs, including the 2014–15 equity raising costs value for its distribution and transmission networks. Evoenergy's revised proposal adopted these amendments in full.

We also noted in the draft decision that the proposed capex for 2017–18 and 2018–19 were estimates and that Evoenergy would provide the actual capex for 2017–18 in its revised proposal, and that it may revise the 2018–19 capex estimate. Evoenergy's revised proposal provided these updates to the 2017–18 and 2018–19 capex.<sup>34</sup>

For the reasons discussed in attachment 2, we have corrected the allocations of the 2017–18 actual capex and disposals to reconcile with the annual RIN for that year. These amendments do not have a material impact on the total revised proposed opening TAB values as at 1 July 2019. We have accepted the revised estimate of the 2018–19 capex as it reflects more recent data.

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

For this final decision, we accept Evoenergy's revised proposed standard tax asset lives subject to a change for the 'Buildings' asset class. We have updated the remaining tax asset lives as at 1 July 2019 to reflect the amendments we made to the actual capex value for 2017–18 in the RFM.

In the draft decision, we accepted Evoenergy's proposed standard tax asset lives, except for the asset class labelled 'Opening distribution assets'.<sup>35</sup> This asset class does not require the assigning of a standard tax asset life. We also accepted

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associated with internal fit outs and associated equipment and fittings, rather than structural building alterations. Evoenergy indicated that it has been depreciating these assets for tax purposes using the DV method.

<sup>34</sup> Evoenergy, *Revised regulatory proposal*, November 2018, p. 65.

<sup>35</sup> In the draft decision we assigned this asset class a tax asset life value of 'n/a' to reflect the fact that it will no longer have any allocated capex going forward.

Evoenergy's proposal to use the RFM's weighted average remaining life approach to determine the remaining tax asset lives as at 1 July 2019. However, we updated the remaining tax asset life for the 'Equity raising costs' asset class.<sup>36</sup>

Evoenergy'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 values. Discussed in section 7.4.1, as part of the implementation of the new tax depreciation approach, Evoenergy did not propose any forecast capex associated with buildings or in-house software to be exempted from the DV tax depreciation method in the amended PTRM. Evoenergy has an existing asset class for 'Buildings' and the forecast capex being allocated to it does not satisfy the definition of a capital work. As such, the tax depreciation of the forecast capex in this asset class is calculated under the DV method in the PTRM.

Evoenergy's revised proposal assigned a standard tax asset life for its 'Buildings' asset class of 100 years, consistent with its previous determinations. We have reviewed the relevant tax rules on the effective life for assets associated with buildings,<sup>37</sup> and also compared Evoenergy to its peers. We consider that a shorter standard tax asset life of 40 years would be more appropriate for this asset class. Therefore, we are satisfied that this standard tax asset life provides a better estimate of the tax depreciation amount for a benchmark efficient distributor.<sup>38</sup> We have adjusted this standard tax asset life in Evoenergy's distribution and transmission PTRMs. We raised this issue with Evoenergy and it has noted this change going forward.<sup>39</sup>

We accept Evoenergy's revised proposed approach to calculate the 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. However, we have updated the remaining tax asset lives as at 1 July 2019 to reflect the amendments we made to the actual capex value for 2017–18 in the RFM (attachment 2).

Table 7.9 and Table 7.10 set out our final decision on the standard and remaining tax asset lives as at 1 July 2019 for Evoenergy for its distribution and transmission networks. 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.<sup>40</sup>

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<sup>36</sup> In the draft decision this remaining asset life was amended to reflect the updated 2014–15 equity raising costs input arising from the remittal decision for the 2014–19 regulatory control period.

<sup>37</sup> ATO, *Taxation Ruling 2018/4– Income tax: effective life of depreciating assets (applicable from 1 July 2018)*.

<sup>38</sup> NER, cl. 6.5.3.

<sup>39</sup> Evoenergy, *Response to AER email: Implementation of the tax review - Evoenergy*, 1 April 2019. No adjustment was made to the remaining tax asset life of buildings which is 94.1 years and 94.7 years as at 1 July 2019 respectively for the distribution and transmission PTRMs.

<sup>40</sup> NER, cl. 6.5.3.

**Table 7.9 AER's final decision on Evoenergy's standard and remaining tax asset lives as at 1 July 2019 – distribution (years)**

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2019 <sup>a</sup>
Opening distribution assets	n/a	13.6
Zone substation	40.0 <sup>b</sup>	36.5
Distribution substations	40.0 <sup>b</sup>	35.5
Distribution overhead lines	45.0 <sup>b</sup>	40.7
Distribution underground lines	50.0 <sup>b</sup>	45.7
IT & communication systems (networks)	10.0 <sup>b</sup>	7.2
Motor vehicles	8.0 <sup>b</sup>	5.3
Other non-system assets (networks)	5.8 <sup>b</sup>	4.6
IT systems (corporate)	4.1 <sup>b</sup>	3.5
Telecommunications (corporate)	6.7 <sup>b</sup>	n/a
Other non-system assets (corporate)	5.7 <sup>b</sup>	3.7
Land	n/a	n/a
Buildings	40.0 <sup>b</sup>	94.1
Equity raising costs	5.0 <sup>c</sup>	29.2

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 and/or remaining tax asset life to some asset classes because the assets allocated to those asset classes are not subject to tax depreciation, have already been fully depreciated or no longer have any allocated capex going forward.

**Table 7.10 AER's final decision on Evoenergy's standard and remaining tax asset lives as at 1 July 2019 – transmission (years)**

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2019 <sup>a</sup>
Opening distribution assets	n/a	13.6
Sub-transmission overhead	47.5 <sup>b</sup>	42.7
Sub-transmission underground	47.5 <sup>b</sup>	46.7
Zone substation	40.0 <sup>b</sup>	35.0
IT & communication systems (networks)	10.0 <sup>b</sup>	7.4
Motor vehicles	8.0 <sup>b</sup>	5.4
Other non-system assets (networks)	5.8 <sup>b</sup>	4.6
IT systems (corporate)	4.1 <sup>b</sup>	3.5
Telecommunications (corporate)	6.7 <sup>b</sup>	5.0
Other non-system assets (corporate)	5.7 <sup>b</sup>	3.5
Land	n/a	n/a
Buildings	40.0 <sup>b</sup>	94.7
Equity raising costs	5.0 <sup>c</sup>	27.9

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 some asset classes because the assets allocated to those asset classes are not subject to tax depreciation or no longer have any allocated capex going forward.