Attachment 20

Working capital and corporate tax

30 September 2024

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Attachment 8

1. Tax allowance

WaterNSW has included in its proposed notional revenue requirement its estimated tax liability (i.e. the regulatory tax allowance), in accordance with IPART's decision on the *Incorporation of Company Tax in Pricing Decisions*.

The first step in calculating the tax liability is to estimate taxable income. In simple terms, this considers gross income, tax depreciation, tax deductions (including deductible interest) and tax losses. The estimated taxable income is then multiplied by the corporate tax rate (with an appropriate adjustment for franking credits[1]) to determine the tax bill for the pipeline services.

WaterNSW has used a notional gearing ratio of 60:40 debt to equity to compute the interest deductions for the tax allowance. This is the standard IPART approach, which also aligns with WaterNSW's actual gearing ratio forecast as specified in the SCI.

There are two elements of the regulatory tax allowance which are discussed further in this section:

- The accumulated tax losses; and
- Tax depreciation.

1.1 Tax losses

As a state-owned corporation, WaterNSW must apply the relevant National Tax Equivalent Regime (NTER); however, IPART generally does not factor into its pricing decisions actual tax losses. Instead, IPART requires expected tax losses to be rolled forward for each subsequent year of the regulatory period, with a starting balance of zero from the formation of the tax asset base.

Consistent with the IPART methodology, WaterNSW has assumed that the Greater Sydney Determination will have nil accumulated tax losses as at 1 July 2025. The Rural Valley Determination will have $31.6 million in accumulated tax losses as at 1 July 2025.

1.2 Tax depreciation

IPART typically uses the agency's forecast of tax depreciation to calculate the regulatory tax allowance. There are two assumptions for IPART to consider:

- The effective life of depreciating assets for tax purposes
- The rate at which the assets are depreciation (e.g. prime method or diminishing method).

Tax entities are generally able to elect from either the prime cost method or the diminishing depreciation method, and once an election is made, it is generally not possible to amend the chosen approach. WaterNSW has calculated its tax depreciation forecast for new assets using a diminishing depreciation method for new assets and utilising the same asset life assumptions for the calculation of depreciation under the Regulatory Asset Base. For existing assets, WaterNSW has provided our actual tax depreciation figures.

[1] A tax imputation credit factor of 0.25 as per IPART's 2018 WACC Method.

1.3 Tax rate

We have calculated the tax allowance for the Greater Sydney and Rural Valley Determinations using a notional corporate tax rate of 30% in accordance with the 2011 IPART review of *The incorporation of company tax in price determinations*.

1.3.1 Tax allowance – Greater Sydney

After inputting the accumulative tax losses, tax depreciation assumptions, and the tax rate, WaterNSW has forecast a regulatory tax allowance of **$48.8 million** per annum across the 2025 Determination period for Greater Sydney as shown in Tables**Error! Reference source not found.** below in nominal and real terms.

Table 1 – Tax allowance Greater Sydney - Base Case ($m, $nominal)

Tax allowance ($millions, $nominal)							
	2025-26	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**Total**	**Average**
Notional revenue requirement (excl. tax)	$312.3	$328.6	$358.5	$392.3	$395.9	**$1,787.6**	$357.5
Less:							
Operating expenditure	$143.3	$141.3	$146.7	$154.9	$161.0	**$747.3**	$149.5
Tax depreciation	$57.6	$67.8	$80.2	$91.4	$96.0	**$393.0**	$78.6
Interest expense allowance	$77.6	$84.2	$94.4	$106.1	$117.0	**$479.3**	$95.9
Taxable income	$33.9	$35.3	$37.2	$39.8	$21.8	**$168.0**	$33.6
Less accumulated tax losses	$0.0	$0.0	$0.0	$0.0	$0.0	**$0.0**	$0.0
Taxable income after tax losses	$33.9	$35.3	$37.2	$39.8	$21.8	**$168.0**	$33.6
Tax before adjustment for franking credits	$13.1	$13.7	$14.4	$15.4	$8.4	**$65.0**	$13.0
Less: Adjustment for franking credits	-$3.3	-$3.4	-$3.6	-$3.9	-$2.1	**-$16.3**	-$3.3
Tax allowance	$9.8	$10.3	$10.8	$11.6	$6.3	**$48.8**	$9.8

Table 2 – Tax allowance Greater Sydney - Base Case ($real) - summary

Tax allowance ($millions, $2024-25)							
	2025-26	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**Total**	**Average**
Tax allowance in required revenue	$12.8	$13.0	$13.4	$14.0	$7.5	**$60.6**	$12.1
Less adjustment for franking credits	-$3.2	-$3.3	-$3.3	-$3.5	-$1.9	**-$15.2**	-$3.0
Tax allowance	$9.6	$9.8	$10.0	$10.5	$5.6	**$45.5**	$9.1

1.3.2 Tax allowance – Rural Valleys

WaterNSW has forecast a regulatory tax allowance of $16.9 million per annum across the 2025 Determination period for the Rural Valley Determination as shown in the table**Error! Reference source not found.** below.

Table 3 – Tax allowance Rural Valleys - Base Case ($millions, $nominal)

Tax allowance ($millions, $nominal)							
	2025-26	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**Total**	**Average**
Notional revenue requirement (excl. tax)	$213.3	$234.4	$262.3	$284.8	$299.2	**$1,293.9**	$258.8
Less:							
Operating expenditure	$125.7	$134.8	$150.0	$162.7	$169.9	**$743.1**	$148.6

Tax allowance ($millions, $nominal)							
	2025-26	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**Total**	**Average**
Tax depreciation	$29.1	$34.8	$38.2	$38.9	$37.7	**$178.7**	$35.7
Interest expense allowance	$49.7	$55.0	$61.1	$65.8	$69.0	**$300.7**	$60.1
Taxable income	$8.7	$9.8	$12.9	$17.3	$22.6	**$71.4**	$14.3
Less accumulated tax losses	-$47.4	-$48.0	-$46.8	-$43.4	-$38.4	**-$224.0**	-$44.8
Taxable income after tax losses	$9.6	$10.3	$11.7	$13.9	$17.6	**$63.2**	$12.6
Tax before adjustment for franking credits	$3.7	$4.0	$4.5	$5.4	$6.8	**$24.5**	$4.9
Less: Adjustment for franking credits	-$0.9	-$1.0	-$1.1	-$1.3	-$1.7	**-$6.1**	-$1.2
Tax allowance	$2.8	$3.0	$3.4	$4.0	$5.1	**$18.3**	$3.7

Table 4 – Tax allowance Rural Valleys - Base Case ($millions, $real) - summary

Tax allowance ($millions, $2024-25)							
	2025-26	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**Total**	**Average**
Tax allowance in required revenue	$3.6	$3.8	$4.2	$4.9	$6.0	**$22.5**	$4.5
Less adjustment for franking credits	-$0.9	-$1.0	-$1.1	-$1.2	-$1.5	**-$5.6**	-$1.1
Tax allowance	$2.7	$2.9	$3.2	$3.7	$4.5	**$16.9**	$3.4

Table 5 – Tax allowance Rural Valleys by valley ($millions, $2024-25)

Tax Allowance ($millions, $2024-25)							
Valley	**2025-26**	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**Total**	**Average**
Border	-	-	-	-	-	**-**	-
Gwydir	$0.8	$0.8	$0.9	$1.0	$1.1	**$4.5**	$0.9
Namoi	$1.1	$1.1	$1.1	$1.3	$1.4	**$6.0**	$1.2
Peel	$0.0	$0.1	$0.1	$0.2	$0.3	**$0.6**	$0.1
Lachlan	$0.5	$0.5	$0.6	$0.7	$0.9	**$3.2**	$0.6
Macquarie	-	-	-	-	-	**-**	-
Murray	-	-	-	-	$0.2	**$0.2**	$0.0
Murrumbidgee	-	-	-	-	$0.2	**$0.2**	$0.0
Lowbidgee	-	-	-	-	-	**-**	-
North Coast	-	-	-	-	-	**-**	-
Hunter	-	-	-	-	-	**-**	-
South Coast	-	-	-	-	-	**-**	-
Fish River	$0.4	$0.4	$0.5	$0.5	$0.6	**$2.3**	$0.5
Total	**$2.7**	**$2.9**	**$3.2**	**$3.7**	**$4.5**	**$16.9**	**$3.4**

Certain rural valleys (e.g. Macquarie, Murray, Murrumbidgee, Lowbidgee, North Coast, Hunter and the South Coast) are forecast to require nil tax allowance due to large accumulative tax losses carried forward in those valleys

2. Working capital

An additional building block is working capital. The difference between current assets and current liabilities arising from the timing differences between accounts payable and accounts receivable, creating a financial liability for WaterNSW.

IPART's methodology of determining the working capital allowance is generally based on a 45-day payment term for account receivable and a 30 day payment term for accounts payable. The calculation for the working capital allowance is as follows:

$$\left[Accounts\ Receivables\ X\ \frac{Creditor\ Days}{365} - Accounts\ Payable\ X\ \frac{Debtor\ Days}{365}\right] X\ WACC$$

The proposed working capital allowance is set out in the tables below for the Greater Sydney and Rural Valley Determinations. This is a small amount and has been included in notional revenue requirement.

Table 6 – Working Capital Requirements – Greater Sydney

Allowance for working capital ($millions, $2024-25)							
	2025-26	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**Total**	**Average**
Receivables	$63.6	$66.9	$71.0	$75.6	$74.6	**$351.7**	$70.3
Inventory	$0.0	$0.0	$0.0	$0.0	$0.0	**$0.0**	$0.0
Prepayments	$0.0	$0.0	$0.0	$0.0	$0.0	**$0.0**	$0.0
Less: Accounts Payable	$25.0	$35.8	$41.7	$41.8	$34.9	**$179.1**	$35.8
Net working capital	$38.6	$31.1	$29.3	$33.9	$39.7	**$172.6**	$34.5
Return on working capital (year end)	$2.4	$1.9	$1.8	$2.1	$2.5	**$10.7**	$2.1
Return on working capital (mid-year)	$2.3	$1.9	$1.8	$2.0	$2.4	**$10.4**	$2.1

Table 7 – Working Capital Requirements – Rural valleys

Working Capital Allowance ($millions, $2024-25)							
Valley	**2025-26**	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**Total**	**Average**
Border	$0.0	$0.0	$0.0	$0.0	$0.1	**$0.2**	$0.0
Gwydir	$0.0	$0.1	$0.1	$0.1	$0.3	**$0.6**	$0.1
Namoi	$0.1	$0.1	$0.1	$0.3	$0.3	**$1.0**	$0.2
Peel	$0.1	$0.1	$0.1	$0.1	$0.1	**$0.4**	$0.1
Lachlan	$0.0	-$0.0	$0.1	$0.3	$0.4	**$0.7**	$0.1
Macquarie	$0.0	-$0.0	$0.0	$0.2	$0.3	**$0.5**	$0.1
Murray	$0.1	$0.1	$0.2	$0.3	$0.5	**$1.2**	$0.2
Murrumbidgee	$0.1	$0.2	$0.2	$0.3	$0.4	**$1.2**	$0.2
Lowbidgee	$0.0	$0.0	$0.0	$0.0	$0.0	**$0.1**	$0.0
North Coast	-$0.0	-$0.0	-$0.0	$0.0	$0.0	**$0.0**	$0.0
Hunter	$0.0	$0.0	$0.1	$0.1	$0.1	**$0.3**	$0.1
South Coast	-$0.0	-$0.0	$0.0	$0.0	$0.0	**$0.0**	$0.0
Fish River	$0.1	$0.1	$0.1	$0.1	$0.0	**$0.5**	$0.1
Total	**$0.6**	**$0.6**	**$1.1**	**$1.9**	**$2.6**	**$6.8**	**$1.4**