

Draft Decision

Power and Water Corporation Electricity Distribution Determination 2024 to 2029 (1 July 2024 to 30 June 2029)

Attachment 7 Corporate income tax

September 2023

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7 Corporate income tax

Our determination of the annual revenue requirement includes the estimated cost of corporate income tax for Power and Water Corporation's 2024–29 regulatory control period.¹ Under the post-tax framework, a corporate income tax amount is calculated as part of the building blocks assessment using our post-tax revenue model (PTRM). This amount allows Power and Water Corporation to recover the costs associated with the estimated corporate income tax payable during the 2024–29 period.

This attachment presents our assessment of Power and Water Corporation's proposed corporate income tax amount for the 2024–29 period. It also presents our assessment of its proposed opening tax asset base (TAB), and the proposed standard tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

7.1 Draft decision

We determine an estimated cost of corporate income tax of zero for Power and Water Corporation over the 2024–29 period, compared to Power and Water Corporation's proposal of \$1.1 million.

We expect Power and Water Corporation to incur a forecast tax loss over the 2024–29 period.² For this reason, our draft decision is to set the cost of corporate income tax at zero for the 2024–29 period. We have determined that \$23.3 million in tax losses as at 30 June 2029 will be carried forward to the 2029–34 period where it can be used to offset future tax liabilities. The forecast tax loss arises because Power and Water Corporation's forecast tax expenses will exceed its revenue for tax assessment purposes over the 2024–29 period. This is mostly due to the continued implementation of our findings from the 2018 *Review of the regulatory tax approach*, where the immediate expensing of capital expenditure (capex) and diminishing value method of tax depreciation have resulted in higher forecast tax depreciation.³

We determine an opening tax asset base (TAB) value of \$1,046.7 million (\$ nominal) as at 1 July 2024 for Power and Water Corporation. This is \$14.0 million higher than Power and Water Corporation's proposed opening TAB value of \$1,032.7 million as at 1 July 2024.⁴ This is due to corrections made to the depreciation module and input updates related to inflation (section 7.4).

We accept Power and Water Corporation's proposal:

- to apply an approach for determining the forecast immediate expensing of its capex for the 2024–29 period consistent with its current tax policy to immediately expense capex related to capitalised overheads. However, we have reduced the proposed

¹ NT NER, cl. 6.4.3(a)(4).

² A forecast tax loss occurs when the forecast assessable 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.

³ AER, *Tax review 2018 - Final report*, 17 December 2018, pp. 64–68.

⁴ PWC, *Regulatory proposal – Attachment 10.02 – Post-tax Revenue Model*, January 2023.

\$144.7 million (\$2023–24) in forecast immediate expensing of capex for the 2024–29 period to reflect our draft decision on forecast capex (section 7.4.2)

- to include an end-of-period adjustment to roll-in the written down value of ‘corporate assets’ capex incurred in the 2014–19 regulatory control period that were not included in the opening TAB as at 1 July 2019. However, we have revised this value for updates to actual and estimated inflation
- to use the year-by-year depreciation tracking method as set out in our depreciation module in the roll forward model (RFM) to calculate the forecast tax depreciation of its existing assets (section 7.4.4). However, our draft decision has corrected an error in the proposed depreciation tracking module, which has resulted in a reduction to forecast tax depreciation
- on the standard tax asset lives for its asset classes for the 2024–29 period (section 7.4.5). The 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 2022/1 and/or are the same as the approved standard tax asset lives for the 2019–24 period.⁵

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

7.2 Power and Water Corporation’s proposal

Power and Water Corporation proposed an estimated cost of corporate income tax of \$6.5 million (\$ nominal) using our PTRM,⁶ and with the following inputs:⁷

- an opening TAB value as at 1 July 2024 of \$1,032.7 million (\$ nominal), including a final year asset adjustment of \$7.8 million related to previously incurred corporate asset related capex
- an expected statutory income tax rate of 30% per year
- a value of imputation credits (gamma) of 0.585
- immediately expensed capex amount of \$144.7 million (\$2023–24) reflecting its forecast of capitalised overheads
- tax depreciation of the opening TAB at 1 July 2024 for each asset class applying the year-by-year tracking approach calculated in the depreciation module of the RFM
- revised standard tax asset lives for some asset classes to better align with those advised by the ATO taxation ruling.

⁵ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, June 2022.

⁶ Our published electricity PTRM 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. All assets acquired prior to 1 July 2019 will continue to be depreciated using the straight-line depreciation method for regulatory tax purposes, until these assets are fully depreciated. The PTRM also allows for the immediate expensing of certain capex for tax purposes.

⁷ Power and Water Corporation, *2024-29 SCS PTRM*, January 2023.

Table 7.1 sets out Power and Water Corporation’s proposed estimated cost of corporate income tax over the 2024–29 period.

Table 7.1 Power and Water Corporation’s proposed cost of corporate income tax for the 2024–29 period (\$million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Tax payable	2.8	0.0	0.0	0.0	0.0	2.8
Less: value of imputation credits	1.6	0.0	0.0	0.0	0.0	1.6
Net cost of corporate income tax	1.1	0.0	0.0	0.0	0.0	1.1

Source: Power and Water Corporation, 2024-29 SCS PTRM, January 2023.

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 Power and Water Corporation’s 2024–29 period.⁸ Our estimate is the taxable income that a benchmark efficient entity would earn for providing standard control services if it operated Power and Water Corporation’s business, which is determined in accordance with the PTRM.

7.3.1 Calculating estimated cost of corporate income tax in the PTRM

Our approach for calculating a distributor's estimated cost of corporate income tax is set out in our PTRM⁹ and involves the following steps:¹⁰

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 distributor that we determined using the building block approach.¹¹ It includes capital contributions where these are subject to taxation.
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 block¹²
 - interest expense is a function of the size of the RAB, the benchmark gearing assumption (60%) 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

⁸ Clause 6.5.3 of the NT NER sets out the formula we must use to estimate corporate income tax.

⁹ AER, *Electricity distribution network service providers: Post-tax revenue model (version 5)*, April 2021.

¹⁰ The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NT NER, cl. 6.4.2(b)(4).

¹¹ 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 other revenue adjustments, but the assessment of whether they should give rise to a tax payable will occur on a case-by-case basis.

¹² Our assessment approach for the opex building block is discussed in Attachment 6 of the draft decision.

PTRM applied the straight-line method for calculating tax depreciation for all assets. Consistent with the findings of the 2018 tax review,¹³ the PTRM (version 5) applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method¹⁴ for all assets acquired after 30 June 2019 except for in-house software, buildings (capital works) and equity raising costs. The expenditure for these assets is 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 incurred.¹⁵ The immediately expensed amount is then included in the total tax depreciation amount for the relevant year.

There may be other revenue adjustments, but the assessment of whether they should give rise to a tax payable 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 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 estimated cost of corporate income tax and is included as a separate building block in determining the distributor's annual 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 distributor's proposed cost of corporate tax by analysing the proposed inputs to the PTRM for calculating that cost. Our assessment approach for each of the tax inputs required in the PTRM are discussed in turn below:

- **The opening TAB as at the commencement of the 2024–29 period:** We consider that the roll forward of the opening TAB should be based on the approved opening TAB as at 1 July 2019 and Power and Water Corporation's actual/estimated capex incurred during the 2019–24 period, and the actual capex incurred in the final year (2018–19) of the previous regulatory control period.¹⁶ The roll forward of the TAB for 2019–24 is calculated in our RFM, which relies on the depreciation tracking module.

¹³ AER, *Final report, Review of regulatory tax approach*, December 2018.

¹⁴ For more explanation of how we calculate depreciation using the diminishing value method, please see: AER, *Distribution PTRM handbook*, April 2019, pp. 22–23.

¹⁵ 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.

¹⁶ 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 distribution determination.

The opening TAB value at 1 July 2024 is used to estimate forecast tax depreciation for the 2024–29 period, including new assets to be added to the TAB over this period. Consistent with the 2019–24 determination, we will continue to apply the straight-line method of tax depreciation for the opening TAB value as at 1 July 2019. However, for all assets added to the TAB after this date (with some exceptions discussed further below), we will apply the diminishing value method of tax depreciation.

- **The form of customer contributions:** On 21 October 2020, the Full Federal Court of Australia published a judgement dealing with the tax treatment of capital contributions.¹⁷ The determination:
 - Confirmed an earlier Court ruling that cash contributions were ordinary income and should be treated as assessable income for tax purposes.
 - Overturned an earlier Court ruling and determined that while a gifted asset was a ‘non-cash business benefit’ there was effectively nil income for tax purposes.
- We consider the Court’s ruling on gifted assets requires us to exclude the cost of construction of these assets from the gross capex and capital contributions inputs to the PTRM. Consequently, this excludes gifted assets from the calculation of the estimated cost of corporate income tax building block. Capital contributions in the form of cash continue to be included in the calculation of the estimated cost of corporate income tax building block.
- **The standard tax asset life for each asset class:** Our assessment of a distributor’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 Power and Water Corporation’s asset classes should be consistent with the ATO taxation ruling 2022/1 regarding the effective life of depreciating assets where possible.¹⁸

As discussed above, the PTRM applies the diminishing value tax depreciation method for all new assets except for in-house software, buildings (capital works) and equity raising costs. It provides designated asset classes for these assets to be depreciated using the straight-line method for tax purposes.¹⁹ We note that the tax effective lives for in-house software, buildings (capital works) and equity raising costs are not covered under the ATO Taxation Ruling 2022/1. 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.

¹⁷ Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation* [2020] FCAFC 169, 21 October 2020.

¹⁸ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, June 2022.

¹⁹ Our assessment approach on new assets to be exempted from the diminishing value method is discussed in detail below.

- 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 year for businesses of the size we regulate, which was adopted in Power and Water Corporation’s proposal.
- **The value of gamma:** The gamma input for Power and Water Corporation is 0.57 for this draft decision. This is consistent with the 2022 *Rate of return instrument*, which requires us to use a gamma value of 0.57.²⁰ This is discussed further in attachment 3.
- **The size and treatment of any tax losses as at 1 July 2024:** Where a business has tax losses under our benchmark approach, 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. Power and Water Corporation does not have any accumulated tax losses as at the start of the 2024–29 period, which is consistent with our final determination for the 2019–24 period.²¹
- **Forecast immediate expensing of capex:** The PTRM requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2024–29 period. 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.²² We will collect actual data relating to this expenditure in our annual reporting regulatory information notices (RINs) 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.²³
- **Diminishing value multiplier:** The PTRM 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% by the ATO.
- **New assets to be exempted from the diminishing value method:** The PTRM 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 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 2011/6²⁴ 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,

²⁰ AER, *Rate of return instrument*, February 2023, p. 19.

²¹ AER, *Power and Water 2019-24 - Final decision - Post-Tax Revenue Model*, April 2019.

²² 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.

²³ AER, *Final report, Review of regulatory tax approach*, December 2018, pp. 66–67.

²⁴ ATO, *Taxation Ruling 2011/6*, July 2016.

consistent with the ITAA and ATO's requirements.²⁵ Further, the distributor may propose capex associated with buildings and in-house software 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 97/25.²⁶ We note that this includes new buildings and structural improvements to existing buildings.²⁷ 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 are 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 2016/3.²⁸ 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.²⁹ However, capex associated with other IT assets such as computer hardware is not consistent with the definition of in-house software, and is therefore required to be depreciated using the diminishing value method in the PTRM.

We note Power and Water Corporation has not proposed such exemptions for its forecast capex for the 2024–29 period.

7.3.3 Interrelationships

The cost of corporate income tax building block feeds directly into the annual 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 corporate income tax payable.

²⁵ The benchmark cost for equity raising costs is determined within the PTRM.

²⁶ ATO, *Taxation Ruling 97/25*, July 2017.

²⁷ ITAA, section 43.20.

²⁸ ATO, *Taxation Ruling 2016/3*, October 2018.

²⁹ ITAA, section 995.1.

Of these factors, the corporate tax rate is set externally by the Australian Government. The higher the tax rate the higher the required tax payable.

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.³⁰ Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.³¹

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 forecast 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 distributor 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

We determine the estimated cost of corporate income tax of zero for Power and Water Corporation over the 2024–29 period, compared to its proposed cost of corporate income tax of \$1.1 million (\$ nominal). While Power and Water Corporation has no forecast tax loss at the beginning of the 2024–29 period, we forecast a tax loss to be \$14.6 million (\$ nominal) by the end of the first year (2024–25) of this period. This is forecast to increase to \$35.1 million in 2026–27, before reducing to \$23.3 million by the end of the 2024–29 period. This expected tax loss will be carried forward to the 2029–34 period where it can be used to offset future tax liabilities.

The following sections discuss the reasons for our draft decision on:

³⁰ 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 tax amounts become stable.

³¹ 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 tax payable in proportion to the company tax rate.

- the opening TAB value as at 1 July 2024
- the forecast immediate expensing of capex
- assets to be exempted from the diminishing value method for tax depreciation
- the year-by-year tracking approach for tax depreciation
- the standard tax asset lives for depreciating forecast capex over the 2024–29 period.

Our draft decision on Power and Water Corporation’s proposed return on capital (Attachments 2, 3 and 5) and regulatory depreciation (Attachment 4) building blocks affect total revenues, and therefore also impact the forecast corporate income tax amount.

7.4.1 Opening tax asset base as at 1 July 2024

We accept Power and Water Corporation’s proposed method to establish the opening TAB value as at 1 July 2024. This is because Power and Water Corporation’s proposed approach is based on our RFM and consistent with that previously approved for the 2019–24 period. Based on the proposed approach, we determine Power and Water Corporation’s opening TAB value as at 1 July 2024 of \$1,046.7 million (\$ nominal). This represents an increase of \$14.0 million (or 1.4%) compared to its proposal.

We have reviewed the inputs to the TAB roll forward and found that they were mostly correct and reconcile with relevant data sources such as annual reporting RINs and the 2019–24 decision models. However, we made some changes to the RFM and depreciation tracking module that impact the opening TAB as at 1 July 2024. Discussed in Attachment 2, we accept the end-of-period adjustment to roll-in the written down value of ‘corporate assets’ capex incurred in the 2014–19 regulatory control period that were not included in the opening TAB as at 1 July 2019. However, we have revised this value for updates to actual and estimated inflation.

Further, the tax depreciation amounts in the RFM over the 2019–24 period were impacted by Power and Water Corporation depreciating its historical TAB using the diminishing value method in the depreciation tracking module. At the 2019–24 determination, weighted average remaining lives were used to depreciate the opening TAB at 1 July 2019 on a straight-line basis. Only tax depreciation of 2019–24 capex was calculated using the diminishing value method, consistent with the 2018 tax review. As a result, we consider the tax depreciation amounts in the proposed RFM were \$14.1 million (5.1%) higher than if diminishing value was only applied to the capex for the 2019–24 period, leading to a lower opening TAB at 1 July 2024. We have therefore corrected the calculations to apply straight-line tax depreciation for assets prior to 1 July 2019 and diminishing value tax depreciation for 2019–24 capex.

In its response to our information request, Power and Water Corporation agreed with our changes.³² We note that the opening TAB value as at 1 July 2024 may be updated to reflect actual 2022–23 capex and any revised 2023–24 capex estimates as part of the final decision.

³² PWC, RE: PWC–IR003–RFM and tracking module questions–20220302, 9 March 2023.

Table 7.2 sets out our draft decision on the roll forward of Power and Water Corporation’s TAB over the 2019–24 period.

Table 7.2 AER’s draft decision on Power and Water Corporation’s TAB roll forward for the 2019–24 period (\$million, nominal)

	2019–20	2020–21	2021–22	2022–23 ^a	2023–24 ^a
Opening TAB	920.6	946.3	952.8	963.8	992.8
Capital expenditure ^b	67.5	47.6	70.8	92.7	118.3
Less: tax depreciation	41.8	41.1	59.9	63.6	72.1
Final year asset adjustment					7.7
Closing TAB	946.3	952.8	963.8	992.8	1,046.7

Source: AER analysis.

- (a) Based on estimated capex. We expect to update the TAB roll forward with actual capex for 2022–23 and a revised capex estimate for 2023–24 in the final decision.
- (b) Net of disposals.

7.4.2 Forecast immediate expensing of capex

We accept Power and Water Corporation’s proposal to forecast its immediately expensed capex based on its forecast of capitalised overheads. However, we have updated the value of immediately expensed capex to reflect our draft decision on forecast capex (Attachment 5).

We consider Power and Water Corporation’s approach to forecast its immediate expensing of capex to be reasonable. Power and Water Corporation’s proposed forecast immediate expensing of capex reflects the expenditure associated with capitalised overheads over the 2024–29 period which are deducted immediately for tax purposes. This is consistent with its current tax policy and the actual immediate expensed capex reported in the annual RINs over the 2019–20 to 2021–22 period.³³

We will continue to collect actual data relating to the immediate expensing of capex in our annual reporting RINs to inform our decision on the amount of forecast immediate expensing of capex in the next determination for Power and Water Corporation.

7.4.3 Assets exempt from the diminishing value method

The PTRM applies the diminishing value method as the regulatory benchmark for tax depreciation to all new capex. 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.³⁴ In the PTRM, the benchmark equity raising costs is determined within the model and depreciated using the straight-line tax depreciation method as default.

³³ PWC, *Power and Water Corporation 2021–22 - Annual RIN Response*, October 2021, Table 2.10 and 8.2.7.

³⁴ Asset classes 47, 48, 49 and 50 in the PTRM provide for this.

We note Power and Water Corporation has not proposed any forecast capex associated with buildings (capital works) or in-house software for the 2024–29 period, and our draft decision capex assessment accepted this part of the proposal. As a result, we accept Power and Water Corporation’s proposal that it would not incur any capex on assets that would be exempt from the diminishing value tax depreciation method.

7.4.4 Year-by-year tracking approach

We accept Power and Water Corporation’s proposed change to using the year-by-year tracking method as set out in our depreciation module in the RFM for calculating the tax depreciation of its existing assets as at 1 July 2024.³⁵

The proposed method represents a change from the weighted average remaining life approach previously adopted in the 2019–24 determination. This change is required as a result of implementing the diminishing value tax depreciation method under the 2018 tax review at the 2019–24 determination.³⁶

Under the diminishing value method, the tax depreciation of the capex for each year of a regulatory control period must be calculated individually. This could not be achieved under the weighted average remaining life approach previously applied by Power and Water Corporation.³⁷ Therefore, Power and Water Corporation is required to switch to using the year-by-year tracking method to correctly calculate its tax depreciation of existing assets in the TAB as at 1 July 2024. Because of this change there will be no single set of remaining tax asset lives for each asset class at the start of the 2024–29 period.

Our draft decision has corrected an error in the depreciation tracking module proposed by Power and Water Corporation. Discussed in section 7.4.1, Power and Water Corporation depreciated its historical TAB using the diminishing value method, when only 2019–24 capex should be depreciated by this method. We have therefore corrected the calculations to apply straight-line tax depreciation for assets prior to 1 July 2019 and diminishing value tax depreciation for 2019–24 capex. Following this correction, we are satisfied the application of the year-by-year tracking method provides an appropriate estimate of the tax depreciation amount for a benchmark efficient service provider as required by the National Electricity Rules – Northern Territory (NT NER).³⁸

7.4.5 Standard tax asset lives

We accept Power and Water Corporation’s proposed standard tax asset lives for its existing asset classes because they are:

³⁵ 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 capital expenditures on those assets occurred.

³⁶ AER, *Explanatory statement, Electricity transmission and distribution network service providers, Proposed amendments to the roll forward models (Distribution – version 3) (Transmission – version 4)*, December 2019, pp. 17, 20.

³⁷ The weighted average remaining life method calculates the remaining tax asset life at the end of the regulatory control period by weighting together the remaining tax asset life at the start of that period with the capex incurred over that period.

³⁸ Clause 6.5.3 of the NT NER sets out the formula we must use to estimate corporate income tax. It requires an estimate of the taxable income of a benchmark efficient entity.

- broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2022/1³⁹
- the same as the approved standard tax asset lives for the 2019–24 period.

Power and Water Corporation proposed a new asset class for ‘Batteries’, with a standard asset life for RAB depreciation purposes of 10 years. As discussed in Attachment 4, we accept this new asset class and standard asset life for RAB depreciation purposes. Power and Water Corporation did not include this asset class in its PTRM, or assign a life for tax depreciation purposes, as its proposal does not include any expenditure on batteries for the 2024–29 period. However, it noted that it is exploring potential battery investments, so for completeness, our draft decision assigns the same tax asset life for tax depreciation purposes as the standard asset life for RAB depreciation purposes. This approach is consistent with the ATO’s guidance on determining the effective life of an asset.⁴⁰

Table 7.3 sets out our draft decision on the standard tax asset lives for Power and Water Corporation. We are satisfied that the standard tax asset lives are appropriate for application over the 2024–29 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.⁴¹

³⁹ ATO, *Taxation Ruling TR2022/1– Income tax: effective life of depreciating assets* (applicable from 1 July 2022), June 2022.

⁴⁰ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets*, p. 9; ITAA 1997, s 40.105.

⁴¹ NT NER, cl. 6.5.3.

Table 7.3 AER’s draft decision on Power and Water Corporation’s standard tax asset lives for its distribution network over the 2024–29 period (years)

Asset class	Standard tax asset life
Substations	40.0
Distribution lines	47.5
Transmission lines	47.5
LV services	18.3
Distribution substations	40.0
Distribution switchgear	30.0
Protection	10.0
SCADA	10.0
Communications	10.0
Land and easements	n/a
Property	40.0
IT and communications	5.7
Motor vehicles	7.5
Plant and equipment	14.0
Property leases	15.8
Fleet leases	7.5
Batteries	10.0
Buildings ^a	40.0
In-house software ^a	5.0
Equity raising costs ^a	5.0 ^b

Source: AER analysis.

n/a Not applicable. We have not assigned a standard tax asset life to the ‘Land and easements’ asset class because the capex allocated to it is not subject to depreciation.

(a) These are the only asset classes used for the straight-line method of tax depreciation for new capex. All new capex for other asset classes used the diminishing value method of tax depreciation.

(b) For this draft decision, the forecast capex determined for Power and Water Corporation does not meet a level to trigger any benchmark equity raising costs.

Shortened forms

Term	Definition
AER	Australian Energy Regulator
ATO	Australian Taxation Office
capex	capital expenditure
ITAA	Income Tax Assessment Act 1997
NT NER	National Electricity Rules – Northern Territory
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RIN	regulatory information notice
RFM	roll forward model
TAB	tax asset base
WACC	weighted average cost of capital
