Draft Decision

Ausgrid 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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Contents

7 Corporate income tax

Our determination of the annual revenue requirement includes the estimated cost of corporate income tax for Ausgrid's 2024–29 regulatory control period.[1] Ausgrid's dual function assets are high voltage assets which support the broader NSW/ACT transmission network owned and operated by Transgrid. The AER has decided to continue applying transmission pricing to these assets.[2] Under the post-tax framework, a corporate income tax amount is calculated as part of the building block assessment using our post-tax revenue model (PTRM). This amount allows Ausgrid to recover the costs associated with the estimated corporate income tax payable during the 2024–29 period.

This attachment presents our assessment of Ausgrid'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 the estimated costs of corporate income tax over the 2024–29 period of $106.5 million and of $16.6 million ($ nominal) for Ausgrid's distribution and transmission networks respectively. These amounts are $26.0 million (32.3%) and $3.7 million (28.6%) higher than Ausgrid's proposal of $80.5 million and $12.9 million ($ nominal) for its distribution and transmission networks respectively. The reasons for the increases are due to our draft decision:

- on a lower tax depreciation amount[3]
- on a lower imputation credit (gamma) consistent with the new 2022 *Rate of Return Instrument* (Attachment 3)[4]
- on a higher return on equity amount (Attachment 3)[5]
- on a higher regulatory depreciation amount (Attachment 4).[6]

Table 7.1 and Table 7.2 set our draft decision on the estimated costs of corporate income tax over the 2024–29 period for Ausgrid's distribution and transmission networks respectively.

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

2 AER, *Framework and approach: Ausgrid, Endeavour Energy and Essential Energy (New South Wales), Regulatory control period commencing 1 July 2024*, July 2022, p. 54.

3 The lower tax depreciation is driven by the reductions to forecast capex in our draft decision compared to Ausgrid's proposal. All else being equal, a lower tax depreciation increases the cost of corporate income tax as it is a component of tax expense.

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 return on equity amount is driven by a higher rate of return on equity in our draft decision compared to Ausgrid's 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.

6 The higher regulatory depreciation is driven by a lower expected inflation rate applied in our draft decision compared to Ausgrid's 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.

Table 7.1 AER's draft decision on Ausgrid's cost of corporate income tax for the 2024–29 period – distribution ($million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Tax payable	47.1	47.5	50.6	53.1	49.5	247.8
Less: value of imputation credits	26.9	27.1	28.8	30.3	28.2	141.2
Net cost of corporate income tax	**20.3**	**20.4**	**21.7**	**22.8**	**21.3**	**106.5**

Source: AER analysis.

Table 7.2 AER's draft decision on Ausgrid's cost of corporate income tax for the 2024–29 period – transmission ($million, nominal)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Tax payable	7.0	7.8	8.4	7.4	7.9	38.5
Less: value of imputation credits	4.0	4.4	4.8	4.2	4.5	21.9
Net cost of corporate income tax	**3.0**	**3.4**	**3.6**	**3.2**	**3.4**	**16.6**

Source: AER analysis.

We determine opening TAB values of $10,410.7 million and $1,508.8 million ($ nominal) as at 1 July 2024 for Ausgrid's distribution and transmission networks respectively. These amounts are $6.5 million and $4.7 million higher than Ausgrid's proposed opening TAB values of $10,404.2 million and $1,504.1 million as at 1 July 2024 for its distribution and transmission networks respectively.[7] This is due to input changes related to capitalised leases, asset disposals and dual function asset reclassifications we made in the roll forward model (RFM) and depreciation module (section 7.4.1).

We accept Ausgrid'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 and the actual immediately expensed capex reported in the annual regulatory information notices (RINs) over the period 2019–20 to 2021–22. However, we updated Ausgrid's proposed immediate expensing of capex for the 2024–29 period amount for its distribution and transmission networks respectively (section 7.4.2)
- that the forecast capex associated with buildings (capital works)[8] and in-house software for the 2024–29 period will be exempted from the diminishing value tax depreciation method. This maintains the approach approved in the 2019–24 determination of applying the straight-line tax depreciation method for these assets (section 7.4.3)

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7 Ausgrid, *Att. 4.1.a - RFM for distribution*, January 2023, Ausgrid, *Att. 4.1.c - RFM for transmission*, January 2023.

8 Ausgrid's 'Buildings (capital works)' asset class is split between system and non-system.

- to use 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 (section 7.4.4)
- on the standard tax asset lives for its existing asset classes for the 2024–29 period. We introduced a new asset class for 'Composite poles' and assign a standard tax asset life that is consistent with the ATO Taxation Ruling 2022/1. We also accept Ausgrid's proposed four new distribution and three new transmission asset classes, as well as the associated standard tax asset lives of (section 7.4.5):
  - For distribution – 'Leases (network)' asset class with a proposed standard tax asset life of 7 years.
  - For distribution and transmission – 'Leases (non-network)' and 'Enterprise resource platform' asset classes with proposed standard tax asset lives of 7 years and 5 years respectively. Ausgrid did not assign a standard tax asset life for its new 'Land (non-system) depreciation' asset class.[9]

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.

7.2 Ausgrid's proposal

Ausgrid proposed the estimated costs of corporate income tax of $80.5 million and $12.9 million ($ nominal) for its distribution and transmission networks respectively for the 2024–29 period. Ausgrid used our PTRM,[10] with the following inputs:[11]

- an opening TAB values as at 1 July 2024 of $10,404.2 million and of $1,504.1 million ($ nominal) for its distribution and transmission networks respectively
- an expected statutory income tax rate of 30% per year for both networks
- a value of imputation credits (gamma) of 0.585 for both networks
- immediately expensed capex amount of $7.2 million and $9.1 million ($2023–24) for its distribution and transmission networks respectively
- 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 tracking module of the RFM for both networks

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9 We agree with Ausgrid not to assign a standard tax asset life to the new 'Land (non-system) depreciation' asset class in the PTRM. This is because the asset class is used for reverse depreciation purposes only in respect of disposed assets with a remaining tax asset life of 5 years as at 30 June 2024 in the final year asset adjustment section of the RFM.

10 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 2024 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.

11 Ausgrid, *Att. 4.1.b - PTRM for distribution*, January 2023; Ausgrid, *Att. 4.1.d - PTRM for transmission*, January 2023.

- the same standard tax asset lives for tax depreciation purposes of new capex for its existing asset classes in the 2024–29 period as approved for the 2019–24 distribution determination
- four new distribution and three new transmission asset classes and its associated standard tax asset lives for 'Leases (network)' for distribution; and 'Leases (Non-network)', 'Enterprise resource platform' and 'Land (non-system) depreciation' for its distribution and transmission network respectively.

Table 7.3 and Table 7.4 set out Ausgrid's proposed estimated costs of corporate income tax over the 2024–29 period for its distribution and transmission networks respectively.

Table 7.3 Ausgrid's proposed cost of corporate income tax for the 2024–29 period – distribution ($million, nominal)

	2024–25	2025–29	2029–27	2027–28	2028–29	Total
Tax payable	40.2	39.0	37.8	40.0	37.1	194.1
Less: value of imputation credits	23.5	22.8	22.1	23.4	21.7	113.5
Net cost of corporate income tax	**16.7**	**16.2**	**15.7**	**16.6**	**15.4**	**80.5**

Source: Ausgrid, *Att. 4.1.b - PTRM for distribution*, January 2023.

Table 7.4 Ausgrid's proposed cost of corporate income tax for the 2024–29 period – transmission ($million, nominal)

	2024–25	2025–29	2029–27	2027–28	2028–29	Total
Tax payable	6.0	6.5	6.7	5.7	6.2	31.0
Less: value of imputation credits	3.5	3.8	3.9	3.3	3.6	18.1
Net cost of corporate income tax	**2.5**	**2.7**	**2.8**	**2.3**	**2.6**	**12.9**

Source: Ausgrid, *Att. 4.1.d - PTRM for transmission*, 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 Ausgrid's 2024–29 period.[12] Our estimate is the taxable income that a benchmark efficient entity would earn for providing standard control services if it operated Ausgrid'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 PTRM[13] and involves the following steps:[14]

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

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

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.[15] 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[16]
   - 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,[17] the PTRM (version 5) applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method[18] 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.[19] 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 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.

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14 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).

15 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.

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

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

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

19 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.

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 Ausgrid'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.[20] 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 judgment dealing with the tax treatment of capital contributions.[21] 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.

  While Ausgrid's proposed treatment of gifted assets is consistent with our PTRM, it raised concerns that it was unclear the Full Federal Court's decision would apply to other jurisdictions. Ausgrid stated that its internal tax advice indicated that the Court's ruling

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20 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.

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

does not apply in NSW because of different capital contribution frameworks.[22] However, we note that both Essential Energy and Endeavour Energy have excluded gifted assets in their proposals for the 2024–29 period and have not raised any issues or concerns that the Court's decision should not apply in NSW. Based on the material before us, our view is that we should treat the NSW distributors consistently by excluding gifted assets from the calculation of the estimated cost of corporate income.

- **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 Ausgrid's asset classes should be consistent with the ATO Taxation Ruling 2022/1 regarding the effective life of depreciating assets where possible.[23]

  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.[24] 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 Ausgrid's proposal.

- **The value of gamma**: The gamma input for Ausgrid 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.[25] 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. Ausgrid does not have any

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22 Ausgrid, *Att. 4.1 - 2024-29 Proposed revenue*, January 2023, p. 15.

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

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

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

accumulated tax losses as at the start of the 2024–29 period, which is consistent with our final determination for the 2019–24 period.[26]

- **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.[27] 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.[28]
- **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[29] 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.[30] 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.[31] We note that this includes new buildings and structural improvements to existing

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

27 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.

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

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

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

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

buildings.[32] However, capex on separate assets within a building such as air-conditioning units, transformers and converters are not consistent with the definition of a capital work, and therefore are required to be depreciated using the 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.[33] 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.[34] 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 Ausgrid has proposed exemptions from the diminishing value method for forecast capex associated with buildings (capital works)[35] and in-house software for the 2024–29 period. This is consistent with the approach applied in the 2019–24 determination.

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.

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

32 ITAA, section 43.20.

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

34 ITAA, section 995.1

35 Ausgrid's 'Buildings (capital works)' asset class are split between system and non-system.

payable.[36] Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.[37]

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 – 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 businesses 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 current period.

7.4 Reasons for draft decision

We determine the estimated cost of corporate income tax amounts over the 2024–29 period of $106.5 million and $16.6 million ($ nominal) for Ausgrid's distribution and transmission networks respectively. These amounts are $26.0 million (32.3%) and $3.7 million (28.6%) higher than Ausgrid's proposal of $80.5 million and $12.9 million ($ nominal) for its distribution and transmission networks respectively. 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.

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36 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.

37 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.

Our draft decision on Ausgrid's 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 Ausgrid's proposed method to establish the opening TAB as at 1 July 2024. This is because Ausgrid'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 Ausgrid's opening TAB values as at 1 July 2024 to be $10,410.7 million and $1,508.8 million ($ nominal) for its distribution and transmission networks respectively. These amounts represent increases of $6.5 million and $4.7 million compared to its proposal.

We have reviewed the inputs to the TAB roll forward and found that they were mostly correct and reconciled with relevant data sources such as annual reporting RINs and the 2019–24 decision models. However, we made the following changes to the RFM and depreciation tracking module inputs which impact the opening TAB value as at 1 July 2024:

- Removed expenditures related to capitalised leases for 2019–20 distribution capex and 2021–22 distribution and transmission capex to reflect our approach to address mid-period changes in accounting standards.[38] For the associated capitalised lease costs we also updated the following final year TAB asset adjustments as at 30 June 2024:
  - For the distribution network leases, the proposed roll-in amount of $0.5 million was updated to $0.3 million ($ nominal) representing the remaining lease value as at 30 June 2024.
  - For the distribution and transmission non-network leases, the proposed roll-in values of $6.3 million and $0.5 million respectively were removed. This is because these leases will expire by 30 June 2024.
- Based on Ausgrid's response to our information request,[39] we updated the asset disposal values for 2022–23 and the final year asset adjustment reallocation of a negative residual closing TAB amount associated with these disposals to reflect our draft decision distribution and transmission closing TABs as at 30 June 2024.[40] This TAB reallocation reflects the same treatment we have made to the distribution and transmission closing RAB as at 30 June 2024, as a result of Ausgrid's proposed 'Property sales strategy to help with affordability' program (see attachments 2 and 4).
- Updated Ausgrid's proposal by reallocating $149.1 million of its distribution TAB assets to its transmission TAB as at 30 June 2024 from the proposed amount of $149.2 million ($ nominal). This TAB reallocation is consistent with the RAB treatment to reflect

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38 Ausgrid, *Response to information request IR046*, 7 July 2023. Forecast costs related to leases will only begin being treated as capex from the start of the 2024–29 period.

39 Ausgrid, *Follow up response to information request IR019*, 21 June 2023.

40 The negative TAB is reallocated from the existing 'Land (non-system)' asset class to a new 'Land (non-system) depreciation' asset class for reverse tax depreciation purposes. This is a TAB reallocation and does not affect the total value of the opening TAB as at 1 July 2024.

changes in assets that meet the definition of a dual function asset in accordance with the National Electricity Rules (NER).[41]

These updates are discussed in more detail in Attachment 2. We note that the opening TAB values 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 7.5 and Table 7.6 set out our draft decision on the roll forward of Ausgrid's TAB values over the 2019–24 period for its distribution and transmission networks respectively.

Table 7.5 AER's draft decision on Ausgrid's TAB roll forward for the 2019–24 period – distribution ($million, nominal)

	2019–20	2020–21	2021–22	2022–23[a]	2023–24[a]
Opening TAB	9,981.2	10,232.1	10,271.6	10,094.4	10,287.0
Capital expenditure[b]	607.0	437.6	251.3	645.1	756.5
Less: tax depreciation	356.2	398.1	428.5	452.5	484.0
Final year asset adjustment[c]					–148.8
Closing TAB	**10,232.1**	**10,271.6**	**10,094.4**	**10,287.0**	**10,410.7**

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.
(c) Reflects capitalised lease costs for existing leases and dual function asset re-classification adjustments as at 30 June 2024.

Table 7.6 AER's draft decision on Ausgrid's TAB roll forward for the 2019–24 period – transmission ($million, nominal)

	2019–20	2020–21	2021–22	2022–23[a]	2023–24[a]
Opening TAB	1,340.9	1,355.0	1,350.4	1,334.2	1,340.5
Capital expenditure[b]	61.6	47.8	38.4	64.0	85.5
Less: tax depreciation	47.5	52.5	54.5	57.8	66.2
Final year asset adjustment[c]					149.1
Closing TAB	**1,355.0**	**1,350.4**	**1,334.2**	**1,340.5**	**1,508.8**

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.
(c) Reflects dual function asset re-classification adjustments as at 30 June 2024.

[41] NER, cl. 6.24.2. Ausgrid, *Att. 4.1 - 2024-29 Proposed revenue*, January 2023, p. 6. This TAB reallocation does not affect Ausgrid's total combined distribution and transmission opening TAB value as at 1 July 2024.

7.4.2 Forecast immediate expensing of capex

Ausgrid proposed $7.2 million and $9.1 million ($2023–24) of forecast capex to be immediately expensed over the 2024–29 period for its distribution and transmission networks respectively.[42]

We consider Ausgrid's approach to forecast its immediate expensing of capex to be reasonable. Ausgrid's proposed forecast immediate expensing of capex reflects the expenditure associated with asset decommissioning over the 2024–29 period which are deducted immediately for tax purposes.[43] This is consistent with its current tax policy and the actual immediate expensed capex reported in the annual RINs over the period 2019–20 to 2021–22.[44]

As discussed in attachment 5, we have made reductions to Ausgrid's proposed forecast capex. Our draft decision is to therefore reduce the proposed amount of forecast immediate expensing of capex to reflect our draft decision on the overall forecast capex. This resulted in a reduction of the forecast immediately expensed capex to $6.4 million from the proposed amount of $7.2 million ($2023–24) over the 2024–29 period, for its distribution network.[45] We also updated the forecast immediately expensed capex for Ausgrid's transmission network, which is not materially different to its proposal.[46]

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 Ausgrid.

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.[47] 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 addition to equity raising costs, Ausgrid proposed forecast capex associated buildings (capital works)[48] and in-house software for the 2024–29 period to be exempted from the diminishing value tax depreciation method. We accept Ausgrid's proposal because the

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42 Ausgrid, *Att. 4.1.b - PTRM for distribution*, January 2023; Ausgrid, *Att. 4.1.d - PTRM for transmission*, January 2023.

43 Ausgrid, *Att. 4.1 - 2024-29 Proposed revenue*, January 2023, p. 15.

44 Ausgrid, *Ausgrid 2020–21 - Annual reporting RIN - Basis of preparation*, October 2021, pp. 55–57. Ausgrid's asset decommissioning expenditure that are immediately tax deductible include activity such as asbestos removal and land remediation costs.

45 All else being equal, a reduction of immediately expensed capex will increase the forecast cost of corporate income tax.

46 The difference between our draft decision and Ausgrid's transmission proposed immediately expensed capex amount is less than $70,000.

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

48 Ausgrid's 'Buildings (capital works)' asset class is split between system and non-system.

forecast capex satisfies the relevant definitions under the tax law.[49] Therefore, these assets will be depreciated using the straight-line method for tax purposes, consistent with the approach applied in the 2019–24 determination.

7.4.4 Year-by year tracking approach

We accept Ausgrid'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.[50]

The proposed method represents a change from the 'weighted average remaining life' (WARL) approach previously adopted in the 2019–24 determination. This change is required as a result of implementing the diminishing tax value depreciation method under the 2018 tax review at the 2019–24 determination.[51]

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 WARL approach previously applied by Ausgrid.[52] Therefore, Ausgrid 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.

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 NER.[53]

7.4.5 Standard tax asset lives

We accept Ausgrid's 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[54]
- the same as the approved standard tax asset lives for the 2019–24 period.

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49 ATO, *Taxation Ruling 2016/3*, October 2018; ATO, *Taxation Ruling 97/25*, July 2017; ITAA, section 995.1; ITAA, section 43.20.

50 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.

51 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.

52 The WARL 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.

53 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.

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

In addition to the existing asset classes approved for the 2019–24 period, Ausgrid proposed the following four new distribution and three new transmission asset classes for the 2024–29 period, as well as the associated standard tax asset lives:

- For distribution – 'Leases (network)' asset class with a proposed standard tax asset life of 7 years.
- For distribution and transmission – 'Leases (non-network)' and 'Enterprise resource platform' asset classes with proposed respective standard tax asset lives of 7 years and 5 years. Ausgrid did not assign a standard tax asset life for its new 'Land (non-system) depreciation' asset class.[55]

Leases (7 years) – For the reasons discussed in Attachment 4, our draft decision accepts the addition of the proposed new network and non-network leases asset classes. This is to give effect to a change in accounting standards (AASB 16) requiring certain lease costs to be capitalised (see Attachment 2).[56] We also accept the proposed standard tax asset life of 7 years, which is consistent with the RAB standard life, as it reflects the average expected lease term for new property leases and therefore the expected economic life of these assets. We are satisfied that this approach is consistent with the ATO's guidance on determining the effective life of an asset.[57]

Enterprise resource platform (5 years) – Consistent with our draft decision in Attachment 4, we accept the addition of the proposed new 'Enterprise resource platform' asset class associated with the software upgrade of Ausgrid's business system operations.[58] We also accept the proposed standard tax asset life of 5 years. Ausgrid noted that the forecast capex for this new asset class would normally be allocated to its existing 'IT systems' or 'In-house software' asset classes, both of which have a standard tax asset life of 5 years. Furthermore, since capex allocated to the 'Enterprise resource platform' asset class generally reflects the nature of an intangible depreciating asset, we consider a standard tax asset life of 5 years is appropriate as it is consistent with subsection 40.95(7) of the ITAA.

Composite poles (45 years) – 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 Ausgrid's 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 the existing asset classes as proposed by Ausgrid. For tax depreciation purposes, we have assigned a standard tax asset life of 45 years for this new asset class, which is

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55 We agree with Ausgrid not to assign a standard tax asset life to the new 'Land (non-system) depreciation' asset class in the PTRM. This is because the asset class is used for reverse depreciation purposes only in respect of disposed assets with a remaining tax asset life of 5 years as at 30 June 2024 in the final year asset adjustment section of the RFM.

56 For leases associated with property, office equipment and motor vehicles.

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

58 Ausgrid, *2024–29 Regulatory Proposal*, January 2023, p. 57.

consistent with that prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2022/1 for this asset type.[59]

Table 7.7 and Table 7.8 set out our draft decision on the standard tax asset lives for Ausgrid's distribution and transmission networks respectively. 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.[60]

Table 7.7 AER's draft decision on Ausgrid's standard tax asset lives over the 2024–29 period – distribution (years)

Asset class	Standard tax asset life
Sub-transmission lines and cables	47.5
Cable tunnel (dx)	40.0
Distribution lines and cables	48.7
Substations	40.0
Transformers	42.0
Low voltage lines and cables	45.8
Customer metering and load control	25.0
Customer metering (digital)	n/a
Communications (digital) - dx	10.0
Total communications	7.4
System IT (dx)	7.0
Ancillary substation equipment (dx)	15.0
Land and easements[a]	n/a
Furniture, fittings, plant and equipment	10.6
Land (non-system)[a]	n/a
Other non system assets	10.5
IT systems	4.0
Motor vehicles	20.0
Land (non-system) depreciation[a]	n/a

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

60 NER, cl. 6.5.3.

Asset class	Standard tax asset life
Enterprise resource platform	5.0
Distribution leases (network)	7.0
Distribution leases (non-network)	7.0
Composite poles	45.0
Buildings (system)[b]	40.0
Buildings (non-system)[b]	40.0
In-house software[b]	5.0
Equity raising costs[b]	5.0[c]

Source: AER analysis.
n/a not applicable. We have not assigned a standard tax asset life to the 'Land and easements' and 'Land (non-system)' asset classes because the capex allocated to them are not subject to depreciation. We have also not assigned a standard tax asset life to the 'Customer metering (digital)' asset class as it has no forecast capex for the 2024–29 period.
(a) We have not assigned a standard tax asset life to the new 'Land (non-system) depreciation' asset class as this is used for reverse depreciation purposes of disposed assets. There is no forecast capex allocated to this asset class.
(b) 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.
(c) For this draft decision, the forecast capex determined for Ausgrid does not meet a level to trigger any benchmark equity raising costs.

Table 7.8 AER's draft decision on Ausgrid's standard tax asset lives over the 2024–29 period – transmission (years)

Asset class	Standard tax asset life
Transmission & zone land & easements	n/a
Transmission buildings 132/66kV	40.0
Zone buildings 132/66kV	40.0
Transmission transformers 132/66kV	40.0
Zone transformers 132/66kV	45.0
Transmission substation equip 132/66kV	40.0
Zone substation equip 132/66kV	40.0
Ancillary substation equipment (tx)	15.0
132kV tower lines	47.6
132kV concrete & steel pole lines	47.6
132kV wood pole lines	47.6

Asset class	Standard tax asset life
132kV feeders underground	47.0
Cable tunnel (tx)	47.6
Network control & com systems	37.2
Communications (digital) - tx	10.0
System IT (tx)	7.0
IT systems	4.0
Furniture, fittings, plant and equipment	10.6
Motor vehicles	20.0
Land (non-system)[a]	n/a
Other non system assets	10.5
Transmission leases (network)	50.0
Land (non-system) depreciation[a]	n/a
Enterprise resource platform	5.0
Transmission leases (non-network)	7.0
Composite poles	45.0
Buildings (system)[b]	40.0
Buildings (non-system)[b]	40.0
In-house software[b]	5.0
Equity raising costs[b]	5.0[c]

Source: AER analysis.

n/a not applicable. We have not assigned a standard tax asset life to the 'Transmission & zone land & easements' and 'Land (non-system)' asset classes because the capex allocated to them are not subject to depreciation.

(a) We have not assigned a standard tax asset life to the new 'Land (non-system) depreciation' asset class as this is used for reverse depreciation purposes of disposed assets. There is no forecast capex allocated to this asset class.

(b) 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.

(c) For this draft decision, the forecast capex determined for Ausgrid does not meet a level to trigger any benchmark equity raising costs.

Shortened forms

Term	Definition
AASB	Australian Accounting Standards Board
AER	Australian Energy Regulator
ATO	Australian Taxation Office
capex	capital expenditure
ERP	enterprise resource platform
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
WARL	weighted average remaining life