Final Decision

Power and Water Corporation Electricity Distribution Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 7
Corporate income tax

April 2024

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List of attachments

This attachment forms part of the AER's final decision on the distribution determination that will apply to Power and Water Corporation for the 2024–29 period. It should be read with all other parts of the final decision.

As a number of issues were settled at the draft decision stage or required only minor updates, we have not prepared all attachments. The final decision attachments have been numbered consistently with the equivalent attachments to our draft decision. In these circumstances, our draft decision reasons form part of this final decision.

The final decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

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Attachment 7 – Corporate income tax

Attachment 13 – Classification of services

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7 Corporate income tax

Our distribution determination includes the estimated cost of corporate income tax for Power and Water Corporation's 2024–29 regulatory control period (period).[1] Under the post-tax framework, the cost of corporate income is calculated as part of the building blocks assessment using our post-tax revenue model (PTRM).

This attachment sets out our final decision on Power and Water Corporation's revised proposed corporate income tax for the 2024–29 period. It presents our assessment of the inputs required in the PTRM for the calculation of the cost of corporate income tax.

7.1 Final decision

We accept Power and Water Corporation's revised proposal of zero for the estimated cost of corporate income tax over the 2024–29 period.[2]

We expect Power and Water Corporation to incur a forecast tax loss over the 2024–29 period.[3] For this reason, our final decision is to set the cost of corporate income tax at zero for the 2024–29 period. We have determined that $31.5 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 Power and Water Corporation's forecast immediate expensing of capital expenditure (capex) over the 2024–29 period which has resulted in higher forecast tax depreciation.

Our final decision is to determine an opening tax asset base (TAB) value as at 1 July 2024 of $1,049.5 million ($ nominal), which is consistent with Power and Water Corporation's revised proposal (section 7.1.1).[4]

For this final decision, we determine that $146.5 million ($2023–24) of Power and Water Corporation's forecast capex will be immediately expensed for tax purposes in the 2024–29 period (section 7.1.2). This is $0.1 million lower than the $146.6 million included in Power and Water Corporation's revised proposal.

We also accept Power and Water Corporation's revised proposal on the standard tax asset lives for the majority of its asset classes, except for the 'Fleet leases' and 'Property leases' asset classes (section 7.1.3). We have updated the standard tax asset lives of these asset classes to be consistent with their standard asset lives for regulatory depreciation purposes.

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

2 Power and Water Corporation, *Revised proposal – Attachment 2.1 – 2024–29 SCS PTRM,* November 2023.

3 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.

4 Our final decision opening TAB is $3,563 lower than Power and Water Corporation's revised proposal as we have updated the final year TAB adjustment for roll-in of corporate assets for actual 2023–24 CPI. This difference cannot be observed when rounding the amounts to 1 decimal place.

This is also consistent with our treatment of capitalised leases assets over the 2019–24 period.

In the draft decision, we made the following changes to Power and Water's modelling of its cost of corporate income tax:[5]

- We revised the opening TAB as at 1 July 2024 to reflect our amendments to some inputs in the roll forward model (RFM) and depreciation tracking module, and corrections for some minor errors:
  - We accepted the end-of-period adjustment to roll-in the written down value of 'corporate assets' capex incurred in the 2014–19 period that were not included in the opening TAB as at 1 July 2019. However, we revised this value for updates to actual and estimated inflation.
  - We accepted Power and Water Corporation's use of 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. However, we corrected the calculations to apply straight line depreciation for assets prior to 1 July 2019 and diminishing value tax depreciation for 2019–24 capex.
- We accepted Power and Water Corporation's proposed standard tax asset lives for its existing asset classes. We also accepted the proposed new asset class for 'Batteries', with a standard asset life for RAB depreciation purposes of 10 years and assigned the same tax asset life for tax depreciation purposes.[6] This approach is consistent with the Australian Taxation Office's (ATO) guidance on determining the effective life of an asset.[7]
- We accepted Power and Water Corporation's approach for determining the forecast of its immediately expensed capex as being consistent with its current tax policy to immediately expense capex related to capitalised overheads. However, we reduced the value of immediately expensed capex for the 2024–29 period to reflect our draft decision on forecast capex.

Power and Water Corporation's revised proposal adopted the changes required by the draft decision in full. It also made some updates to its TAB roll forward and forecast of its immediately expensed capex for the 2024–29 period.[8]

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5 AER, *Draft decision: Power and Water Corporation's distribution determination 2024 to 2029, Attachment 7 – Corporate income tax*, September 2023, pp. 1–2.

6 Power and Water Corporation did not include this asset class in its PTRM, or assign a life for tax depreciation purposes, as its proposal did 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 assigned the same tax asset life for tax depreciation purposes as the standard asset life for regulatory depreciation purposes.

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

8 Power and Water Corporation, *2024–29 Revised regulatory proposal*, 30 November 2023, p. 13.

7.1.1 Opening tax asset base as at 1 July 2024

Our final decision is to determine an opening TAB value as at 1 July 2024 of $1,049.5 million ($ nominal), which is consistent with Power and Water Corporation's revised proposal.[9]

In our draft decision, we accepted Power and Water Corporation's proposed method to establish the opening TAB as at 1 July 2024. However, we amended some of the proposed inputs used for the TAB roll forward—specifically, we made adjustments to correct for some minor errors in the depreciation module and update inputs related to inflation. We noted that the opening TAB may be updated as part of the final decision to reflect actual capex for 2022–23 and any revised capex estimate for 2023–24.[10]

Power and Water Corporation's revised proposal adopted our draft decision changes.[11] It also updated the opening TAB as at 1 July 2024 to reflect the actual capex for 2022–23 and a revised 2023–24 capex estimate. For the reasons discussed in Attachment 2, we accept the actual 2022–23 capex and the updated 2023–24 capex estimate for this final decision. The 2023–24 capex estimate is higher than what we approved in our draft decision, reflecting more recent data. We will update the 2023–24 estimated capex for actuals at the next distribution determination for 2029–34.

For this final decision, we have updated the 2019–20 and 2020–21 actual capex inputs in the RFM and depreciation tracking module to reflect Power and Water Corporation's revisions to capex in its re-submission of its annual reporting Regulatory Information Notices (RINs)for those years. In its response to our information request, Power and Water Corporation agreed with our updates to the RFM.[12]

Table 7.1 sets out our final decision on the roll forward of Power and Water Corporation's TAB over the 2019–24 period.

9 Our final decision opening TAB is $3,563 lower than Power and Water Corporation's revised proposal as we have updated the final year TAB adjustment for roll-in of corporate assets for actual 2023–24 CPI. This difference cannot be observed when rounding the amounts to 1 decimal place.

10 AER, *Draft decision: Power and Water Corporation's distribution determination 2024 to 2029, Attachment 7 – Corporate income tax*, September 2023, p. 9.

11 Power and Water Corporation, *2024–29 Revised regulatory proposal*, 30 November 2023, p. 13.

12 Power and Water Corporation*, RE: PWC – information request - IR#037 - Resubmitted RINs and RFM - 2024022*, 1 March 2024.

Table 7.1 AER's final 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	2023–24[a]
Opening TAB	920.6	946.3	952.8	963.8	994.5
Capital expenditure[b]	67.3	47.4	70.8	101.7	126.2
Less: tax depreciation	41.5	40.9	59.9	70.9	78.9
Final year asset adjustment[c]	–	–	–	–	7.7
Closing TAB	**946.3**	**952.8**	**963.8**	**994.5**	**1,049.5**

Source: AER analysis.

(a) Based on estimated capex. We expect to update the TAB roll forward with actual capex at the next determination.

(b) Net of disposals.

(c) Reflects capitalised corporate assets as at 30 June 2024.

7.1.2 Forecast immediate expensing of capex

For this final decision, we determine that $146.5 million ($2023–24) of Power and Water Corporation's forecast capex is to be immediately expensed for tax purposes in the 2024–29 period. This is slightly lower than the $146.6 million included in Power and Water Corporation's revised proposal.

In our draft decision, we accepted Power and Water Corporation's proposed method to forecast its immediately expensed capex. This approach is based on the forecast expenditure associated with capitalised overheads over the 2024–29 period, which are deducted immediately for tax purposes. However, we reduced the value of immediately expensed capex to reflect our draft decision on forecast capex.[13]

Power and Water Corporation's revised proposal increased its forecast for immediately expensed capex over the 2024–29 period to align with its higher forecast capex.

As discussed in Attachment 5, our final decision accepts Power and Corporation's revised proposed forecast capex subject to some minor modelling updates. As such, we determine a total forecast capex of $537.8 million ($2023–24),[14] which is $0.4 million lower than Power and Water Corporation's revised proposed forecast capex. Consistent with the approach adopted in the draft decision, we need to adjust the amount of immediately expensed capex to reflect the overall estimate of forecast capex. We have therefore calculated a lower immediately expensed capex amount to reflect the forecast capex for this final decision.

We will continue to collect actual data relating to the immediate expensing of capex in our annual reporting RIN to inform our decision for this type of expenditure in the next distribution determination for Power and Water Corporation.

[13] AER, *Power and Water Corporation 2024–29 - Draft decision*, September 2023.

[14] Net capex exclusive of half-year WACC adjustment.

7.1.3 Standard tax asset lives

Our final decision accepts Power and Water Corporation's revised proposed standard tax asset lives for the majority of its asset classes, except for the 'Property leases' and 'Fleet leases' asset classes, because they are broadly consistent with the values prescribed by the Commissioner of Taxation in the ATO Ruling 2022/1 and the *Income Tax Assessment Act 1997*.[15]

Power and Water Corporation's revised proposal sets the standard tax asset lives for the 'Property leases' and 'Fleet leases' asset classes at 15.8 years and 7.5 years respectively. These standard tax asset lives differ from the standard asset lives used for regulatory depreciation purposes for these asset classes.

For the 2019–24 determination, Power and Water had set the standard tax asset lives of these asset classes to be the same as the standard asset lives for regulatory depreciation purposes for these asset classes. At the time, we found this approach to be reasonable as the ATO had not provided a specific ruling on the effective life for assets associated with capitalised leases. Given this, we considered it appropriate to use the economic life of the capitalised leases as the standard tax asset life, which was consistent with the ATO's guidance on determining the effective life of an asset.[16]

We note there is still no specific ruling on the effective life of capitalised leases for tax purposes. Consistent with our 2019–24 determination, we consider that the effective life for capitalised leases should be the same as their economic life (i.e. standard asset life for regulatory depreciation purposes).[17] Therefore, our final decision is to change the standard tax asset lives for the 'Property leases' and 'Fleet leases' asset classes to 4.5 years and 7 years respectively, which align with their standard asset lives (Attachment 2). In its response to our information request, Power and Water Corporation did not raise any concerns with applying this approach for the 'Property leases' asset class. However, for the 'Fleet leases' asset class Power and Water Corporation submitted that its proposed standard tax asset life of 7.5 years was more appropriate as it is the mid-point between:

- 7 years, which reflects the weighted average economic life of its motor vehicle leases
- 8 years, which is the lower bound of ATO's guidance on motor vehicles assets.[18]

We consider that the standard tax asset life of motor vehicle assets *owned* by an entity is not a relevant consideration in determining the tax asset life of *leased* motor vehicle assets. Instead, we expect the lease term to be the key determining factor in calculating the tax depreciation amount of such assets. Therefore, our final decision is to align the tax asset lives of leased assets with their standard asset lives. We note that this change does not

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15 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, June 2022; ITAA 1997, s 40.105.

16 AER, *Power and Water Corporation 2019-24 - Draft decision - Attachment 7 - Corporate income tax*, September 2018, p. 18.

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

18 PWC*, RE: PWC – information request - IR#031 – Tax Asset lives and Corporate Assets – 20240112*, 15 January 2024.

impact Power and Water Corporation's estimated cost of corporate income tax of zero over the 2024–29 period.

Table 7.2 sets out our final decision on the standard tax asset lives as at 1 July 2024 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.[19]

[19] NT NER, cl. 6.5.3.

Table 7.2 AER's final decision on Power and Water Corporation's standard tax asset lives for 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	4.5
Fleet leases	7.0
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 final decision, the forecast capex determined for Power and Water Corporation does not meet a level to trigger any benchmark equity raising costs.

7.2 Assessment approach

We did not change our assessment approach for the cost of corporate income tax from our draft decision. Attachment 7 (section 7.3) of our draft decision details that approach.[20]

[20] AER, *Draft Decision Attachment 07 – Corporate income tax - Power and Water Corporation distribution revenue proposal*, September 2023, pp. 3–8.

Shortened forms

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