Institute of Chartered Accountants Australia

3 May 2013

Manager
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By email: companylosses@treasury.gov.au

Dear Sir

Tax loss incentive for designated infrastructure projects

The Institute of Chartered Accounts in Australia welcomed the opportunity to participate in the consultation meeting on 29 April 2013 to discuss the Exposure Draft legislation (**ED**) and accompanying explanatory material (**EM**) to implement the proposed tax loss incentive announced by the Government on 10 May 2011.

We welcome the fact that the ED will be amended to ensure that where a designated infrastructure project is carried on through a partnership, those partners which qualify as a designated infrastructure project entity (**DIPE**) will be able to take advantage of the tax loss incentive. However, we are disappointed that only consolidatable groups whose sole activities are a single DIP will be able to qualify as a DIPE.

Set out below are some observations on the ED and EM, some of which have already been raised in discussion with Treasury. Given the short consultation period our comments are not intended to be comprehensive.

1. Uplift of tax losses

Uplift of tax losses of DIP entities

- To qualify for the uplift, proposed section 415-10(2) requires that an entity must have notified the Commissioner in the approved form and on the day specified in 415-10(3) that it was at any time a DIP entity. The day specified in that later subsection is *the day after* the latest of the days mentioned in that subsection.

  This requirement is extremely unusual in that it requires that notification be made:
  - *on* a specific day and not *by* a specific date as suggested in paragraph 1.20 of the EM
  - the specific day is the day after an event, e.g. the day after the 28th day after the Infrastructure Coordinator designates an infrastructure project under proposed section 415-60
  - identifying the day of some events is unlikely to be clear cut, e.g. the first day an entity carries on the infrastructure project mentioned in paragraph proposed section 415-15(b).

  We do not appreciate the reasons the provisions have been drafted in the way they have. However, we envisage that they will create problems resulting the Commissioner having to exercise his discretion pursuant to proposed paragraph (d) of section 415-10(3) in far too many circumstances. This is not ideal from the perspective of the Commissioner and particularly taxpayers.

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We understand from the consultation meeting that Treasury will reconsider the drafting of this provision.

- As noted in the previous dot point, one of the days specified in proposed section 415-10(3) is "(c) the 28th day after the first day the entity *carries on the infrastructure project mentioned in paragraph 415-15(b)". In order to qualify as a DIP entity, proposed section 415-15(b) requires that "the entity *carries on a single investment in, or enhancement to, infrastructure (the ***infrastructure project***) at the relevant time or a later time". We make two observations:

  - despite the asterisks, neither the term in proposed sections 415-10(3) nor 415-15(b) is currently defined and the ED does not appear to be inserting a definition.

  - if proposed section 415-10(3) is concerned merely with identifying the relevant designated infrastructure project, should the reference be to the project mentioned in proposed section 415-15(d)?

Designated infrastructure project entity

- To qualify as a DIP entity it is a requirement that the only activities which the entity engages in are or were for the purposes of the entity carrying on the infrastructure project.

  In our submission on the consultation paper in respect of this measure we highlighted the fact that it was important that commercial decisions about the best way to exploit a DIP are not hamstrung by rigid tax rules to avoid the sorts of issues which arise in relation to the application of the trading trust rules in Division 6C of the *Income Tax Assessment Act 1936*. So, for example, if the DIP is a toll road project, the derivation of advertising revenue from billboards located on the side of the toll road by a DIPE should not cause it to fail the sole activity test.

  As indicated in our earlier submission any legislation should ensure that an entity does not lose the benefit of the tax loss concessions where:

  - the nature of income or expenses, while perhaps not directly for the purpose of carrying on the DIP, are incidental or of a kind that would typically be derived as a by-product of the DIP and
  - the amount of any offensive income or expenditure is de minimis.

  If Treasury is of the view that the ED as drafted achieves this outcome, at a minimum, the ED should reflect this by way of note to the section and bolstered by commentary and/or examples in the EM.

- As Treasury is aware, very few trusts qualify as fixed trusts absent the exercise of the Commissioner's discretion. Accordingly, we would expect that any trust which seeks to carry on a DIP will be required to apply to the Commissioner for a private ruling that it is in fact a fixed trust.

  We recommend that Treasury put the ATO on notice that this is a highly likely outcome of the proposed legislation to ensure that entities do not face undue delays.

- As noted above, to be a DIP entity it is a requirement that the entity "*carries on a single investment in, or enhancement to, infrastructure " but, despite the asterisk, the term is not defined.

2. Tax losses and bad debts written off by trusts and companies

- In Example 1.3 of the EM it may be more accurate to say that the test period collapses into a single point at the end of 2014-15 and in these circumstances Brine is deemed to satisfy the continuity of ownership test (**COT**) because of proposed section 415-30(3). It currently says because the test period collapses into a single point, so Brine would pass the COT.

  It would be helpful if the Example stated that the 2013-14 loss would be further uplifted in the 2015-16 year as Brine was a DIP entity for part of the year.

- Where a company ceases to be a DIP entity during a year and subsequently fails the adjusted COT it must rely on the same business test (**SBT)** as adjusted by proposed section 415-30 where it applies. Among other things, the effect of proposed section 415-30 is, we think, to treat the start of the "same business test period" in section 165-13(2) as being the start of the adjusted ownership test period determined under section 415-30(2) if it would otherwise start earlier.

  Is so then in Example 1.3:
  - the same business test period under section 165-13(2) is the income year, i.e. 1 July 2015 to 30 June 2016
  - the adjusted ownership test period would be from when Brine ceased to be a DIP entity, i.e. 1 June 2016 to 30 June 2016
  - as the same business test period starts earlier than the adjusted ownership test period, the adjusted same business test period is the period 1 June 2016 to 30 June 2016.

  Under section 165-13(2) the SBT must be applied to the business carried on immediately before the time of the 100% ownership change in 2014-15 (the test time). The effect of proposed section 415-30(5) is to adjust the test time so that it is just after the start of the adjusted ownership test period which is later, i.e. just after 30 May 2016.

  So, Brine will satisfy the same business test if it carries on the same business during the period 1 June 2016 to 30 June 2016 as it carried on immediately after 30 May 2016.

  If this is indeed how the provisions are intended to work then we recommend that the Brine example be continued in the section of the EM dealing with the same business test.

- We think that paragraph 1.30 of the EM seeks to outline the operation of the SBT in section 165-13. It says that a company which fails the continuity of ownership test may be able to pass the SBT by carrying on the same business throughout the deduction income year that it carried on "at the moment" it failed the COT. It should be "immediately before" it fails that test (assuming that it is practicable to say exactly when COT was failed).

  This begs the question of whether the business to which one should have regard when applying the adjusted SBT is just before or just after the start of the adjusted ownership test period.

- In relation to the current year loss rules, proposed paragraph (c) of section 165-35 will exclude from their operation a company which is a DIP entity for the entire income year.

  Where a company which is a DIP entity for only part of a year fails the 50% stake test in a year and does not satisfy the SBT, the current year loss rules in Subdivision 165-B are modified by proposed section 415-30(7).

We are far from clear how the modified rules are intended to apply and recommend that an appropriate example(s) be included in the explanatory memorandum.

- In the time available we have not road tested the proposed amendments to the company losses rules in more complex situations or how they apply to bad debt write offs or the trust loss rules. We understand that following the consultation meeting Treasury is reviewing the interaction of the proposed rules with Subdivisions 165-CC and CD.

  If Treasury has not already done so, we recommend that the proposed amendments to the loss and related rules be subject to robust road testing.

Designating infrastructure projects

- We understand from the 29 April 2013 consultation meeting that Treasury will include in the final EM a flowchart/diagram showing how the provisional and final designation process is intended to operate.

- Proposed section 415-45 envisages that an entity may apply to have the Infrastructure Coordinator designate a proposed investment in, or an enhancement to, infrastructure as being an infrastructure project to which the new loss tax loss incentives will apply. This suggests that an entity carrying on an existing infrastructure project, e.g. a toll road, which may or may not itself be designated, may apply for enhancements to be designated , e.g. an additional lane to the toll road. This of itself is welcome.

  However, it would appear that to avoid breaching the single DIP rule/activity test in proposed section 415-15 an entity would need to house the enhancement in an entity different to the entity which carries on the original infrastructure project.

  If this is correct we recommend that:
  - prior to finalising the legislation Treasury consider whether this is the optimal outcome and that tax is not unduly impeding the way enhancement projects would ordinarily be structured for commercial reasons; and
  - if it is the case that enhancements must be housed in a separate entity, the final EM make this clear.

- In relation to applications for designation, we suggest that the legislation include a definition of “financial close”, being the term used in proposed section 415-60(2)(b).

If you have any questions in relation to our comments please call Susan Cantamessa on 02 9290 5625.

Yours sincerely

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