

Draft Decision

ElectraNet Transmission Determination 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 7 Corporate income tax

September 2022

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AER reference: 202188

Amendment record

Version	Date	Pages
1	30 September 2022	20

Note

This attachment forms part of the AER’s draft decision on ElectraNet’s 2023–28 transmission determination. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

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7 Corporate income tax

Our revenue determination includes the estimated cost of corporate income tax for ElectraNet’s 2023–28 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 ElectraNet to recover the costs associated with the estimated corporate income tax payable during the 2023–28 period.

This attachment presents our assessment of ElectraNet’s proposed corporate income tax amount for the 2023–28 period. It also presents our assessment of its proposed opening tax asset base (TAB), and its proposed standard tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

7.1 Draft decision

We accept ElectraNet’s proposed approach to calculate its estimated cost of corporate income tax amount for the 2023–28 period. ElectraNet has used our PTRM which implements the findings from our 2018 *Review of the regulatory tax approach* (tax review).²

Our draft decision determines an estimated cost of corporate income tax amount of \$5.2 million (\$ nominal) for ElectraNet over the 2023–28 period. This decision represents an increase of \$5.2 million from ElectraNet’s proposal of zero. The key reason for the increase is due to our draft decision to apply a higher rate of return on equity (Attachment 3) using updated market data.³

Our draft decision on the forecast tax amount for the 2023–28 period is significantly lower than that forecast for the 2018–23 period. This change is primarily due to the implementation of our findings from the tax review. The introduction of immediate expensing of capital expenditure (capex) and diminishing value method of tax depreciation have significantly increased ElectraNet’s forecast tax depreciation amount.

For our draft decision, we are satisfied that ElectraNet’s proposed approach for determining the forecast immediate expensing of its capex over the 2023–28 period is reasonable. We accept the actuals informed approach for calculating \$51.7 million (\$2022–23) in forecast immediate expensing of capex associated with its capital refurbishment and refit expenditure (section 7.4.1.1).

We determine an opening TAB value as at 1 July 2023 of \$2,443.6 million for ElectraNet. This is \$22.1 million lower than the amount proposed by ElectraNet due to:

- the removal of a residual value from the TAB as at 30 June 2023 to account for assets that have fully depreciated
- updating the final year asset adjustments to reflect our decision on accelerated depreciation

¹ NER, cl. 6A.5.4(a)(4)

² AER, *Final report: Review of regulatory tax approach*, December 2018.

³ All else being equal, a higher rate of return on equity will increase the cost of corporate income tax because it increases the return on equity component of taxable income.

- the inclusion of additional final year asset adjustments to reflect the roll-in of capitalised leases due to a change in accounting standards
- the inclusion of estimates for asset disposal values for 2021–22 and 2022–23.

We accept ElectraNet’s proposed standard tax asset lives for all of its asset classes for the 2023–28 period. These 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 consistent with the approved standard tax asset lives for the 2018–23 period.⁴

In addition to the existing asset classes, ElectraNet proposed 2 new asset classes for the 2023–28 period. We accept ElectraNet’s proposed new asset class for ‘Transmission line refit – insulators replacement 2023–28’ and associated standard tax asset life. While we accept the proposed new asset class for ‘Right of use assets’, we have amended the standard tax asset life (section 7.4.4).

We also accept ElectraNet’s proposal to use the year-by-year depreciation tracking method to calculate the forecast tax depreciation of its existing assets. This method is a continuation of the approved approach used in the 2018–23 period and applies the approach as set out in our depreciation module in the roll forward model (RFM). Under this approach, the capex for each year of a regulatory control period is depreciated individually for tax purposes (section 7.4.3).

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.

Table 7.1 sets out our draft decision on the estimated cost of corporate income tax for ElectraNet over the 2023–28 period.

Table 7.1 AER’s draft decision on ElectraNet’s cost of corporate income tax for the 2023–28 regulatory control period (\$ million, nominal)

	2023–24	2024–25	2025–26	2026–27	2027–28	Total
Tax payable	0.0	0.0	0.0	3.8	8.7	12.5
Less: value of imputation credits	0.0	0.0	0.0	2.2	5.1	7.3
Net cost of corporate income tax	0.0	0.0	0.0	1.6	3.6	5.2

Source: AER analysis.

⁴ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*.

7.2 ElectraNet’s proposal

ElectraNet proposed an estimated cost of corporate income tax of zero for the 2023–28 period using our PTRM,⁵ and with the following inputs:⁶

- an opening TAB value as at 1 July 2023 of \$2,465.7 million (\$ nominal)⁷
- an expected statutory income tax rate of 30% per year
- a value of imputation credits (gamma) of 0.585
- immediately expensed capex amount of \$51.7 million (\$2022–23)
- depreciation of the opening TAB at 1 July 2023 for each asset class applying the year-by-year tracking approach calculated in the depreciation tracking module of the RFM
- the same standard tax asset lives for tax depreciation purposes of new assets for its existing asset classes in the 2023–28 period as approved for the 2018–23 transmission determination
- two new asset classes and associated standard tax asset lives for ‘Transmission line refit – insulators replacement 2023–28’ and ‘Right of use assets’, which are subject to the diminishing value method of tax depreciation.

7.3 Assessment approach

We make an estimate of taxable income for each regulatory year as part of our determination of the annual building block revenue requirement for ElectraNet’s 2023–28 regulatory control period.⁸ Our estimate is the taxable income that a benchmark efficient entity would earn for providing prescribed transmission services if it operated ElectraNet’s business and is determined in accordance with the PTRM. Our draft decision uses version 5.1 of the PTRM, which was published after ElectraNet submitted its revenue proposal.⁹ This new version of the PTRM applies the same regulatory tax approach as version 5 and makes a minor amendment to the expected inflation calculation (related to regulatory control periods greater than 5 years).¹⁰

In May 2018, we commenced a review of our regulatory tax approach (tax review). We released the final report of the tax review in December 2018, which identified some required changes to our approach to estimating tax depreciation expenses in our regulatory models

⁵ 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 2023 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.

⁶ ElectraNet, *2023–28 Revenue proposal, Post-tax revenue model*, January 2022.

⁷ This includes the removal of grandfathered assets, working capital depreciation and accelerated depreciation. See attachments 2 and 4.

⁸ NER, cl. 6A.6.4.

⁹ AER, *Electricity transmission network service providers: Post-tax revenue model (version 5.1)*, May 2022.

¹⁰ Version 5 of the PTRM gives effect to the changes set out in the AER’s final position paper on the treatment of inflation in its regulatory framework. See AER, *Final position, Regulatory treatment of inflation*, December 2020, pp. 6–8.

(PTRM and RFM).¹¹ The changes to our regulatory tax approach require amending our models to:¹²

- recognise immediate tax expensing of some capex forecast for a regulatory control period
- adopt the diminishing value method for tax depreciation to all future capex except for a limited number of assets which must be depreciated using the straight-line depreciation method under the tax law.¹³

The above changes to the regulatory tax approach were implemented in version 4 of the PTRM.

Our tax review final report stated that the required changes to the tax depreciation approach would only apply to new assets created in future regulatory control periods.¹⁴ The 2023–28 period is the first period for ElectraNet after the release of the tax review final report. Therefore, only changes to the PTRM were required when adopting the new tax approach. As such, no immediate change to the TAB roll forward would be required until the subsequent regulatory control period.¹⁵

In April 2021, we published version 5 of the PTRM, which ElectraNet used for its revenue proposal. This version of the PTRM applies the same regulatory tax approach as version 4 but implements the changes set out in the AER’s final position paper on the treatment of inflation in its regulatory framework.¹⁶ In May 2022, a new version of the PTRM (version 5.1) was published which amended the expected inflation formula related to regulatory control periods greater than 5 years. Accordingly, our draft decision uses version 5.1 of the PTRM to forecast ElectraNet’s cost of corporate income tax over the 2023–28 period.¹⁷

¹¹ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76. The PTRM specifies the manner in which the estimated cost of corporate income tax is to be calculated. The RFM calculates the TNSP’s tax asset base, which is an input to the PTRM for the calculation of the tax building block.

¹² Capping of gas asset tax lives was also a finding from the final report, but does not require a model change.

¹³ We will continue to apply straight-line tax depreciation for assets acquired prior to 1 July 2023 for the 2023–28 regulatory control period and until they are fully depreciated.

¹⁴ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 73.

AER, *Explanatory statement, Electricity transmission and distribution network service providers: Proposed amendments to the roll forward models (Distribution – version 3) (Transmission – version 4), Appendix A*, April 2020.

¹⁵ In this case, the diminishing value method and the immediate expensing of certain capex did not apply for ElectraNet’s TAB roll forward for the 2018–23 regulatory control period. The changes to the regulatory tax approach under version 4 of the RFM will apply in the subsequent reset to roll forward the TAB for ElectraNet during the 2023–28 regulatory control period.

¹⁶ The changes to the regulatory treatment of inflation does not have a direct impact on the cost of corporate income tax. See AER, *Final position, Regulatory treatment of inflation*, December 2020, pp. 6–8.

¹⁷ AER, *Electricity transmission network service providers: Post-tax revenue model (version 5.1)*, May 2022.

7.3.1 Calculating estimate cost of corporate income tax in the PTRM

Our approach for calculating a transmission network service provider's (TNSP's) estimated cost of corporate income tax is set out in our PTRM¹⁸ and involves the following steps:¹⁹

1. We estimate the annual assessable income (taxable revenue) that would be earned by a benchmark efficient entity operating the TNSP's business. This is the approved forecast revenues for the transmission business that we determined using the building block approach.²⁰
2. We then estimate the benchmark tax expenses such as operating expenditure (opex), interest expense, tax depreciation in the following ways:
 - operating expense is set equal to the opex building block²¹
 - interest expense is a function of the size of the regulatory asset base (RAB), the benchmark gearing assumption (60 per cent) 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 tax review, the PTRM (version 5.1) applies the straight-line tax depreciation method for existing assets and the diminishing value tax depreciation method²² for all assets acquired after 30 June 2023 except for in-house software, buildings 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 commissioned.²³ 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 cost 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 TNSP's business by subtracting the benchmark estimates of tax expenses (step 2) from the approved forecast revenues for the transmission business (step 1).

¹⁸ Ibid.

¹⁹ The PTRM must specify the manner in which the estimated cost of corporate income tax is to be calculated: NER, cl. 6A.5.3(b)(4).

²⁰ 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. It may also include other revenue adjustments, but the assessment of whether they should give rise to a tax cost will occur on a case-by-case basis.

²¹ Our assessment approach for the opex building block is discussed in Attachment 6 of the draft decision.

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

²³ 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.

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 cost of corporate income tax and is included as a separate building block in determining the TNSP's annual building block revenue requirement.

7.3.2 Assessing tax inputs to the PTRM

The estimated cost of corporate income tax is an output of our PTRM. We therefore assess the TNSP's proposed cost of corporate tax by analysing the proposed inputs to the PTRM for calculating that cost. While our assessment approach for most of the tax inputs remain largely the same for the current 2018–23 regulatory control period, our amended PTRM (version 5.1) requires two new sets of inputs for the calculation of tax depreciation—the forecast immediate expensing of certain capex and the assets to be exempted from the diminishing value method of tax depreciation.

Our assessment approach for each of the tax inputs required in the PTRM, including the two new inputs are discussed below:

- **the opening TAB as at the commencement of the 2023–28 regulatory control period:** We consider that the roll forward of the opening TAB should be based on the approved opening TAB as at 1 July 2018 and ElectraNet's actual capex incurred during the 2018–23 period, and the final year (2017–18) of the previous regulatory control period.²⁴ As noted above, we do not adjust the TAB value for immediate expensing of past capex in the roll forward process over the 2018–23 period. This is consistent with our final report for the tax review and our 2018–23 transmission determination which applied straight-line tax depreciation to capex commissioned during that period as prescribed in the PTRM.

The roll forward of the opening TAB for 2018–23 is calculated in our RFM. The tax review final report set out that the required changes to the tax depreciation approach would apply to new assets only. As such, the approach for determining the opening TAB value remains the same as the previous determination for the purposes of this draft decision. We have published the amended RFM (version 4) implementing the findings of the tax review.²⁵ We expect that the approach set out in this version of the RFM will be used for the purposes of the TAB roll forward for 2023–28 at the next reset.²⁶

The opening TAB value at 1 July 2023 is used to estimate forecast tax depreciation for the 2023–28 period, including new assets to be added to the TAB over this period. We will continue to apply the straight-line method of tax depreciation for the opening TAB

²⁴ 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.

²⁵ See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/electricity-roll-forward-models-transmission-and-distribution-2020-amendment/final-decision>.

²⁶ We have subsequently updated version 4 of the RFM to version 4.1, which corrected default adjustments for capitalised provision in the 'Inputs working' sheet and minor formula errors in the 'TAB roll forward' and 'Remaining lives' sheets.

value. However, for all new assets forecast to be added to the TAB in the 2023–28 period (with some exceptions discussed further below), we will apply the diminishing value method of tax depreciation.

- **the standard tax asset life for each asset class:** Our assessment of a TNSP's proposed standard tax asset lives is generally guided by the effective life of depreciating assets determined by the Commissioner of Taxation. We consider that the standard tax asset lives for the majority of ElectraNet's asset classes should be consistent with the ATO Taxation Ruling 2022/1 regarding the effective life of depreciating assets where possible.²⁷

As discussed above, the PTRM applies the diminishing value tax depreciation method for all new assets except for in-house software, buildings and equity raising costs. It provides designated asset classes for these assets to be depreciated using the straight-line method for tax purposes.²⁸ We note that the tax effective lives for in-house software, buildings and equity raising costs are not covered under the ATO Taxation Ruling 2022/1. Therefore, our assessment of the standard tax asset lives for these asset classes are guided by the *Income Tax Assessment Act 1997* (ITAA). Specifically, we consider that the standard tax asset life should be:

- 40 years for buildings – This is consistent with the number of years required to completely depreciate a capital works asset such as buildings for tax purposes when applying sections 43.15, 43.140 and 43.210 of the ITAA.
- 5 years for in-house software – This is consistent with subsection 40.95(7) of the ITAA.
- 5 years for equity raising costs – This is consistent with section 40.880 of the ITAA.
- **the income tax rate:** The statutory income tax rate is 30% per year, which was adopted in ElectraNet's proposal.
- **the value of gamma:** The gamma input for ElectraNet is 0.585 for this draft decision. This is consistent with the 2018 *Rate of Return Instrument*, which requires us to use a gamma value of 0.585, and adopted in ElectraNet's proposal.²⁹ Refer to Attachment 3 for further discussion on this matter.
- **the size and treatment of any tax losses as at 1 July 2023:** Where a business has tax losses, 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. ElectraNet does not have any accumulated tax losses as at the start of the 2023–28 regulatory control period, which is consistent with our final determination for the 2018–23 period.³⁰

²⁷ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*.

²⁸ Our assessment approach on new assets to be exempted from the diminishing value method is discussed in detail below.

²⁹ AER, *Rate of Return Instrument*, December 2018, p. 19.

³⁰ ElectraNet, *2023–28 Revenue proposal, Post-tax revenue model*, January 2022.

- **forecast immediate expensing of capex:** The PTRM requires a forecast for immediately deductible capex to be provided for each regulatory year of the 2023–28 period. Our assessment of forecast immediate expensing of capex will be guided by the TNSP's actual immediate expensing of capex from the previous regulatory control period.³¹ We will collect actual data relating to this expenditure in our annual regulatory accounts 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.³²
- **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 cost for 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 2011/6³³ 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.³⁴ Further, the TNSP may propose capex associated with buildings and in-house software to 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 97/25.³⁵ We note that this includes new buildings and structural improvements to existing buildings.³⁶ 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 required to be depreciated using the diminishing value method in the PTRM.

³¹ 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.

³² AER, *Final report, Review of regulatory tax approach*, December 2018, pp. 66–67.

³³ ATO, *Taxation Ruling 2011/6*, July 2016.

³⁴ The benchmark cost for equity raising costs is determined within the PTRM.

³⁵ ATO, *Taxation Ruling 97/25*, July 2017.

³⁶ ITAA, section 43.20.

- **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 2016/3.³⁷ We note that this includes computer software, or the right to use computer software that the TNSP acquires, develops or has someone else develop for the TNSP's business use.³⁸ However, capex associated with other IT assets such as computer hardware is not consistent with the definition of in-house software, and therefore required to be depreciated using the diminishing value method in the PTRM.

7.3.3 Interrelationships

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

Of these factors, the corporate tax rate is set externally by the Government. The higher the tax rate the higher the required cost of corporate income tax.

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.³⁹ Depending on the source of the revenue increase, the tax increase may be equal to or less than proportional to the company tax rate.⁴⁰

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:

³⁷ ATO, *Taxation Ruling 2016/3*, October 2018.

³⁸ ITAA, section 995.1.

³⁹ 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.

⁴⁰ For example, although increased opex adds to the 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 cost of corporate income tax in proportion to the company tax rate.

- 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 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 TNSP reflecting tax rules. This TAB is affected by many of the same factors as the RAB, such as capex, although unlike the RAB value it is maintained at its historical cost with no indexation. The TAB is also affected by the depreciation rate/method and asset lives assigned for tax depreciation purposes.

A business that has tax expenses which are greater than its taxable revenue in a period would not be subject to pay tax and generate a tax loss. A tax loss can be carried forward to offset against tax payable in the future.

7.4 Reasons for draft decision

Our draft decision on the estimated cost of corporate income tax is \$5.2 million over the 2023–28 regulatory control period. This represents an increase of \$5.2 million from ElectraNet’s proposal of zero. The key components of our tax treatment are discussed in the following sections.

7.4.1 Implementation of the tax review

The amended PTRM (version 5.1) provides for two new inputs which affect the calculation of tax depreciation compared to the current 2018–23 period:

- **immediate expensing of capex** – we allow for certain capex to be immediately expensed when estimating the benchmark tax expense
- **diminishing value depreciation method** – we apply the diminishing value method for tax depreciation purposes to all new depreciable assets except for capex associated with in-house software, buildings and equity raising costs.⁴¹

Our assessment of the new tax inputs submitted by ElectraNet are discussed below.

7.4.1.1 Forecast immediate expensing of capex

ElectraNet proposed that \$51.7 million (\$2022–23) of forecast capex (4.5% of total capex)⁴² will be immediately expensed for tax purposes in the 2023–28 period.⁴³

We accept ElectraNet’s proposed method to calculate its forecast immediate expensing of capex. Forecast immediate expensing of capex has been set using the actuals informed approach as set out in our final position of the tax review. This approach involves forecasting

⁴¹ The buildings asset class is for capital works.

⁴² Compared with the proposed gross capex of \$1,159.7 million (\$2022–23) on an as commissioned basis.

⁴³ ElectraNet, *2023–28 Revenue proposal, Post-tax revenue model*, January 2022.

a certain proportion of capex as immediately expensed. This proportion is informed by the amount of actual capex that was treated as immediately deductible over a previous period.⁴⁴

Specifically, ElectraNet has stated that the entirety of its \$51.7 million forecast expensing is associated with capital refurbishment and refit expenditure.⁴⁵ We consider it reasonable to expect that the same type of capex will also be deducted immediately by ElectraNet for tax purposes during the 2023–28 period. This approach is consistent with its actual immediate expensing of capex types for the 2018–23 period. We are therefore satisfied that ElectraNet’s proposed approach for determining forecast immediate expensing of its capex over the 2023–28 period is reasonable. As discussed in Attachment 5, we have accepted ElectraNet’s proposed forecast capex for the 2023–28 period. Therefore, our draft decision is to also accept the proposed amount of forecast immediate expensing of capex.

We will collect actual data relating to the immediate expensing of capex in our annual reporting regulatory information notices to further inform our decision for this type of expenditure in the next regulatory determination for ElectraNet.

7.4.1.2 Assets exempt from the diminishing value method

The PTRM (version 5.1) applies the straight-line tax depreciation method to the opening TAB at 1 July 2023, but applies the diminishing value method as the regulatory benchmark for tax depreciation to all new capex.⁴⁶ 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.

ElectraNet has not proposed any forecast capex that relate to the above categories which would be required to be depreciated using the straight-line method for tax depreciation purposes. As a result, all of ElectraNet’s forecast assets acquired after 30 June 2023 are subject to the diminishing value method of tax depreciation.⁴⁸ We accept ElectraNet’s proposal and have not allocated any forecast capex to be depreciated under the straight-line method for tax depreciation.

7.4.2 Opening tax asset base as at 1 July 2023

We accept ElectraNet’s proposed method to establish the opening TAB as at 1 July 2023. Based on the proposed approach, we determine an opening TAB value for ElectraNet as at 1 July 2023 of \$2,443.6 million (\$ nominal). This draft decision represents a decrease of \$22.1 million (or 0.9%) compared to ElectraNet’s proposal.

For the reasons discussed in Attachment 2, we have accepted ElectraNet’s proposal to remove \$13.7 million (\$ nominal) from the ‘Substation primary plant’ and ‘Substation secondary systems – electronic’ asset classes as it reflects the remaining value of assets

⁴⁴ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 66.

⁴⁵ ElectraNet, *2023–28 Revenue proposal, Overview*, January 2022, p. 49.

⁴⁶ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76.

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

⁴⁸ ElectraNet, *2023–28 Revenue proposal, Overview*, January 2022, p. 49.

that no longer provides a prescribed connection service. We also accept ElectraNet’s proposed capitalisation of lease costs for the 2023–28 period. However, we have included this as an additional tax roll-in value of \$2.0 million (\$ nominal) as a final year asset adjustment to account for the remaining value of ElectraNet’s existing leases as at 30 June 2023. A remaining tax asset life of 3.8 years was assigned, reflecting the weighted average of the remaining terms of these leases. ElectraNet’s proposal did not include any estimated asset disposals for 2021–22 and 2022–23 in its RFM, despite recording actual disposals for prior years. In its response to our information request, ElectraNet provided estimates of expected asset disposals (as incurred and as commissioned) for certain asset classes for 2021–22 and 2022–23.⁴⁹ We accept these estimates for the purposes of this draft decision. As a result of including these estimates for asset disposals, our draft decision determines an opening TAB that is \$2.8 million lower than ElectraNet’s proposal. We will update the 2021–22 asset disposal amount with actuals, which will be available for the final decision. The 2022–23 disposal amount will be trued-up at the next reset.

We have reviewed the remaining inputs to the TAB roll forward and found that they were correct and reconcile with relevant data sources such as annual regulatory accounts and the 2018–23 decision models. We note that the opening TAB as at 1 July 2023 may be updated to reflect actual 2021–22 capex and any revised 2022–23 capex estimates as part of the final decision.

Table 7.2 sets out our draft decision on the roll forward of ElectraNet’s TAB values over the 2018–23 period.

Table 7.2 AER’s draft decision on ElectraNet’s TAB roll forward for the 2018–23 regulatory control period (\$ million, nominal)

	2018–19	2019–20	2020–21	2021–22 ^a	2022–23 ^a
Opening TAB	1831.5	1916.8	1859.7	1830.4	2041.6
Capital expenditure ^b	174.5	40.8	68.7	309.2	532.9
Less: tax depreciation	89.3	97.8	98.0	98.0	119.1
Final year asset adjustment ^c					–11.7
Closing TAB	1916.8	1859.7	1830.4	2041.6	2443.6

Source: AER analysis.

(a) Based on estimated capex.

(b) As commissioned, net of disposals.

(c) Includes the addition of capitalised leases and removal of assets as at 30 June 2023 that do not provide prescribed services.

7.4.3 Year-by-year tracking approach

We accept ElectraNet’s proposal to continue applying the year-by-year tracking approach for calculating tax depreciation of its existing assets. This is consistent with our final decision for ElectraNet’s 2018–23 period. Under this approach, the capex for each year of a regulatory control period is depreciated individually for tax purposes. This results in each tax asset class

⁴⁹ ElectraNet, *Response to information request AER IR013*, 18 May 2022.

having an expanding list of sub-assets to reflect the regulatory year in which capex on those assets occurred. This extra data helps track remaining tax asset values and associated tax depreciation, and is therefore consistent with the NER.

We are satisfied that the continued application of the year-by-year tracking method to calculate ElectraNet's tax depreciation of existing assets provides an estimate of the tax depreciation amount for a benchmark efficient service provider as required by the NER.⁵⁰

ElectraNet has moved from its existing depreciation model to the AER's depreciation tracking module in the RFM to implement year-by-year tracking. We have reviewed ElectraNet's application of this module and made some minor updates, consistent with those made to the RAB as discussed in Attachment 2.⁵¹

7.4.3.1 Accelerated tax depreciation

ElectraNet has proposed to accelerate the depreciation of assets which are to be decommissioned following the completion of an asset replacement or augmentation project.⁵² For the reasons discussed in Attachment 4, we accept the reallocation of \$17.0 million (\$ nominal) of assets from several existing asset classes to a dedicated 'Accelerated depreciation' asset class for depreciation over the 2023–28 period. Our draft decision also accepts ElectraNet's proposed remaining tax asset life of 5 years, reflecting the length of the 2023–28 period, for this asset class.

Our draft decision reallocates the closing TAB value of \$34.5 million (\$ nominal) as at 30 June 2023 from the 'Refurbishment' asset class to a new asset class for accelerated tax depreciation with a one year life for the 2023–28 period. This change is required to reflect the amendments we have made to the closing RAB as at 30 June 2023 (Attachment 2) to address the 'Refurbishment' asset class being fully depreciated. In its response to our information request, ElectraNet agreed with our amendment.⁵³ The additional accelerated tax depreciation for this asset class does not have a material impact to the forecast tax modelling for the 2023–28 period.

7.4.4 Standard tax asset lives

We broadly accept ElectraNet's proposed standard tax asset lives for its existing asset classes because they are:

- consistent with the values prescribed by the Commissioner of Taxation in ATO Taxation Ruling 2022/1⁵⁴
- the same as the approved standard tax asset lives for the 2018–23 period.

However, ElectraNet proposed a standard tax asset life of one year for the 'Equity raising costs' asset class for the 2023–28 period. This is inconsistent with tax guidance and the standard tax asset life we approved as part of the 2018–23 final decision. As a result, our

⁵⁰ NER, cl. 6A.6.4.

⁵¹ AER, *ElectraNet 2023–28 Draft decision, Attachment 2 – Regulatory asset base*, September 2022, p. 12.

⁵² ElectraNet, *2023–28 Revenue proposal, Attachment 4 – Regulatory Depreciation*, January 2022 p. 7.

⁵³ ElectraNet, *Response to information request AER IR008*, 2 May 2022.

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

draft decision is to assign a standard tax asset life to 5 years in the PTRM, reflecting the ITAA and ATO’s Taxation Ruling.⁵⁵

In addition to the existing asset classes approved for the 2018–23 transmission determination, ElectraNet proposed two new asset classes for the 2023–28 period:

- ‘Transmission line refit – insulators replacement 2023–28’ related to capex refurbishments
- ‘Right of use assets’ reflecting the change in accounting standards (AASB 16) requiring certain lease costs to be capitalised.⁵⁶

As discussed in Attachment 2, our draft decision is to accept the addition of the proposed two new asset classes. We also accept the proposed standard tax asset life of 42.5 years for the ‘Transmission line refit – insulators replacement 2023–28’ asset class, as it reflects the weighted average of the technical lives of the relevant assets.

While we accept ElectraNet’s proposal to capitalise its forecast leases over the 2023–28 period, we have amended the standard tax asset life. ElectraNet proposed a standard tax asset life of one year reflecting its approach to capitalising the expected lease payments on an annual basis.⁵⁷ As discussed in attachments 2, 4 and 8, we do not consider ElectraNet’s approach to capitalising leases to be consistent with accounting standards (AASB 16), which requires leases to be recognised as the present value of all remaining lease payments.⁵⁸ Our draft decision is to assign a standard tax asset life of 4.8 years for this asset class, reflecting the weighted average of the lease terms as submitted by ElectraNet in its response to our information request.⁵⁹ It is consistent with the RAB standard life, reflecting 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.⁶⁰

Table 7.3 sets out our draft decision on the standard tax asset lives for ElectraNet. We are satisfied that the standard tax asset lives are appropriate for application over the 2023–28 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.⁶¹

⁵⁵ ITAA, Section 40.880; ATO, *Taxation Ruling 2011/6*, July 2016.

⁵⁶ For property, office equipment and motor vehicles.

⁵⁷ ElectraNet, *2023–28 Revenue proposal, Attachment 4 – Regulatory Depreciation*, January 2022, p. 7.

⁵⁸ AASB 16, Para. C8.

⁵⁹ ElectraNet, *Response to information request AER IR010*, 16 May 2022.

⁶⁰ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets*, p. 9; ITAA 1997, s 40.105.

⁶¹ NER, cl. 6A.6.4.

Table 7.3 AER's draft decision on ElectraNet's standard tax asset lives for the 2023–28 regulatory control period (years)

Asset class ^a	Standard tax asset life
Commercial buildings	40.0
Communications – civil	12.5
Communications – other	12.5
Computers, software, and office machines	3.3
Easement	n/a
Land	n/a
Network switching centres	4.0
Office furniture, movable plant, and misc	12.8
Substation primary plant	40.0
Substation demountable buildings	40.0
Substation establishment	40.0
Substation fences	40.0
Substation secondary systems – electromechanical	12.5
Substation secondary systems – electronic	12.5
Transmission lines – overhead	47.5
Transmission lines – underground	47.5
Accelerated depreciation	n/a
Transmission line refit – insulators replacement 2013–18	27.0
Communications – other (post 2018)	10.0
Transmission line refit – insulators replacement 2018–23	47.5
Synchronous condensers	30.0
Working capital depreciation	n/a
Refurbishment TAB depreciation	n/a
Transmission line refit – insulators replacement 2023–28	42.5
Right of use assets	4.8
Equity raising costs ^b	5.0

Source: AER analysis.

- (a) All asset classes apply the diminishing value method of tax depreciation for new capex.
- (b) For this draft decision, the forecast capex determined for ElectraNet 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 to the 'Land' and 'Easements' asset classes because these assets are not subject to depreciation. We have also not assigned a standard tax asset life to the 'Accelerated depreciation', 'Working capital depreciation' and 'Refurbishment TAB depreciation' asset classes as these do not contain forecast capex for the 2023–28 period.

Glossary

Term	Definition
AER	Australian Energy Regulator
ATO	Australian Taxation Office
Capex	Capital expenditure
DV	Diminishing value
ERC	Equity raising costs
ITAA	Income Tax Assessment Act 1997
NER	National Electricity Rules
Opex	Operating expenditure
PTRM	Post-tax revenue model
RAB	Regulatory asset base
RFM	Roll forward model
SL	Straight-line
TAB	Tax asset base
TNSP	Transmission network service provider