FINAL DECISION

Powercor
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 Powercor 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

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7 Corporate income tax

Our distribution determination includes the estimated cost of corporate income tax for Powercor's 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 Powercor's 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 Powercor's estimated cost of corporate income tax is zero over the 2021–26 regulatory control period. This is consistent with Powercor's revised proposal and our draft decision.

We expect Powercor to incur a forecast tax loss over the 2021–26 regulatory control period.[1] We have determined that $257.0 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 Powercor's 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 $945.8 million to $800.1 million ($2020–21)[2]
- increased the revised proposed opening tax asset base (TAB) value as at 1 July 2021 by $62.3 million to $4048.3 million[3]
- accepted Powercor's revised proposal on the standard tax asset lives for all of its asset classes, consistent with our draft decision
- updated Powercor's remaining tax asset lives as at 1 July 2021 to reflect our amendments to the opening TAB value

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 All else equal, a higher opening TAB value will increase the tax depreciation, a component of the tax expense, and lower the cost of corporate income tax.

- accepted Powercor's revised proposal to change 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]
- not accepted Powercor's revised proposal to change the tax treatment for large embedded generators by directly charging for the tax cost associated with their connections.

In the draft decision, we made the following changes to Powercor's 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 2018 historical capex. We updated the 2019 estimated capex with actuals and amended the estimated capex for the six month period of 1 January to 30 June 2021. We also reallocated the opening TAB value to the new asset class of 'Accelerated depreciation assets' from the existing asset class of 'Distribution system assets' in relation to accelerated depreciation of assets which are expected to be redundant by the end of the 2021−26 regulatory control period.[6]
- We revised Powercor's forecast immediate expensing of capex by applying an approach that is informed by Powercor's current immediate expensing rate.[7]
- We accepted Powercor's proposed standard tax asset lives. We also determined a standard tax asset life of 5 years for the new asset class of 'In-house software'[8] that is subject to the straight-line method of tax depreciation.[9]
- While we accepted Powercor's 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 5 years for the new asset class of 'Accelerated depreciation assets'.[10]

Powercor's revised proposal adopted the changes required by the draft decision in full.[11]

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

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

6 AER, *Draft decision: Powercor distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 16–18.

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

8 This is consistent with the Income Tax Assessment Act 1997, s. 40.95(7).

9 AER, *Draft decision: Powercor distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, p. 19.

10 AER, *Draft decision: Powercor distribution determination 2021 to 2026, attachment 7 – Corporate Income Tax*, September 2020, pp. 18–19.

11 Powercor, *Revised regulatory proposal 2021–26,* December 2020, pp. 62, 68.

Opening tax asset base as at 1 July 2021

Our final decision is to determine an opening TAB value as at 1 July 2021 of $4048.3 million ($ nominal) for Powercor. This amount is $62.3 million (or 1.6 per cent) higher than Powercor's revised proposed opening TAB of $3986.0 million ($ nominal) as at 1 July 2021.

In our draft decision, we accepted Powercor's 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.

Powercor's revised proposal adopted our draft decision changes.[12] It provided a revised estimate for 2020 capex in its response to our information request.[13] Powercor submitted that the capex estimate for the six month period of 1 January to 30 June 2021 remains appropriate.

For the reasons discussed in attachment 2, we accept the updated 2020 capex estimate for this final decision. This capex estimate is higher than 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 Powercor's TAB values over the 2016–21 period.

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

	2016	2017	2018	2019	2020[a]	2021[b]
Opening TAB	2356.5	2580.3	2872.5	3174.5	3502.1	3871.1
Capital expenditure[c]	331.8	419.4	447.1	478.9	537.6	269.4
Less: tax depreciation	107.9	127.2	145.1	151.3	168.5	92.2
Closing TAB	**2580.3**	**2872.5**	**3174.5**	**3502.1**	**3871.1**	**4048.3**

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.

12 Powercor, *Revised regulatory proposal 2021–26,* December 2020, pp. 62, 68.

13 Powercor, *Response to AER Information Request #082*, 05 February 2021.

Forecast immediate expensing of capex

For this final decision, we determine that forecast capex of $800.1 million ($2020–21) is to be immediately expensed for tax purposes in the 2021–26 regulatory control period.

In our draft decision, we amended Powercor's approach to forecast its immediately expensed capex. Powercor's 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 2016–2018. 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 Powercor for its annual tax returns during the 2021–26 regulatory control period.

Powercor's 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.[14] However, Powercor - updated its forecast immediate expensing amount to $945.8 million ($2020–21, or 43.4 per cent of total capex),[15] which reflected its revised proposal overall forecast capex.[16]

As discussed in attachment 5, we have reduced Powercor's proposed forecast capex by 6 per cent.[17] 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 $800.1 million ($2020–21).

We will collect actual data relating to the immediately expensing of capex in our annual reporting regulatory information notice to further inform our decision for this type of expenditure in the next regulatory determination for Powercor.

Treatment of gifted assets

We accept Powercor's revised proposal for changing the tax treatment of gifted assets. 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.

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14 Powercor, *Revised regulatory proposal 2021–26,* December 2020, p. 68.

15 Compared with the proposed gross capex of $2181.4 million ($2020–21).

16 Powercor*, Revised regulatory proposal 2021–26 MOD 10.02 – PTRM 2021–26,* updated 24 March 2021).

17 AER, *Final decision: Powercor distribution determination 2021 to 2026, attachment 5 – Capital Expenditure*, April 2021, p. 6.

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.[18] 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.

Powercor's revised proposal noted this determination—in particular, on the changed tax treatment of gifted assets.[19] As a result, Powercor suggested that the cost of construction of gifted assets be excluded from 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. The impact of this change in approach for gifted assets will increase Powercor's forecast tax loss, all else being equal.

We have assessed Powercor's revised proposal and are satisfied that it reflects the Court's ruling on the tax treatment of gifted assets.

Tax treatment for embedded generators

Powercor’s 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.[21] Currently, these tax costs are borne by all customers using standard control services. For the reasons discussed in attachment 18, we do not accept Powercor’s revised proposal to change the tax treatment for large embedded generator connections because it did not consult on this change from the initial proposal. We have therefore maintained the current approach in Powercor's final decision PTRM and included the forecast capex for these connections in the input sections for both gross capex and capital contributions. This is consistent with our draft decision approach.

Standard and remaining tax asset lives

For this final decision, we accept Powercor's 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

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

19 Powercor, *Revised regulatory proposal 2021–26,* December 2020, pp. 100–102.

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

21 Powercor, *Revised regulatory proposal 2021–26,* December 2020, pp. 97–98; Powercor, *Revised regulatory proposal 2021–26 – ATT59 - Connection policy,* December 2020, p.15.

prescribed by the Commissioner for taxation in the Australian Tax Office ruling 2020/3 and the Income Tax Assessment Act 1997.

We also accept Powercor's 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.[22] 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.[23]

Table 7.2 sets out our final decision on the standard and remaining tax asset lives as at 1 July 2021 for Powercor. 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.[24]

Table 7.2 AER's final decision on Powercor's standard and remaining tax asset lives as at 1 July 2021 (years)

Asset class	Standard tax asset life	Remaining tax asset lives as at 1 July 2021[b]
Subtransmission	44.0	35.2
Distribution system assets	46.0	33.5
SCADA/Network control	10.0	7.9
Non-network general assets - IT	4.0	3.1
Non-network general assets - Other	12.0	9.1
VBRC	n/a	40.3
Land	n/a	n/a
Accelerated depreciation assets	n/a	5.0
In-house software	5.0[a]	n/a
Equity raising costs	5.0[a]	3.0

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.

22 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.

23 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 Powercor's 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.

24 National Electricity Rules, cl. 6.5.3.

(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 asset classes of 'VBRC' and 'Accelerated depreciation assets' because there is no forecast capex allocated to these classes. We also have not assigned a remaining tax asset life to the 'In-house software' asset class prescribed for SL tax depreciation because it has no opening TAB value 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.[25]

[25] AER, *Draft decision: Powercor 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