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Dear Mr Wright

Fixed line services review – request for further information

I am writing in response to your letter dated 31 May 2011. In that letter you requested clarification of information provided to you in our letter dated 26 May 2011 in relation to Telstra's demand forecasts for fixed line services and the Tax value of Telstra's assets. Telstra's response to your request is set out below.

1. **What accelerated depreciation rate do the tax rules allow on new assets purchased after 30 June 2011?**

The rules regarding tax depreciation are dealt with under the Uniform Capital Allowances regime under Division 40 of the *Income Tax Assessment Act 1997* (ITAA 1997). These rules apply to all types of plant and fixed assets except land and buildings.

These rules, amongst other things, allow a series of choices for a taxpayer with regards to tax depreciation for any particular asset, being:

- Whether to use prime cost or diminishing value method; and
- Whether to use the effective life determined by the Commissioner of Taxation or self-assess the effective life.

There are instances where specific depreciation methods and/or effective lives are prescribed under the tax rules, but otherwise these are the only choices open to the taxpayer. There is no ability to "accelerate" the tax depreciation rate for a particular asset apart from choosing the diminishing value method over the prime cost method and/or choosing the shorter of effective lives between the Commissioner's effective life or the taxpayer's own self-assessed effective life (both choices being permitted under tax law).

The tax rules with respect to buildings are dealt with under Division 43 of the ITAA 1997, which prescribe that the prime cost method and an effective life of 40 years (i.e. 2.5% rate) must be used based on how Telstra typically uses its buildings. There are no choices open to a taxpayer in this regard.

As mentioned in our previous letter, land is not depreciable for tax purposes.

2. Why are network buildings purchased prior to 1982-83 not depreciated for tax purposes? Please advise also whether these assets are depreciated for accounting purposes and were depreciated in the asset information Telstra submitted to the ACCC in response to the September 2010 Draft Report on the fixed line services.

The ability to claim tax depreciation for network buildings was only introduced into the tax legislation for network buildings constructed after 19 July 1982. Prior to this, the tax legislation did not allow tax depreciation for any buildings (apart from building constructed from 22 August 1979 used as hotel or apartment buildings, which Telstra does not have).

However, these buildings constructed prior to 20 July 1982 were subject to depreciation for accounting purposes and the accounting values provided in Telstra's submission to the ACCC in response to the September 2010 Draft Report reflect this.

3. In Appendix A, what is the date at which these written down values were calculated? If these values were not calculated as at 1 July 2009, please provide the corresponding values at this date, which is the starting date for the Fixed Line Services Model.

The values reflected at Appendix A were calculated as at 30 June 2009.

4. In Appendix A, the tax written down values (WDVs) for the 'main cables' and 'switching equipment—other' asset classes are greater than their accounting values. Please explain the reason for their higher tax WDVs.

The tax WDV's for these asset categories are greater than the accounting WDV due to a number of factors. Broadly, the depreciation methods for accounting and tax are prime cost and diminishing value respectively. These assets are also at or near the end of the effective lives for both accounting and tax purposes.

Whilst the diminishing value method results in accelerated depreciation early in an asset's life, the prime cost method catches up and depreciates faster than the diminishing value method towards the end of an asset's effective life, resulting in a WDV lower than the diminishing value method at this time. This is the case for both of these asset categories.

Further, for main cables specifically, accounting depreciation had been accelerated in the past in anticipation of the network being updated, however this acceleration did not occur for tax purposes. Besides this accounting acceleration, effective lives for accounting and tax purposes have been relatively similar.

5. In Appendix A, the tax WDV for network buildings exceeds its accounting WDV. Please advise whether this difference reflects the lack of tax depreciation on network buildings purchased prior to 1982-83 and any other reasons.

The tax WDV of network buildings exceeds the accounting WDV because of two factors, being:

- Lack of tax depreciation on network buildings constructed prior to 20 July 1982; and

- Uplift in the tax cost base of network buildings acquired prior to 20 September 1985 (effective from 19 November 2006).

The lack of tax depreciation on network buildings constructed prior to 20 July 1982 is explained at 2 above.

In addition to the above, the tax treatment of buildings acquired prior to 20 September 1985 was that no tax gain or loss arose on disposal of the building. This was because, prior to this time, no Capital Gains Tax (CGT) regime existed, but was brought into existence from that date. Buildings acquired before this time are called "pre-CGT buildings" and their status as not subject to CGT is carried with them post the above date (i.e. a network building acquired in 1984 and sold in 2005 would generally not result in any tax gain or loss). However, in order for an asset of this type to maintain its pre-CGT status, majority continuity of ownership of the entity that owns the asset must be maintained. It was determined that as a result of the T1, T2 and T3 share offers, majority continuity of ownership of Telstra Corporation Ltd was lost in 2006 (i.e. when T3 occurred).

As a result, the pre-CGT status of these buildings was lost and the tax rules deemed the buildings as subject to CGT. These rules also deemed the buildings to have a cost base equal to the market value of the buildings at the time continuity majority ownership was lost (i.e. 2006). The tax WDV of buildings acquired prior to 1985 have therefore been uplifted because of this rule (accounting values and any tax depreciable cost base are unaffected by this tax uplift), although uplifted buildings constructed prior to 20 July 1982 are still non-tax depreciable.

The tax cost base of network buildings acquired from 20 September 1985 were unaffected by the above and retained their original cost base, although have been subject to tax depreciation.

6. In Appendix A, the tax WDV for network land exceeds its accounting WDV. The ACCC understands from previous information submitted by Telstra that Telstra does not depreciate land for accounting purposes. Please explain the reason for the difference in the tax and accounting values.

The tax WDV of network land purchased prior to 20 September 1985 (i.e. pre-CGT) was uplifted in 2006 as a result of the T3 share offer for the same reasons and manner that network buildings discussed at query 5 above were uplifted. Network land assets acquired from 20 September 1985 retained their original cost base. As previously discussed, land is not subject to depreciation for tax purposes and the above tax uplift did not affect the accounting WDV.

Telstra has responded to the ACCC's queries on the tax value of assets as best it is able in the time that the ACCC has provided. Should the ACCC require any further information or clarification in relation to the above, please let me know.

Yours sincerely

Christine Williams
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Strategy & Corporate Services