Final decision

Australian Gas Networks (Victoria & Albury)
Gas distribution access arrangement
1 July 2023 to 30 June 2028

Attachment 7 – Corporate income tax

June 2023

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Our determination of the total revenue for AGN includes the estimated cost of corporate income tax for the 2023–28 access arrangement period (2023–28 period).[1] Under the post-tax framework, a corporate income tax amount is calculated as part of the building blocks assessment using our post-tax revenue model (PTRM). This amount allows AGN to recover the estimated cost of corporate income tax for the 2023–28 period.

This attachment presents our assessment of AGN's proposed corporate income tax amount for the 2023–28 period. It also presents our assessment of the proposed opening tax asset base (TAB), and the standard and remaining tax asset lives as at 1 July 2023 used to estimate tax depreciation for the purpose of calculating tax expenses.

7.1 Final decision

Our final decision on AGN's estimated cost of corporate income tax is $28.0 million ($ nominal) over the 2023–28 period. This decision represents an increase of $6.8 million (31.7%) from AGN's revised proposed cost of corporate income tax of $21.3 million. The reasons for the increase are due to our final decision:

- on a higher regulatory depreciation amount (section 4.1 of attachment 4)[2]
- on a lower imputation credit (gamma) consistent with the new 2022 *Rate of Return Instrument* (attachment 3)[3]
- on a lower tax depreciation.[4]

This increase is partially offset by our final decision on a lower return on equity (attachment 3).[5]

For this final decision, we accept AGN's revised proposal and determine an opening TAB value as at 1 July 2023 of $1260.0 million.

Table 7-1 sets out our final decision on the estimated cost of corporate income tax for AGN over the 2023–28 period.

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1 NGR, r. 76(c).

2 The higher regulatory depreciation is driven by lower expected inflation in our final decision compared to AGN's revised 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 All else being equal, a lower gamma increases the cost of corporate income tax as it is an offset to the tax payable.

4 The lower tax depreciation is driven by lower expected inflation in our final decision compared to AGN's revised proposal. All else being equal, a lower tax depreciation increases the cost of corporate income tax as it is a component of tax expense.

5 The lower return on equity amount is driven by a lower rate of return on equity and lower expected inflation, which in turn decreases the capital base, in our final decision compared to AGN's revised proposal. All else being equal, a lower return on equity amount decreases the cost of corporate income tax as it is a component of revenue for tax purposes.

Table 7-1 AER's final decision on AGN's cost of corporate income tax for the 2023–28 access arrangement period ($ million, nominal)

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
Tax payable	8.1	13.1	12.4	15.9	15.7	65.2
Less: value of imputation credits	4.6	7.5	7.1	9.1	9.0	37.2
Net corporate income tax	**3.5**	**5.6**	**5.3**	**6.8**	**6.8**	**28.0**

Source: AER analysis.

In our draft decision, we accepted:[6]

- AGN's proposed method to establish the opening TAB as at 1 July 2023.
- AGN's proposed standard tax asset lives for all of its existing asset classes and the continuation of using the weighted average method to calculate remaining tax asset lives for estimating the forecast tax depreciation.
- AGN's implementation of the findings of our 2018 tax review, including the introduction of immediate expensing of capital expenditure, diminishing value method of tax depreciation and applying a 20 year cap on the tax asset lives for certain classes of new gas assets.[7]

However, our draft decision updated:

- the 2017 capex and capital contributions inputs for the 'Meters' and 'Mains and services' asset classes, respectively, to be consistent with the values reported in the resubmitted regulatory information notice (RIN) for that year.
- The tax calculations to include the carrying forward for the forecast tax loss of $25.0 million ($2022–23) as at 1 July 2023, consistent with the final decision PTRM for the half-year extension period.

AGN's revised proposal broadly adopted all our draft decision amendments. It has also updated the estimated capex for 2022 and the six-month extension period.[8] We accept AGN's revisions based on our capex assessment.

Our final decision confirms our acceptance of AGN's approach to forecasting its cost of corporate income tax for the 2023–28 period as set out in the PTRM.

Consistent with our draft decision, we accept AGN's proposed $31.5 million ($2022–23) of forecast immediate expensing of capex for the 2023–28 period. We are satisfied that AGN's approach to immediate expensing based on mains replacement capex for the 2023–28 period is reasonable. We will collect actual data relating to this expenditure in our annual

6 AER, *Draft decision, AGN Gas Services Access Arrangement 2023–28, Attachment 7 – Corporate income tax*, December 2022, pp. 14–18.

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

8 AGN, *AGN - Revised Final Plan 2023-28 - Attachment 1.5B - Post Tax Revenue Model*, January 2023

reporting RIN to further inform our decision on the forecast for the immediate expensing of capex in the next review for AGN.

In its response to our information request, AGN confirmed that its revised proposed gross capex and capital contributions for the 2023–28 period do not contain any gifted assets.[9] We are satisfied that this approach is consistent with the Federal Court's ruling on the tax treatment of gifted assets.[10]

Opening tax asset base as at 1 July 2023

For our final decision, we accept AGN's revised proposed opening TAB value of $1260.0 million ($ nominal). This is $28.7 million lower than our draft decision.

In our draft decision, we accepted AGN's proposed method to establish the opening TAB as at 1 July 2023. However, we amended the proposed value of 2017 actual capex to reflect the information in the resubmitted 2017 annual reporting RIN.

We noted in our draft decision that the opening TAB may be updated to reflect any revisions for 2022 and the six-month extension period capex estimates as part of the final decision.[11]

AGN's revised proposal adopted the amendments we made to the opening TAB value in the draft decision in full. It also updated the capex estimates for 2022 and the six-month extension period with revised amounts, which are lower than the total amount approved in our draft decision for this period.

We accept AGN's revised capex estimates for 2022 and the six-month extension period based on our capex assessment. We will update the 2022 and the six-month extension period capex estimates for actuals at the next access arrangement review.

Table 7-2 sets out our final decision on the roll forward of AGN's TAB values over the 2018–23 period.

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[9] AGN, *Response to information request #029*, 23 February 2023, p. 1.

[10] Federal Court of Australia, *Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169*, 21 October 2020. The Court confirmed that cash contributions were ordinary income and should be treated as assessable income for tax purposes. Therefore, cash contributions are included in gross capex and customer contributions. The Court determined that while a gifted asset was a 'non-cash business benefit' there was effectively nil income for tax purposes. As a result, the cost of construction of gifted assets are excluded from gross capex and customer contributions.

[11] AER, *Draft decision, Australian Gas Networks (Victoria and Albury) Access Arrangement 2023–28, Attachment 7 – Corporate income tax*, December 2022, p. 17.

Table 7-2 AER's final decision on AGN's tax asset base roll forward over the 2018–23 period ($ million, nominal)

	2018	2019	2020	2021	2022[a]	2023[b]
Opening TAB	698.6	766.2	849.4	956.0	1091.7	1202.1
Capital expenditure[c]	94.9	114.4	142.8	177.4	159.9	85.5
Less: tax depreciation	27.2	31.2	36.2	41.7	49.6	27.5
Closing TAB	**766.2**	**849.4**	**956.0**	**1091.7**	**1202.1**	**1260.0**

Source: AER Analysis.

(a) Based on estimated capex. We expect to update the TAB for actual capex at the next review.

(b) The half year period of 1 January to 30 June 2023. Based on estimated capex.

(c) Net of disposals.

Standard and remaining tax asset lives as at 1 July 2023

For this final decision, we accept AGN's revised proposed standard and remaining tax asset lives for all its asset classes. AGN's revised proposed standard tax asset lives are consistent with our draft decision, and we confirm our position that they are broadly consistent with the values prescribed by the Commissioner for taxation in ATO ruling 2022/1 and the *Income Tax Assessment Act* (ITAA).[12]

Consistent with the draft decision, we also accept AGN's revised proposal to apply the weighted average method for calculating the remaining tax asset lives as at 1 July 2023. This method is a continuation of the approved approach used in the 2018–23 period and applies the approach as set out in our roll forward model (RFM). Consequently, our final decision is to accept AGN's revised proposed remaining tax asset lives.

Table 7-3 sets out our final decision on the standard and remaining tax asset lives for AGN. We are satisfied that these lives are appropriate for application over the 2023–28 period. We are also satisfied these 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.[13]

12 ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*, p. 179.

13 NGR, r. 87A(1).

Table 7-3 AER's final decision on AGN's standard and remaining tax asset lives as at 1 July 2023 (years)

Asset class	Standard tax asset life[a]	Remaining tax asset life[b]
Mains & services	20.0	39.7
Meters	15.0	10.4
Buildings	35.0	3.0
SCADA	10.0	7.7
Computer equipment	4.0	3.0
Other assets	15.0	11.6
Land	n/a	n/a
Mains & services Albury	20.0	37.4
Meters Albury	15.0	10.4
Buildings Albury	n/a	n/a
SCADA Albury	10.0	2.8
Computer equipment Albury	4.0	3.9
Other assets Albury	15.0	11.1
Land Albury	n/a	n/a
Equity raising costs[c]	5.0	0.5

Source: AER analysis.

(a) All new assets use the diminishing value method of tax depreciation.

(b) Used for straight-line method of tax depreciation.

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

n/a Not applicable. We have not assigned a standard tax asset life and remaining tax asset life to some asset classes because the assets allocated to them are non-depreciating assets. For the 'Buildings Albury' asset class, we have not allocated a standard or remaining tax life as there are no forecast capex or opening tax value allocated to the asset class.

7.2 Assessment approach

For this final decision, with the exception for the value of imputation credits (gamma), we have followed 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.[14]

[14] AER, *Draft decision, Australian Gas Networks (Victoria and Albury) Access Arrangement 2023–28, Attachment 7 – Corporate income tax*, December 2022, pp. 7–14.

The gamma input for AGN is 0.57 for this final decision. This is consistent with the 2022 *Rate of Return Instrument*, which requires us to use a gamma value of 0.57.[15] Refer to Attachment 3 for further discussion on this matter.

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

Glossary

Term	Definition
AER	Australian Energy Regulator
AGN	Australian Gas Networks (Victoria and Albury)
ATO	Australian Tax Office
capex	Capital expenditure
ITAA	Income Tax Assessment Act 1997
NGR	National Gas Rules
opex	Operating expenditure
PTRM	Post-tax revenue model
RFM	Roll forward model
RIN	Regulatory Information Notice
TAB	Tax asset base