



DRAFT DECISION
Powerlink Queensland
Transmission Determination

2022 to 2027

Attachment 7
Corporate income tax

September 2021

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Note

This attachment forms part of the AER's draft decision on Powerlink Queensland's transmission network revenue determination for the 2022–27 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Pricing methodology

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Attachment 13 – Demand management innovation allowance mechanism

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7 Corporate income tax

Our revenue determination includes the estimated cost of corporate income tax for Powerlink's 2022–27 regulatory control period.¹ 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 amount allows Powerlink to recover the costs associated with the estimated corporate income tax payable during the 2022–27 period.

This attachment presents our assessment of Powerlink's proposed corporate income tax amount for the 2022–27 period. It also presents our assessment of its proposed opening tax asset base (TAB), and its proposed standard asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

7.1 Draft decision

Our draft decision on the estimated cost of corporate income tax is \$41.0 million (nominal) over the 2022–27 regulatory control period. This decision represents an increase of \$15.0 million (58.0 per cent) from Powerlink's proposal of \$25.9 million. The key reason for the increase is due to our draft decision to apply a higher rate of return on equity (Attachment 3) using updated market data.²

Our draft decision on the forecast tax amount for the 2022–27 period is significantly lower than that forecast for the 2017–22 period. This change 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.

We accept Powerlink's proposed standard tax asset lives for all of its asset classes for the 2022–27 period. These proposed standard tax asset lives are broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in Australian Taxation Office (ATO) Taxation Ruling 2021/3 and/or are the same as the approved standard tax asset lives for the 2017–22 period.³

We also accept Powerlink's proposal to use the year-by-year depreciation tracking approach to calculate the forecast tax depreciation of its existing assets. Under this approach, the capex for each year of a regulatory control period is depreciated individually for tax purposes (section 7.4.3).

¹ NER, cl. 6A.5.4(a)(4).

² All else being equal, a higher rate of return on equity will increase the cost of corporate income tax because it increases the return on equity, a component of taxable income.

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

Our adjustments to the return on capital (Attachments 2, 3 and 5) and the regulatory depreciation (Attachment 4) building blocks affect revenues, which in turn impact the tax calculation. The changes affecting revenues are discussed in Attachment 1.

Table 7.1 sets out our draft decision on the estimated cost of corporate income tax for Powerlink over the 2022–27 period.

Table 7.1 AER's draft decision on Powerlink's cost of corporate income tax for the 2022–27 regulatory control period (\$ million, nominal)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Tax payable	12.3	8.2	15.2	31.2	31.8	98.8
Less: value of imputation credits	7.2	4.8	8.9	18.3	18.6	57.8
Net cost of corporate income tax	5.1	3.4	6.3	13.0	13.2	41.0

Source: AER analysis.

7.2 Powerlink's proposal

Powerlink proposed an estimated cost of corporate income tax of \$25.9 million (nominal) for the 2022–27 regulatory control period using our PTRM,⁴ and with the following inputs:⁵

- an opening TAB value as at 1 July 2022 of \$4595.8 million (nominal)⁶
- an expected statutory income tax rate of 30 per cent per year
- a value of imputation credits (gamma) of 0.585
- application of version 4 of the electricity transmission PTRM released in April 2019⁷ which applies the diminishing value method for tax depreciation to all new depreciable assets except for those exempt from this method,⁸ and recognises the immediate expensing of certain capex for tax purposes
- immediately expensed capex amount of \$100.9 million (\$2021–22)

⁴ This model now uses the diminishing value tax depreciation approach for all new assets with the exception of in-house software, buildings (capital works) and equity raising costs.

⁵ Powerlink, *2023–27 Revenue proposal, Post-tax revenue model, January 2021*.

⁶ This includes the proposed disposal of \$4.4 million in 2021–22 for assets no longer providing prescribed services, and addition of \$1.0 million of assets to the TAB as an end of period adjustment. See Attachment 2.

⁷ Version 4 of the electricity transmission PTRM was the latest published template at the time of Powerlink's proposal. An amended version 5 was published in April 2021 and used for this draft decision. The tax treatment of assets was unchanged.

⁸ All assets acquired prior to 1 July 2022 will continue to be depreciated using the straight-line depreciation method for regulatory tax purposes, until these assets are fully depreciated.

- depreciation of the opening TAB at 1 July 2022 for each asset class applying the year-by-year tracking approach calculated in the depreciation tracking module of the roll forward model (RFM)
- the same standard tax asset lives for tax depreciation purposes of new assets for its existing asset classes in the 2022–27 regulatory control period as approved for the 2017–22 transmission determination
- two new asset classes and associated tax asset lives related to in-house software and buildings – capital works, which are exempt from the diminishing value method of tax depreciation.

Table 7.2 sets out Powerlink proposed cost of corporate income tax for the 2022–27 period.

Table 7.2 Powerlink’s proposed cost of corporate income tax for the 2022–27 regulatory control period (\$ million, nominal)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Tax payable	5.1	1.0	8.0	23.9	24.5	62.5
Less: value of imputation credits	3.0	0.6	4.7	14.0	14.3	36.6
Net cost of corporate income tax	2.1	0.4	3.3	9.9	10.2	25.9

Source: Powerlink, *2023–27 Revenue proposal, Post-tax revenue model, January 2021*.

7.3 Assessment approach

We make an estimate of taxable income for each regulatory year as part of our determination of the annual building block revenue requirement for Powerlink’s 2022–27 regulatory control period.⁹ Our estimate is the taxable income that a benchmark efficient entity would earn for providing prescribed services if it operated Powerlink’s business and is determined in accordance with the PTRM. Our draft decision used version 5 of the PTRM, which was published after Powerlink submitted its revenue proposal.¹⁰ This new version of the PTRM gives effect to the changes set out in the AER’s final position paper on the treatment of inflation in its regulatory framework.¹¹

In May 2018, we commenced a review of our regulatory tax approach (tax review). We released the final report of the tax review in December 2018, which identified some required changes to our approach to estimating tax depreciation expenses in our

⁹ NER, cl. 6A.6.4

¹⁰ AER, *Electricity transmission network service providers: Post-tax revenue model (version 5)*, 7 April 2021.

¹¹ AER, *Final position, Regulatory treatment of inflation*, December 2020, pp. 6–8.

regulatory models (PTRM and RFM).¹² The changes to our regulatory tax approach require amending our models to:¹³

- recognise immediate tax expensing of some capex forecast for a regulatory control period
- adopt the diminishing value method for tax depreciation to all future capex except for a limited number of assets which must be depreciated using the straight-line depreciation method under the tax law.¹⁴

The above changes to the regulatory tax approach was implemented in version 4 of the PTRM, which Powerlink used for its revenue proposal. In April 2021, we published a new version of the PTRM (version 5), after the submission of Powerlink’s revenue proposal. This new version of the PTRM applies the same regulatory tax approach as version 4 but implements the changes set out in the AER’s final position paper on the treatment of inflation in its regulatory framework.¹⁵ Accordingly, our draft decision used version 5 of the PTRM to forecast Powerlink’s cost of corporate income tax over the 2022–27 period.¹⁶

Our tax review final report stated that the required changes to the tax depreciation approach would only apply to new assets created in future regulatory control periods.¹⁷ The 2022–27 period is the first period for Powerlink after the release of the tax review final report. Therefore, only changes to the PTRM were required when adopting the new tax approach. As such, no immediate change to the TAB roll forward would be required until the subsequent regulatory control period.¹⁸

¹² AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76. The PTRM specifies the manner in which the estimated cost of corporate income tax is to be calculated. The RFM calculates the TNSP’s tax asset base, which is an input to the PTRM for the calculation of the tax building block.

¹³ Capping of gas asset tax lives was also a finding from the final report, but does not require a model change.

¹⁴ We will continue to apply straight-line tax depreciation for assets acquired prior to 1 July 2022 for the 2022–27 regulatory control period and until they are fully depreciated.

¹⁵ The changes to the regulatory treatment of inflation does not have a direct impact on the cost of corporate income tax. See AER, *Final position, Regulatory treatment of inflation*, December 2020, pp. 6–8.

¹⁶ AER, *Electricity transmission network service providers: Post-tax revenue model (version 5)*, 7 April 2021.

¹⁷ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 73.

AER, *Explanatory statement, Electricity transmission and distribution network service providers Proposed amendments to the roll forward models (Distribution – version 3) (Transmission – version 4), Appendix A*, April 2020.

¹⁸ In this case, the diminishing value method and the immediate expensing of certain capex did not apply for Powerlink’s TAB roll forward for the 2017–22 regulatory control period. The changes to the regulatory tax approach under version 4 of the RFM will apply in the subsequent reset to roll forward the TAB for Powerlink during the 2022–27 regulatory control period.

7.3.1 Calculating estimated cost of corporate income tax in the PTRM

Our approach for calculating a transmission network service provider's (TNSP) estimated cost of corporate income tax is set out in our PTRM¹⁹ and involves the following steps:²⁰

1. We estimate the annual assessable income (taxable revenue) that would be earned by a benchmark efficient entity operating the TNSP's business. This is the approved forecast revenues for the transmission business that we determined using the building block approach.²¹
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 block²²
 - 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
 - tax depreciation expense is calculated using a separate value for the TAB, and standard and/or remaining tax asset lives for taxation purposes. Previously, the PTRM applied the straight-line method for calculating tax depreciation for all assets. Consistent with the findings of the tax review, the PTRM (version 5) applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method²³ for all assets acquired after 30 June 2022 except for in-house software, buildings and equity raising costs. The expenditure for these assets are to be depreciated using the straight-line method under the tax law. The PTRM 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 being depreciated for tax purposes for the year in which it is forecast to be commissioned.²⁴ The immediately expensed amount is then included in the total tax depreciation amount for the relevant year.

¹⁹ AER, *Transmission PTRM (version 5)*, April 2021.

²⁰ The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NER, cl. 6A.5.3(b)(4).

²¹ 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. It may also include other revenue adjustments, but the assessment of whether they should give rise to a tax cost will occur on a case by case basis.

²² Our assessment approach for the opex building block is discussed in Attachment 6 of the draft decision.

²³ For more explanation of how we calculate depreciation using the diminishing value method, please see: AER, *Transmission PTRM handbook*, April 2019, pp. 22–23.

²⁴ 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.

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

3. We estimate the annual taxable income that would be earned by a benchmark efficient entity operating the TNSP's business by subtracting the benchmark estimates of tax expenses (step 2) from the approved forecast revenues for the transmission 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 cost of corporate income tax and is included as a separate building block in determining the TNSP's annual building block revenue requirement.

7.3.2 Assessing tax inputs to the PTRM

The estimated cost of corporate income tax is an output of our PTRM. We therefore assess the TNSP's proposed cost of corporate tax by analysing the proposed inputs to the PTRM for calculating that cost. While our assessment approach for most of the tax inputs remain largely the same for the current 2017–22 regulatory control period, our amended PTRM (version 5) requires two new sets of inputs for the calculation of tax depreciation—the forecast immediate expensing of certain capex and the assets to be exempted from the diminishing value method of tax depreciation.

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

- **the opening TAB as at the commencement of the 2022–27 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 2017 and Powerlink's actual capex incurred during the 2017–22 period, and the final year (2016–17) of the previous regulatory control period.²⁵ As noted above, we do not adjust the TAB value for immediate expensing of past capex in the roll forward process over the 2017–22 period. This is consistent with our final report for the tax review and our 2017–22 transmission determination which applied straight-line tax depreciation to capex commissioned during that period as prescribed in the PTRM.

The roll forward of the opening TAB for 2017–22 is calculated in our RFM. The tax review final report set out that the required changes to the tax depreciation approach would apply to new assets only. As such, the approach for determining the opening TAB value remains the same as the previous determination for the

²⁵ 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.

purposes of this draft decision. We have published the amended RFM (version 4) implementing the findings of the tax review.²⁶ We expect that the approach set out in this version of the RFM will be used for the purposes of the TAB roll forward for 2022–27 at the next reset.

The opening TAB value at 1 July 2022 is used to estimate forecast tax depreciation for the 2022–27 period, including new assets to be added to the TAB over this period. We will continue to apply the straight-line method of tax depreciation for the opening TAB value. However, for all new assets forecast to be added to the TAB in the 2022–27 period (with some exceptions discussed further below), we will apply the diminishing value method of tax depreciation.

- **the standard tax asset life for each asset class:** Our assessment of a TNSP's proposed standard tax asset lives is generally guided by the effective life of depreciating assets determined by the Commissioner of Taxation. We consider that the standard tax asset lives for the majority of Powerlink's asset classes should be consistent with the ATO Taxation Ruling 2021/3 regarding the effective life of depreciating assets where possible.²⁷

As discussed above, the PTRM (version 5) applies the diminishing value 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 straight-line method for tax purposes.²⁸ We note that the tax effective lives for in-house software, buildings and equity raising costs are not covered under the ATO Taxation Ruling 2021/3. Therefore, our assessment of the standard tax asset lives for these asset classes are guided by the *Income Tax Assessment 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 subsection 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, which was adopted in Powerlink's proposal.
 - **the value of gamma:** The gamma input for Powerlink is 0.585 for this draft decision. This is consistent with the 2018 Rate of Return Instrument, which requires

²⁶ See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-roll-forward-models-transmission-and-distribution-2020-amendment/final-decision>.

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

²⁸ Our assessment approach on new assets to be exempted from the diminishing value method is discussed in detail below.

us to use a gamma value of 0.585, and adopted in Powerlink's proposal.²⁹ Refer to Attachment 3 for further discussion on this matter.

- **the size and treatment of any tax losses as at 1 July 2022:** 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. Powerlink does not have any accumulated tax losses as at the start of the 2022–27 regulatory control period, which is consistent with our final determination for the 2017–22 period.³⁰
- **forecast immediate expensing of capex:** The PTRM (version 5) requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2022–27 regulatory control period. Our assessment of forecast immediate expensing of capex will be guided by the TNSP's actual immediate expensing of capex from the previous regulatory control period.³¹ We will collect actual data relating to this expenditure in our annual regulatory accounts to further inform our decision on the amount of forecast immediate expensing of capex in future regulatory determinations. Benchmarking may also be considered going forward.³²
- **diminishing value multiplier:** The PTRM (version 5) applies the diminishing value method of tax depreciation and provides an input section for the 'diminishing value multiplier' to be recorded for each year of the regulatory control period. We note that currently the diminishing value multiplier is set at 200 per cent by the ATO.
- **new assets to be exempted from the diminishing value method:** The PTRM (version 5) applies the diminishing value method for tax depreciation purposes to all new depreciable assets except for certain assets. It provides for asset classes 47 to 50 to be depreciated using the straight-line method for tax purposes rather than the diminishing value method. These asset classes are to contain new assets associated with in-house software, buildings (capital works) and equity raising costs.

We consider that the benchmark cost for equity raising costs should not be depreciated using the diminishing value method. We note that section 40.880 of the ITAA and the ATO's Taxation Ruling 2011/6³³ require that businesses claim deductions on equity raising costs in equal proportions over a five-year period. Therefore, in the PTRM, we apply the straight-line method for calculating the tax depreciation for equity raising costs, consistent with the ITAA and ATO's requirements.³⁴ Further, the TNSP may propose capex associated with buildings

²⁹ AER, *Rate of Return Instrument*, December 2018, p. 19.

³⁰ Powerlink, *2023–27 Revenue proposal, Post-tax revenue model*, January 2021.

³¹ In the tax review final report we labelled our approach to determining the amount of capex that is to be immediately expensed as an 'actuals informed approach'. AER, *Final report, Review of regulatory tax approach*, December 2018, p. 66.

³² AER, *Final report, Review of regulatory tax approach*, December 2018, pp. 66–67.

³³ ATO, *Taxation Ruling 2011/6*, July 2016.

³⁴ The benchmark cost for equity raising costs is determined within the PTRM.

and in-house software to be exempted from the diminishing value method of tax depreciation in the PTRM if the proposal satisfies the following requirements:

- **buildings:** We consider that capex for buildings may be exempted from the diminishing value method in the PTRM, consistent with sections 43.15, 43.140 and 43.210 of the ITAA. However, such capex must be consistent with the definition of a capital work under section 43.20 of the ITAA and in ATO Taxation Ruling 97/25.³⁵ We note that this includes new buildings and structural improvements to existing buildings.³⁶ 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 required to be depreciated using the diminishing value method in the PTRM.
- **in-house software:** We consider that capex for in-house software may be exempted from the diminishing value method in the PTRM, consistent with section 40.72 of the ITAA. However, such capex must be consistent with the definition of in-house software under section 995.1 of the ITAA and in ATO Taxation Ruling 2016/3.³⁷ We note that this includes computer software, or the right to use computer software that the TNSP acquires, develops or has someone else develop for the TNSP's business use.³⁸ However, capex associated with other IT assets such as computer hardware is not consistent with the definition of in-house software, and therefore required to be depreciated using the diminishing value method in the PTRM.

7.3.3 Inter-relationships

The cost of corporate income tax building block feeds directly into the annual building block revenue requirement. This cost is determined by five factors:

- pre-tax revenues
- tax expenses (including tax depreciation)
- the corporate tax rate
- any tax losses carried forward
- gamma—the expected proportion of company tax that is returned to investors through the utilisation of imputation credits—which is offset against the cost of corporate income tax.

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

³⁵ ATO, *Taxation Ruling 97/25*, July 2017.

³⁶ ITAA, section 43.20.

³⁷ ATO, *Taxation Ruling 2016/3*, October 2018.

³⁸ ITAA, section 995.1.

The pre-tax revenues depend on all the building block components. Any factor that affects revenue will therefore affect pre-tax revenues. Higher pre-tax revenues can increase the tax payable.³⁹ Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.⁴⁰

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

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

A business that has tax expenses which are greater than its taxable revenue in a period would not be subject to pay tax and generate a tax loss. A tax loss can be carried forward to offset against tax payable in the future.

7.4 Reasons for draft decision

Our draft decision on the estimated cost of corporate income tax is \$41.0 million (nominal) over the 2022–27 regulatory control period. This represents an increase of \$15.0 million (58.0 per cent) from Powerlink’s proposal of \$25.9 million. The key components of our tax treatment are discussed in the following sections.

³⁹ In fact, there is an iterative relationship between tax and revenues. That is, revenues lead to tax, being applied, which increases revenues and leads to slightly more tax and so on. The PTRM is therefore set up to run an iterative process until the revenue and the cost of corporate income tax become stable.

⁴⁰ For example, although increased opex adds to revenue requirement, these expenses are also offset against the revenues as deductions in determining tax, so there is no net impact in this case. A higher return on equity, in contrast, gives rise to no offsetting tax expenses and therefore increases the cost of corporate income tax in proportion to the company tax rate.

7.4.1 Implementation of the tax review

The amended PTRM (version 5) provides for two new inputs which affect the calculation of tax depreciation compared to the current 2017–22 regulatory control period:

- **immediate expensing of capex** – we allow for certain capex to be immediately expensed when estimating the benchmark tax expense
- **diminishing value depreciation method** – we apply the diminishing value method for tax depreciation purposes to all new depreciable assets except for capex associated with in-house software, equity raising costs and buildings.⁴¹

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

7.4.1.1 Forecast immediate expensing of capex

Powerlink proposed that \$100.9 million (\$2021–22) of forecast capex (11.1 per cent of total gross as-commissioned capex) will be immediately expensed for tax purposes in the 2022–27 regulatory control period.⁴²

We accept Powerlink’s proposed method to calculate its forecast immediate expensing of capex. Powerlink has set the forecast immediate expensing capex using the actuals informed approach as set out in our final position of the tax review. This approach involves forecasting a certain proportion of capex as immediately expensed. This proportion is informed by the amount of actual capex that was treated as immediately deductible over a previous period.⁴³ We consider it reasonable to expect that the same proportion of capex previously expensed in Powerlink’s annual tax returns (11.1 per cent) will also be expensed immediately by Powerlink during the 2022–27 period.

As discussed in Attachment 5, we have accepted Powerlink’s proposed forecast capex for the 2022–27 period. Our draft decision is to therefore also accept the proposed amount of forecast immediate expensing capex.

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

7.4.1.2 Assets exempt from the diminishing value method

The PTRM (version 5) applies the straight-line tax depreciation method to the opening TAB at 1 July 2022, but applies the diminishing value method as the regulatory

⁴¹ The buildings asset class is for capital works.

⁴² Powerlink, *Proposed PTRM*, January 2021.

⁴³ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 66.

benchmark for tax depreciation to all new capex.⁴⁴ However, as discussed above, there are some exceptions to this approach under the tax law such as assets relating to in-house software, buildings (capital works) and equity raising costs.⁴⁵ In the PTRM, the benchmark equity raising costs is determined within the model and depreciated using the straight-line tax depreciation method as default.

In its proposal, Powerlink submitted that \$51.6 million (\$2021–22) of forecast in-house software related capex and \$28.1 million (\$2021–22) of forecast buildings capex are to be exempted from the diminishing value tax depreciation method.⁴⁶

We accept Powerlink’s proposed allocation of forecast capex for in-house software and buildings (capital works) to be depreciated using the straight-line method for tax depreciation purposes. This is because the proposed forecast capex for:

- in-house software satisfies the definition under section 995.1 of the ITAA and in ATO Taxation Ruling 2016/3⁴⁷
- buildings satisfies the definition of a capital work under section 43.20 of the ITAA and in ATO Taxation Ruling 97/25.⁴⁸

Accordingly, these assets are not required to be depreciated using the diminishing value method for tax purposes.

7.4.2 Opening tax asset base as at 1 July 2022

For this draft decision, we determine an opening TAB value for Powerlink as at 1 July 2022 of \$4595.8 million (nominal). This draft decision value is slightly lower than Powerlink’s proposed opening TAB value.⁴⁹

For the reasons discussed in Attachment 2, we accept Powerlink’s proposal to remove \$4.4 million (\$2021–22) of assets no longer considered to be providing prescribed services from the TAB as a final year disposal. We also accept the proposed roll-in of assets that provide prescribed services as an end-of-period adjustment.⁵⁰ The residual TAB value of the assets to be included is \$1.0 million (lower than the residual RAB value of \$2.0 million). Our draft decision has updated the proposed values of these

⁴⁴ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76.

⁴⁵ Asset classes 47, 48, 49 and 50 in the PTRM (version 5) provide for this.

⁴⁶ Powerlink, *2023–27 Revenue proposal, Post-tax revenue model*, January 2021; Powerlink, *2023–27 Revenue proposal*, January 2021, p. 119. Our draft decision also moves the opening TAB value in the ‘Buildings - capital works’ asset class back to its original ‘Commercial buildings’ asset class for continuity between the RFM and PTRM. This change has no impact on tax depreciation, as the opening TAB value is depreciated using straight-line depreciation in both asset classes.

⁴⁷ ATO, *Taxation Ruling 2016/3*, October 2018.

⁴⁸ ATO, *Taxation Ruling 97/25*, July 2017.

⁴⁹ Due to updates discussed below, the difference between the draft decision and Powerlink’s proposal is about \$20,000.

⁵⁰ AER, *Draft decision, Powerlink transmission determination 2022–27, Attachment 2 – Regulatory asset base*, September 2021.

transfers for actual inflation that has become available. This update has resulted in a minor decrease to Powerlink's opening TAB as at 1 July 2022.

We have reviewed the remaining inputs to the TAB roll forward and found that they were correct and reconcile with relevant data sources such as annual regulatory accounts and the 2017–22 decision models.⁵¹

Table 7.3 sets out our draft decision on the roll forward of Powerlink's TAB values over the 2017–22 regulatory control period.

Table 7.3 AER's draft decision on Powerlink's TAB roll forward for the 2017–22 regulatory control period (\$ million, nominal)

	2017–18	2018–19	2019–20	2020–21 ^a	2021–22 ^a
Opening TAB	4953.6	4847.3	4822.2	4653.1	4705.9
Capital expenditure ^b	118.5	208.4	73.8	301.0	143.8
Less: tax depreciation	224.9	233.5	242.9	248.1	255.0
Final year adjustment ^c					1.0
Closing TAB	4847.3	4822.2	4653.1	4705.9	4595.8

Source: AER analysis.

(a) Based on estimated capex.

(b) As-commissioned, net of disposals.

(c) Roll-in of assets at 30 June 2022 that provide prescribed services.

7.4.3 Year-by-year tracking approach

We accept Powerlink's proposal to use the year-by-year tracking approach for calculating tax depreciation of its existing assets. This is consistent with our draft decision to accept Powerlink's use of year-by-year tracking for regulatory depreciation purposes (Attachment 4). Under this approach, the capex for each year of a regulatory control period is depreciated individually for tax purposes. It will result in each tax asset class having an expanding list of sub-assets to reflect the regulatory year in which capex on those assets occurred. This extra data helps track remaining tax asset values and associated tax depreciation, and is therefore consistent with the NER.

We are satisfied that the application of the year-by-year tracking method to calculate Powerlink's tax depreciation of existing assets provides an estimate of the tax depreciation amount for a benchmark efficient service provider as required by the

⁵¹ In the PTRM, our draft decision also moves the opening TAB value in the 'Buildings - capital works' asset class back to its original 'Commercial buildings' asset class for continuity between the RFM and PTRM. This change has no impact on Powerlink's revenues, as the forecast tax depreciation of this asset value is unchanged.

NER.⁵² The use of year-by-year tracking means it is no longer necessary to explicitly calculate remaining tax asset lives as at 1 July 2022.

Powerlink used the AER's depreciation tracking module in the RFM to implement year-by-year tracking. We have reviewed Powerlink's application of this module and made some minor updates, consistent with those made to the RAB as discussed in Attachment 2.⁵³

7.4.4 Standard tax asset lives

We accept Powerlink's proposed standard tax asset lives for its existing asset classes because they are:

- broadly consistent with the values prescribed by the Commissioner of taxation in ATO Taxation Ruling 2021/3⁵⁴
- the same as the approved standard tax asset lives for the 2017–22 regulatory control period.

In addition to the existing asset classes approved for the 2017–22 transmission determination, Powerlink proposed two new asset classes for the 2022–27 period. These reflect the new asset classes using the straight-line method of tax depreciation for buildings (capital works) and in-house software. Discussed in section 7.4.1.2, we accept Powerlink's proposal to allocate forecast capex associated with buildings (capital works) and in-house software to the prescribed straight-line tax depreciation asset classes in the PTRM. We also accept the proposed standard tax asset lives of 40 years and 5 years respectively for these asset classes. The proposed standard tax asset lives are consistent with the approved standard tax asset lives for the relevant assets in the 2017–22 period, and consistent with the ITAA.⁵⁵

Table 7.4 sets out our draft decision on the standard tax asset lives for Powerlink. We are satisfied that the standard tax asset lives are appropriate for application over the 2022–27 period. We are also satisfied that the standard tax asset lives provide an estimate of the tax depreciation amount that would be consistent with the tax expenses used to estimate the annual taxable income for a benchmark efficient service provider.⁵⁶

⁵² NER, cl. 6A.6.4.

⁵³ AER, *Powerlink 2022–27 – Draft decision – Attachment 2 – Regulatory asset base*, September 2021, p. 14.

⁵⁴ ATO, *Taxation Ruling TR2021/3 – Income tax: effective life of depreciating assets (applicable from 1 July 2021)*.

⁵⁵ ITAA, sections 40.95(7), 43.15, 43.140 and 43.210.

⁵⁶ NER, cl. 6A.6.4.

Table 7.4 AER's draft decision on Powerlink's standard tax asset lives for the 2022–27 regulatory control period (years)

Asset class	Standard tax asset life
Transmission lines - overhead	47.5
Transmission lines - underground	45.0
Transmission lines - refit	30.0
Substations primary plant	40.0
Substations secondary systems	12.5
Communications other assets	12.5
Comms - civil works	40.0
Network switching centres	12.0
Land	n/a
Easements	n/a
Commercial buildings	40.0
Computer equipment	2.5
Office furniture & miscellaneous	15.0
Office machines	10.0
Vehicles	7.0
Moveable plant	5.0
Insurance spares	n/a
Buildings - capital works ^a	40.0
In-house software ^a	2.5

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.

n/a not applicable. We have not assigned a standard tax asset life to the 'Land', 'Easements' and 'Insurance spares' asset classes because these assets are not subject to depreciation.

A. Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ATO	Australian Taxation Office
Capex	capital expenditure
ITAA	Income Tax Assessment Act 1997
NER	national electricity rules
Opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
TAB	tax asset base
TNSP	transmission network service provider