

Draft Decision

Transgrid Transmission Determination 2023 to 2028

(1 July 2023 to 30 June 2028)

Attachment 7 Corporate income tax

September 2022

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Note

This attachment forms part of the AER’s draft decision on Transgrid’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

Attachment 11 – Demand management innovation allowance mechanism

Attachment 12 – Pricing methodology

Attachment 13 – Pass through events

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7 Corporate income tax

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

This attachment presents our assessment of Transgrid’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 and remaining tax asset lives used to estimate tax depreciation for the purpose of calculating tax expenses.

7.1 Draft decision

Our draft decision determines an estimated cost of corporate income tax amount of \$105.3 million (\$ nominal) over the 2023–28 period. This decision represents an increase of \$34.9 million (49.6%) from Transgrid’s proposal of \$70.4 million. The key reason for the increase is our draft decision on the rate of return on equity (Attachment 3) which, in turn, increased Transgrid’s taxable revenue and, therefore, the cost of corporate income tax.²

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 2018 *Review of the regulatory tax approach* (tax review), which introduced the diminishing value method of tax depreciation, resulting in a significant increase in forecast tax depreciation.³

We determine an opening TAB value as at 1 July 2023 of \$4,920.2 million for Transgrid. This is \$24.8 million (0.5%) higher than the amount proposed by Transgrid due to:

- including reported expenditure as capital expenditure (capex) in 2021–22 and 2022–23 for Software as a Service (SaaS) related costs to be included in the TAB for the 2018–23 period to reflect our approach to mid-period changes in accounting standards⁴
- removing expenditure in 2021–22 and 2022–23 relating to capitalised leases and instead including an amount reflecting the present value of its existing leases at 30 June 2023 to be capitalised as a final year asset adjustment.⁵

¹ NER, cl. 6A.5.4(a)(4)

² 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, a component of taxable revenue.

³ The 2018 tax review also introduced the immediate expensing of capex. However, this does not apply to Transgrid as it did not propose any immediate expensing of capex.

⁴ Costs related to SaaS are considered capital expenditure for the 2018–23 period and will only begin being treated as operating expenditure from the start of the 2023–28 period. Details of our approach is further discussed in Attachments 2 and 8.

⁵ Likewise, leases related expenditure is expected to continue being classified as operating expenditure until the end of the 2018–23 period where we roll in the remaining value as at 30 June 2023 into the asset base (Attachments 2 and 8).

We accept Transgrid’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 are the same as the approved standard tax asset lives for the 2018–23 period.⁶

In addition to the existing asset classes, Transgrid proposed three new asset classes for the 2023–28 period—one new asset class relates to capitalised leases and two new asset classes are for using the straight-line method of tax depreciation for in-house software and buildings (capital works). We accept Transgrid’s proposed new asset classes and associated standard tax asset lives, with the exception of the ‘Leasehold land and property’ asset class for capitalised leases (section 7.4.3).

We also accept Transgrid’s proposed weighted average method to calculate 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). In accepting the weighted average method, we have updated Transgrid’s proposed remaining tax asset lives to reflect our adjustments to its opening TAB value as at 1 July 2023. However, we do not accept the proposed remaining tax asset life for the new ‘Leasehold land and property’ asset class (section 7.4.4).

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 Transgrid over the 2023–28 period.

Table 7.1 AER’s draft decision on Transgrid’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	53.6	48.9	40.8	52.2	58.5	253.9
Less: value of imputation credits	31.3	28.6	23.8	30.5	34.2	148.5
Net cost of corporate income tax	22.2	20.3	16.9	21.6	24.3	105.3

Source: AER analysis.

7.2 Transgrid’s proposal

Transgrid proposed an estimated cost of corporate income tax of \$70.4 million (\$ nominal) for the 2023–28 regulatory control period using our PTRM,⁷ and with the following inputs:

- an opening TAB value as at 1 July 2023 of \$4,895.4 million (\$ nominal)

⁶ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*.

⁷ 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.

- an expected statutory income tax rate of 30% per year
- a value of imputation credits (gamma) of 0.585
- remaining tax asset lives of assets in existence as at 30 June 2023 calculated using a weighted average remaining life approach as set out in our 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
- three new asset classes and associated standard tax asset lives related to buildings (capital works), in-house software and capitalised leases for the 2023–28 period.

Table 7.2 sets out Transgrid’s proposed cost of corporate income tax for the 2023–28 period.

Table 7.2 Transgrid’s proposed 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	38.6	32.7	24.2	34.8	39.4	169.7
Less: value of imputation credits	22.6	19.1	14.1	20.4	23.1	99.3
Net cost of corporate income tax	16.0	13.6	10.0	14.4	16.4	70.4

Source: Transgrid, *2023–28 Post-tax revenue model*, January 2022.

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 Transgrid’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 Transgrid’s business and is determined in accordance with the PTRM. Our draft decision uses version 5.1 of the PTRM, which was published after Transgrid 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

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 Transgrid 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 Transgrid 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 Transgrid’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 Transgrid’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 Transgrid 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 estimated 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%) 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

¹⁸ AER, *Electricity transmission network service providers: Post-tax revenue model (version 5.1)*, May 2022.

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.

expenses (step 2) from the approved forecast revenues for the transmission business (step 1).

4. We apply the statutory income tax rate to the estimated annual taxable income (after adjustment for any tax loss carried forward) to arrive at a notional amount of tax payable.
5. We deduct the expected value for the utilisation of imputation credits (γ) 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 Transgrid'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

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.

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 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 Transgrid'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 Transgrid's proposal.
 - **the value of gamma:** The gamma input for Transgrid 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 is adopted in Transgrid'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. Transgrid does not have any accumulated tax losses as at the

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.

start of the 2023–28 regulatory control period, which is consistent with our final determination for the 2018–23 period.³⁰

- **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

³⁰ Transgrid, *2023–28 Post-tax revenue model*, January 2022.

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.

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.

- **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

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 operating expenditure 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.

tax expenses offset revenues as deductions in the tax calculation and therefore reduce the cost of corporate income tax (all things being equal). Tax expenses include:

- Interest on debt – because interest is a tax offset. The size of this offset depends on the ratio of debt to equity and therefore the proportion of the RAB funded through debt. It also depends on the allowed return on debt and the size of the RAB.
- General expenses – these expenses generally will match the opex 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 \$105.3 million (\$ nominal) over the 2023–28 period. This represents an increase of \$34.9 million from Transgrid’s proposal of \$70.4 million. 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 Transgrid are discussed below.

7.4.1.1 Forecast immediate expensing of capex

Transgrid did not propose any forecast capex to be immediately expensed for tax purposes in the 2023–28 period.⁴² Transgrid submitted that its forecast capex does not contain any repair or maintenance capex projects that can be immediately expensed for tax purposes.⁴³

For this draft decision, we accept Transgrid’s proposal that it has no forecast immediate expensing of capex for the 2023–28 period. We will collect actual data relating to this

⁴¹ The buildings asset class is for capital works.

⁴² Transgrid, *2023–28 Post-tax revenue model*, January 2022.

⁴³ Transgrid, *Regulatory Information Notice Compliance Checklist*, January 2022, p. 36.

expenditure in our annual reporting regulatory information notices to further inform our decision on the amount of forecast immediate expensing of capex in the next determination for Transgrid.

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.⁴⁴ 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.⁴⁵ 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 its proposal, Transgrid submitted that \$23.2 million (\$2022–23) of forecast capex for buildings and \$53.9 million (\$2022–23) of forecast in-house software related capex are to be exempted from the diminishing value tax depreciation method.⁴⁶

We accept Transgrid’s proposed allocation of forecast capex for in-house software and buildings (capital works) to be depreciated using the straight-line method for tax depreciation purposes. This is because the proposed forecast capex for:

- in-house software satisfies the definition under section 995.1 of the ITAA and in ATO Taxation Ruling 2016/3⁴⁷
- buildings satisfy the definition of a capital work under section 43.20 of the ITAA and in ATO Taxation Ruling 97/25.⁴⁸

Accordingly, these assets are not required to be depreciated using the diminishing value method for tax purposes.

7.4.2 Opening tax asset base as at 1 July 2023

We accept Transgrid’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 Transgrid as at 1 July 2023 of \$4,920.2 million (\$ nominal). This draft decision represents an increase of \$24.8 million (or 0.5%) compared to Transgrid’s proposal.

For the reasons discussed in Attachments 2 and 8, we do not approve of Transgrid’s approach to mid-period changes in capitalisation. Transgrid proposed to reclassify SaaS expenditure for the final two years of the 2018–23 period (2021–22 and 2022–23) as opex, which was previously treated as capex. Similarly, Transgrid’s proposal included estimated capex for 2021–22 and 2022–23 in the RFM relating to lease costs that were previously

⁴⁴ AER, *Final report, Review of regulatory tax approach*, December 2018, p. 76.

⁴⁵ Asset classes 47, 48, 49 and 50 in the PTRM provide for this.

⁴⁶ Transgrid, *2023–28 Post-tax revenue model*, January 2022; Transgrid, *2023–28 Revenue proposal*, January 2022, pp. 136–137.

⁴⁷ ATO, *Taxation Ruling 2016/3*, October 2018.

⁴⁸ ATO, *Taxation Ruling 97/25*, July 2017.

treated as opex. The proposal RFM allocated this capex to an unapproved ‘Leasehold land and property’ asset class and assigned a standard tax life of 10 years.

As discussed in Attachment 8, our draft decision approach is to maintain the current capitalisation treatment for the 2018–23 period consistent with the basis approved in the 2018–23 determination, and allocate capex and opex costs accordingly. We will then apply the new capitalisation changes from the start of the 2023–28 period. Transgrid has indicated it has no concerns with our approach.⁴⁹ As a result, we have reinstated SaaS related capex of \$24.1 million and \$5.0 million (\$ nominal) for 2021–22 and 2022–23 respectively to the ‘Business IT’ asset class to be rolled into the TAB over the 2018–23 period.⁵⁰ We have also removed Transgrid’s proposed capex for capitalised leases for the same years from the RFM. Our draft decision rolls in a tax value of \$4.2 million (\$ nominal) as a final year asset adjustment, representing the present value of its existing leases as at 30 June 2023.⁵¹ We have also calculated a remaining tax life of 11.6 years for tax depreciation of this final year asset adjustment, which reflects our decision on the RAB remaining life (Attachment 4).

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

Table 7.3 AER’s draft decision on Transgrid’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	3,911.6	4,045.3	4,102.2	4,142.4	4,563.6
Capital expenditure ^b	270.2	208.9	200.1	582.3	544.4
Less: tax depreciation	136.5	152.1	159.8	161.1	192.0
Final year asset adjustment ^c					4.2
Closing TAB	4,045.3	4,102.2	4,142.4	4,563.6	4,920.2

Source: AER analysis.

- (a) Based on estimated capex.
- (b) As commissioned, net of disposals.
- (c) Includes the roll-in of capitalised leases as at 30 June 2023.

⁴⁹ Transgrid, *Response to information request IR 033*, 4 August 2022.

⁵⁰ Transgrid, *Response to information request IR 033*, 8 August 2022.

⁵¹ Transgrid, *Email response to AER information request IR 007*, 20 May 2022.

7.4.3 Standard tax asset lives

We broadly accept Transgrid’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 2022/1⁵²
- the same as the approved standard tax asset lives for the 2018–23 period.

In addition to the existing asset classes approved for the 2018–23 transmission determination, Transgrid proposed three new asset classes for the 2023–28 period. Two new asset classes were proposed relating to buildings (capital works) and in-house software that use the straight-line method of tax depreciation as provided for in our 2018 tax review. As discussed in section 7.4.1.2, we accept Transgrid’s proposal to allocate forecast capex associated with buildings (capital works) and in-house software to the prescribed straight-line tax depreciation asset classes in the PTRM. We also accept the proposed standard tax asset lives of 40 years and 5 years respectively for these asset classes. The proposed standard tax asset lives are consistent with the approved standard tax asset lives for the relevant assets in the 2018–23 period, and consistent with the ITAA.⁵³

We also approve the new ‘Leasehold land and property’ asset class to account for the change in accounting standards (AASB 16) requiring certain lease costs to be capitalised.⁵⁴ However, we do not approve Transgrid’s proposed standard tax asset life of 10 years. As discussed in Attachment 4, Transgrid’s proposed PTRM did not forecast any such capex for the 2023–28 regulatory period. In its response to our information request, Transgrid submitted a revised PTRM which included forecast capex for this asset class and an amended standard tax asset life of 5 years.⁵⁵ Our draft decision is to therefore amend the standard tax asset life to 5 years, consistent with the RAB standard life, reflecting the average lease terms of Transgrid’s forecast capex and the expected economic life of the leases. We are satisfied that this approach is consistent with the ATO’s guidance on determining the effective life of an asset.⁵⁶

Table 7.4 sets out our draft decision on the standard tax asset lives for Transgrid. 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.⁵⁷

7.4.4 Remaining tax asset lives

We accept Transgrid’s proposed weighted average method to calculate the remaining tax asset lives as at 1 July 2023 for its existing asset classes. The proposed method is a

⁵² ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets (applicable from 1 July 2022)*.

⁵³ ITAA, sections 40.95(7), 43.15, 43.140 and 43.210.

⁵⁴ For property, office equipment and motor vehicles.

⁵⁵ Transgrid, *Email response to AER information request #007*, 20 May 2022.

⁵⁶ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets*, p. 9; ITAA 1997, s 40.105.

⁵⁷ NER, cl. 6A.6.4.

continuation of the approved approach used in the 2018–23 period and applies the approach as set out in our RFM.

In accepting the weighted average method, we have updated Transgrid’s proposed remaining tax asset lives to reflect our adjustments to the opening TAB value as at 1 July 2023 (section 7.4.2). We will update the remaining tax asset lives for the final decision for any changes to the estimated capex values in the RFM because they are used as inputs for calculating the remaining tax asset lives.⁵⁸

Consistent with Transgrid’s proposal, we have not assigned a remaining tax asset life for the ‘Buildings – capital works’ and ‘In-house software’ asset classes as there are no opening tax values for these asset classes, and only forecast capex is being allocated to these asset classes over the 2023–28 period. We therefore record ‘n/a’ in the PTRM for these asset classes.

We do not accept Transgrid’s proposed tax remaining life of 9.4 years for the ‘Leasehold land and property’ asset class, as we do not approve of Transgrid’s proposed approach to accounting for capitalised leases (Attachment 8). We have instead determined a remaining tax asset life of 11.6 years based on the expected remaining lease terms for Transgrid’s existing leases (and therefore reflecting the economic lives) included in the TAB as final year asset adjustment (section 7.4.2). We are satisfied that this approach is consistent with the ATO’s guidance on determining the effective life of an asset.⁵⁹

Table 7.4 sets out our draft decision on the remaining tax asset lives at 1 July 2023 for Transgrid. We are satisfied that the remaining tax asset lives are appropriate for application over the 2023–28 period. We are also satisfied that the remaining 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

⁵⁸ At the time of this draft decision, the roll forward of Transgrid’s TAB includes estimated capex values for 2021–22 and 2022–23. We will update the 2021–22 estimated capex value with the actual value for the final decision, and may further update the estimate of 2022–23 capex. The capex values are used to calculate the weighted average remaining tax asset lives in the RFM. Therefore, for the final decision we will recalculate Transgrid’s remaining tax asset lives as at 1 July 2023 using the method approved in this draft decision.

⁵⁹ ATO, *Taxation Ruling TR2022/1 – Income tax: effective life of depreciating assets*, p. 9; ITAA 1997, s 40.105.

⁶⁰ NER, cl. 6A.6.4.

Table 7.4 AER's draft decision on Transgrid's standard and remaining tax asset lives for the 2023–28 regulatory control period (years)

Asset class	Standard tax asset life	Remaining tax asset life as at 1 July 2023 ^c
Transmission lines (2018 onwards)	50.0	49.0
Underground cables (2018 onwards)	45.0	44.9
Substations (2018 onwards)	40.0	38.6
Secondary systems (2018 onwards)	15.0	13.3
Communications (short life) (2018 onwards)	10.0	8.6
Business IT (2018 onwards)	4.0	2.8
Minor plant, motor vehicles & mobile plant (2018 onwards)	8.0	5.6
Transmission Line Life Extension (2018–23) ^a	33.4	35.0
Land and easements	n/a	n/a
Synchronous condensers	30.0	n/a
Leasehold land and property	5.0	11.6
Buildings – capital works ^b	40.0	n/a
In-house software ^b	5.0	n/a
Equity raising costs ^b	5.0	6.7

Source: AER analysis.

- (a) We have changed this asset class name back to 'Transmission line life extension (2018–23)' consistent with the approved PTRM with the 2018–23 determination.
- (b) These are the only asset classes used for the straight-line method of tax depreciation for new assets. All new assets for other asset classes used the diminishing value method of tax depreciation
- (c) Used for straight-line method of tax depreciation.
- n/a not applicable. We have not assigned a standard tax asset life and remaining tax asset life to the 'Land and easements' asset class because the assets allocated to it are non-depreciating assets. We have not assigned a remaining tax asset life to the 'Synchronous condensers', 'Buildings - capital works' and 'In-house software' asset classes because they have no opening TAB values as at 1 July 2023.

Glossary

Term	Definition
AASB	Australian Accounting Standards Board
AER	Australian Energy Regulator
ATO	Australian Taxation Office
Capex	Capital expenditure
ITAA	Income Tax Assessment Act 1997
NER	National Electricity Rules
Opex	Operating expenditure
PTRM	Post-tax revenue model
RAB	Regulatory asset base
RFM	Roll forward model
SaaS	Software as a Service
TAB	Tax asset base
TNSP	Transmission network service provider
