Draft Decision

TasNetworks Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 7
Corporate income tax

September 2023

AUSTRALIAN ENERGY REGULATOR

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7 Corporate income tax

Our determination of the annual revenue requirement includes the estimated cost of corporate income tax for TasNetworks' 2024–29 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 TasNetworks to recover the costs associated with the estimated corporate income tax payable during the 2024–29 period.

This attachment presents our assessment of TasNetworks' proposed corporate income tax amount for its distribution network over 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 amount of $46.5 million ($ nominal) for TasNetworks over the 2024–29 period. This amount is $11.1 million (31.2%) higher than TasNetworks' proposed cost of corporate income tax amount of $35.4 million. The reasons for the increase are due to our draft decision:

- on a higher regulatory depreciation amount (Attachment 4).[2]
- on a higher return on equity amount (Attachment 3).[3]
- on a lower imputation credit (gamma) consistent with the new 2022 *Rate of Return Instrument* (Attachment 3).[4]

This increase is partially offset by our draft decision on a higher tax depreciation amount.[5]

Table 7.1 sets out our draft decision on the estimated cost of corporate income tax for TasNetworks over the 2024–29 period.

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

2 The higher regulatory depreciation is driven by corrections made to the RFM depreciation model and a lower expected inflation rate applied in our draft decision compared to TasNetworks' proposal. All else being equal, a higher regulatory depreciation increases the cost of corporate income tax as it is a component of revenue for tax purposes.

3 The higher return on equity amount is driven by a higher rate of return on equity in our draft decision compared to TasNetworks' proposal. All else being equal, a higher return on equity amount increases the cost of corporate income tax as it is a component of revenue for tax purposes.

4 All else being equal, a lower gamma increases the cost of corporate income tax as it is an offset to the tax payable.

5 The higher tax depreciation is driven by corrections made to the RFM depreciation module which increased the forecast tax depreciation amounts for TasNetworks existing asset classes in this draft decision. All else being equal, a higher tax depreciation decreases the cost of corporate income tax as it is a component of tax expense.

Table 7.1 AER's draft decision on TasNetworks' 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	22.3	21.4	20.1	21.3	22.9	108.0
Less: value of imputation credits	12.7	12.2	11.5	12.1	13.1	61.6
Net cost of corporate income tax	**9.6**	**9.2**	**8.6**	**9.2**	**9.9**	**46.5**

Source: AER analysis.

We determine an opening TAB value of $1,697.7 million ($ nominal) as at 1 July 2024 for TasNetworks. This is $58.8 million lower than TasNetworks' proposed opening TAB value of $1,756.5 million as at 1 July 2024.[6] This is due to the input corrections related to the adjustment for the difference between actual and estimated final year (2018–19) capex for the 2019–14 period, and equity raising costs we made in the roll forward model (RFM) and depreciation module (section 7.4.1).

We accept TasNetworks' proposal:

- for no immediate expensing of forecast capex, consistent with the 2019–24 distribution determination and the actual immediately expensed capex reported in the annual regulatory information notices (RINs) for the 2019–24 period (section 7.4.2)
- that there is no forecast capex associated with buildings (capital works) for the 2024–29 period that would be exempted from the diminishing value tax depreciation method (section 7.4.3)
- to continue using the year-by-year depreciation tracking method as set out in our depreciation module in the RFM to calculate the forecast tax depreciation of its existing assets, subject to a correction to the commencement date for the tracking approach (section 7.4.4)
- 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.[7] We also introduce a new asset class for 'Composite poles' and assign a standard tax asset life that is consistent with the ATO Taxation Ruling 2022/1 (section 7.4.5).

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.

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6 TasNetworks, *TasNetworks-Post Tax Revenue Model - Standard Control -Dec 22-Public,* January 2023.

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

7.2 TasNetworks' proposal

TasNetworks proposed an estimated cost of corporate income tax of $35.4 million ($ nominal) for the 2024–29 period using our PTRM,[8] and with the following inputs:[9]

- an opening TAB value as at 1 July 2024 of $1,756.5 million ($ nominal)
- an expected statutory income tax rate of 30% per year
- a value of imputation credits (gamma) of 0.585
- tax depreciation of the opening TAB as at 1 July 2024 for each asset class applying the year-by-year tracking approach calculated in the depreciation module of the RFM, with a commencement date of 2019–20 for the tracking approach
- the same standard tax asset lives for tax depreciation purposes of new capex for its asset classes in the 2024–29 period as approved for the 2019–24 distribution determination
- no immediate expensing of forecast capex.

Table 7.2 sets out TasNetworks' proposed estimated cost of corporate income tax over the 2024–29 period.

Table 7.2 TasNetworks' 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	20.7	16.4	15.1	16.8	16.3	85.3
Less: value of imputation credits	12.1	9.6	8.8	9.8	9.5	49.9
Net cost of corporate income tax	**8.6**	**6.8**	**6.2**	**7.0**	**6.8**	**35.4**

Source: TasNetworks, *TasNetworks-Post Tax Revenue Model - Standard Control -Dec 22-Public,* 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 TasNetworks' 2024–29 period.[10] Our estimate is the taxable income that a benchmark efficient entity would earn for providing standard control services if it operated TasNetworks' business, which is determined in accordance with the PTRM.

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8 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.

9 TasNetworks, *TasNetworks-Post Tax Revenue Model - Standard Control -Dec 22-Public,* January 2023.

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

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 PTRM[11] and involves the following steps:[12]

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.[13] 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 and tax depreciation in the following ways:
   - operating expense is set equal to the opex building block[14]
   - interest expense is a function of the size of the regulatory asset base (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 PTRM applied the straight-line method for calculating tax depreciation for all assets. Consistent with the findings of the 2018 tax review,[15] the PTRM (version 5) applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method[16] 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.[17] 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.

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

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

13 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.

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

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

16 For more explanation of how we calculate depreciation using the diminishing value method, please see: AER*, Distribution PTRM handbook*, April 2021, pp. 22–23.

17 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.

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 distributor (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 the tax inputs to the PTRM

The estimated cost of corporate income tax is an output of the PTRM. We therefore assess the distributor's proposed cost of corporate income 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 value 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 TasNetworks' 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.[18] The roll forward of the opening TAB for the 2019–24 period is calculated in our RFM, which relies on the depreciation module.

  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.[19] 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

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18 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.

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

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 live 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 TasNetworks' asset classes should be consistent with the ATO Taxation Ruling 2022/1 regarding the effective life of depreciating assets where possible.[20]

  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.[21] 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 capital works assets 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 annum for businesses of the size we regulate, which was adopted in TasNetworks' proposal.

- **The value of gamma**: The gamma input for TasNetworks 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.[22] 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. TasNetworks 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.[23]

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

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

22 AER, *Rate of Return Instrument*, February 2023, p. 19.

23 AER, *Final Decision, TasNetworks Distribution Determination, 2019 to 2024, Attachment 7*, Corporate income tax, April 2019, p. 5. Positive tax amounts were forecast in that determination.

- **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.[24] We will collect actual data relating to this expenditure in our annual reporting RINs to further inform our decision on the amount of forecast immediate expensing of capex in future regulatory determinations. Benchmarking may also be considered going forward.[25]
- **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 2011/6[26] 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.[27] 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.[28] We note that this includes new buildings and structural improvements to existing buildings.[29] However, capex on separate assets within a building such as air-conditioning units, transformers and converters are not consistent with the definition

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24 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.

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

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

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

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

29 ITAA, section 43.20.

of a capital work, and therefore are 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.[30] 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.[31] 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 TasNetworks has not proposed any forecast immediate expensing of capex nor has it proposed any forecast capex associated with buildings (capital works) and in-house software for the 2024–29 period.

7.3.3 Interrelationships

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

- pre-tax revenues
- tax expense (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.

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.[32] Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.[33]

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

31 ITAA, section 995.1

32 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.

33 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 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 instead will 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 amount is $46.5 million ($ nominal) for TasNetworks over the 2024–29 period. This represents an increase of $11.1 million from TasNetworks' proposal of $35.4 million. The following sections discuss the reasons for our draft decision on:

- 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 TasNetworks' proposed return on capital (Attachments 2, 3 and 5) and the regulatory depreciation (Attachment 4) building blocks affect 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 TasNetworks proposed method to establish the opening TAB value as at 1 July 2024. This is because TasNetworks' 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 TasNetworks' opening TAB value as at 1 July 2024 to be $1,697.7 million ($ nominal). This represents a decrease of $58.8 million compared to its proposal.

We have reviewed the inputs to the RFM for the TAB roll forward. While we found the inputs were generally correct and reconcile with relevant data sources such as annual reporting

RINs and the 2019–24 decision models, some needed correcting. In addition, we consider that some of TasNetworks' proposed RFM inputs require updating with newly available data.

Therefore, we have made the following amendments to TasNetworks' proposed RFM and year-by-year tracking depreciation module, which impact the opening TAB value as at 1 July 2024:

- corrected the 2018–19 and 2019–20 actual gross capex values to include $12.4 million of capital contributions and $1.2 million of equity raising costs respectively. These costs were not included in TasNetworks' proposed RFM and as a result, the net capex was understated. The corrections resulted in around $13.6 million increase to the opening TAB as at 1 July 2024. TasNetworks agreed with these corrections in its response to our information request[34]
- corrected the 2018–19 forecast gross capex values to reflect the approved amounts set out in the 2014–19 final determination. The 2018–19 forecast gross capex is an input used to calculate the adjustment to the opening TAB as at 1 July 2024 for the difference between actual and forecast net capex for that final year of the 2014–19 period. This correction resulted in around $6.5 million increase to the opening TAB as at 1 July 2024. TasNetworks agreed with this correction in its response to our information request[35]
- corrected the input errors in the depreciation module for calculating the actual year-by-year tracking tax depreciation for the 2019–24 period, including the commencement date of the tracking approach.[36] This amendment increased the tax depreciation for the 2019–24 period and resulted in a $79 million reduction to the opening TAB as at 1 July 2024. TasNetworks agreed with these corrections in its response to our information request.[37]

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.

Table 7.3 sets out our draft decision on the roll forward of TasNetworks' TAB over the 2019–24 period.

34 TasNetworks, *Response to AER IR#029*, 11 May 2023.

35 TasNetworks, *Response to AER IR#029*, 11 May 2023.

36 The details of our corrections to the depreciation module are set out in section 7.4.4.

37 TasNetworks, *Response to AER IR#029*, 11 May 2023.

Table 7.3 AER's draft decision on TasNetworks' TAB roll forward for the 2019–24 period ($million, nominal)

	2019–20	2020–21	2021–22	2022–23[a]	2023–24[a]
Opening TAB	1,383.8	1,446.9	1,519.4	1,574.8	1,630.5
Capital expenditure[b]	132.1	152.1	146.5	155.6	169.6
Less: tax depreciation	69.0	79.6	91.1	99.9	102.4
Closing TAB	**1,446.9**	**1,519.4**	**1,574.8**	**1,630.5**	**1,697.7**

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

TasNetworks did not propose any forecast capex to be immediately expensed for tax purposes over the 2024–29 period.

TasNetworks did not report any actual immediate expensing of capex in the 2019–20 to 2021–22 annual RINs. For this reason, we consider TasNetworks' proposal to be reasonable as its proposed amount is consistent with its current approach and informed by the actual amount of capex immediately expensed historically.

For this draft decision, we accept TasNetworks' proposal that it has no forecast immediate expensing of capex for the 2024–29 period. 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 TasNetworks.

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.[38] In the PTRM, the benchmark equity raising costs are determined within the model and depreciated using the straight-line tax depreciation method as default.

We note TasNetworks has not proposed any forecast capex associated with buildings (capital works) and 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 TasNetworks' proposal that it would not incur any capex on assets that would be exempt from the diminishing value tax depreciation method.

[38] Asset classes 47, 48, 49 and 50 in the PTRM provide for this.

7.4.4 Year-by-year tracking approach

We accept TasNetworks' proposal to continue applying 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.[39] However, we corrected the commencement date for the tracking approach to 2012–13 instead of 2019–20 proposed by TasNetworks to be consistent with the 2017–19 distribution determination. We also corrected a number of other inputs in the proposed depreciation module.

For the reasons discussed in Attachment 2, we corrected the commencement date of the tracking approach to be consistent with that approved in the 2017–19 distribution determination. Under the tracking approach, the commencement date of 2012–13 must be maintained in the depreciation module for the correct implementation to calculating tax depreciation going forward. This was also the case for the 2019–24 distribution determination.[40] In its response to our information request, TasNetworks agreed with our correction to the commencement date.[41]

We also updated various other inputs to the module as set out in section 7.4.1, such as historical capex amounts to be consistent with those made to the RFM.[42]

We note that the corrections we made to the depreciation module, in particular, the commencement date of the year-by-year tracking approach has materially increased the forecast tax depreciation by around $60 million. This is because the later commencement of 2019–20 for the tracking approach proposed by TasNetworks resulted in an overstatement of tax depreciation in the 2019–24 period for capex incurred from 2012–13 to 2018–19. This means the proposed depreciation module incorrectly deducted more depreciation from the TAB over the 2019–24 period and this resulted in a lower forecast tax depreciation for the 2024–29 period. Our correction to the commencement date to 2012–13 removed this overstatement of the tax depreciation for the 2019–24 period. As a result, there is a higher forecast tax depreciation for the 2024–29 period compared to the proposal.

Following these corrections and updates, 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 (NER).[43]

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39 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.

40 AER, *TasNetworks distribution determination 2019–24, attachment 4, April 2019*, p. 6.
AER, *TasNetworks 2019-24 - Distribution - Final decision - Depreciation Model - April 2019*.

41 TasNetworks, *Response to AER IR#029*, 11 May 2023.

42 This includes corrections to 2018–19 actual gross capex value, asset disposal values and actual inflation rate, adjustments for the difference and the return on that difference between the actual and forecast net capex for the final year (2018–19) of the previous 2017–19 period, and the rate of return values.

43 Clause 6.5.3 of the 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.

7.4.5 Standard tax asset lives

We accept TasNetworks' proposed standard tax asset lives assigned to its existing asset classes, because they are:

- broadly consistent with the tax asset lives prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2022/1[44]
- the same as the approved standard tax asset lives for the 2019–24 period.

For our draft decision and discussed in Attachment 4, we also decided to introduce a new asset class for 'Composite poles' to provide a depreciation schedule that better reflects the nature and economic life of this type of assets. Following our review of TasNetworks' proposed capex for poles (discussed in Attachment 5), we consider this capex should be allocated to a new asset class of 'Composite poles' for depreciation instead of existing asset classes as proposed by TasNetworks. For tax depreciation purposes, we have assigned a standard tax asset life of 45 years for this new asset class, which is consistent with that prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2022/1 for this asset type.[45]

Table 7.4 sets out our draft decision on TasNetworks' standard tax asset lives for each of its asset classes. 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.[46]

Table 7.4 AER's draft decision on TasNetworks' standard asset lives (years)

Asset class	Standard tax asset life
Overhead subtransmission lines (urban)	44.5
Underground subtransmission lines (urban)	50.0
Urban zone substations	32.8
Rural zone substations	32.8
SCADA	32.8
Distribution switching stations (ground)	36.3
Overhead high voltage lines urban	34.9
Overhead high voltage lines rural	33.4

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

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

46 NER, cl. 6.5.3.

Asset class	Standard tax asset life
Voltage regulators on distribution feeders	45.5
Underground high voltage lines	31.4
Underground high voltage lines SWER	31.4
Distribution substations HV (pole)	37.6
Distribution substations HV (ground)	33.2
Distribution substations LV (pole)	36.6
Distribution substations LV (ground)	34.1
Overhead low voltage lines underbuilt urban	37.4
Overhead low voltage lines underbuilt rural	38.7
Overhead low voltage lines urban	35.3
Overhead low voltage lines rural	36.7
Underground low voltage lines	42.5
Underground low voltage common trench	43.1
HVST service connections	36.4
HV service connections	36.4
HV metering CA service connections	36.4
HV/LV service connections	36.4
Business LV service connections	36.3
Business LV Metering CA service connections	36.4
Domestic LV service connections	36.4
Domestic LV metering CA service connections	36.4
Emergency network spares	n/a
Motor vehicles	9.2
Minor assets	5.2
Non-system property	34.5
Spare parts	n/a
NEM assets	3.0
Business management systems	5.0
Land	n/a

Asset class	Standard tax asset life
Easements	n/a
Composite poles	45.0
Buildings[a]	40.0
Equity raising costs[a]	5.0

Source: AER analysis.

n/a not applicable. We have not assigned a standard tax asset life to the ‘Land’ and ‘Easements’ asset classes because the capex allocated to them are not subject to depreciation. We also have not assigned a standard tax asset life to the 'Emergency Network Spares’ and ‘Spare Parts’ asset classes because there is no forecast capex allocated to these asset classes for the 2024–29 period.

(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.

Shortened forms

Term	Definition
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
RIN	regulatory information notice
RFM	roll forward model
TAB	tax asset base
WACC	weighted average cost of capital