INFRASTRUCTURE
PARTNERSHIPS
AUSTRALIA
BUILDING AUSTRALIA TOGETHER

SUBMISSION:

Exposure Draft:
Tax Laws Amendment (2013 Measures No.1) Bill 2013:
Tax loss incentives for designated infrastructure projects

MAY 2013

INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

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Infrastructure Partnerships Australia is a national forum, comprising public and private sector CEO Members, advocating the public policy interests of Australia's infrastructure industry.

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ABOUT INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

Infrastructure Partnerships Australia is the nation's peak infrastructure body. Our mission is to advocate the best solutions to Australia's infrastructure challenges, equipping the nation with the assets and services we need to secure enduring and strong economic growth and importantly, to meet national social objectives.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how we do business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

Infrastructure Partnerships Australia seeks to ensure governments have the maximum choice of options to procure key infrastructure. We believe that the use of public or private finance should be assessed on a case-by-case basis. Infrastructure Partnerships Australia also recognises the enhanced innovation and cost discipline that private sector project management and finance can deliver, especially with large and complex projects.

Our Membership is comprised of the most senior industry leaders across the spectrum of the infrastructure sector, including financiers, constructors, operators and advisors. Importantly, a significant portion of our Membership is comprised of government agencies.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policies and priority projects that will build Australia for the challenges ahead.

INTRODUCTION

On 18 April 2013, Assistant Treasurer and Minister Assisting for Deregulation, David Bradbury, announced the release of exposure draft legislation for a new tax loss incentive for designated infrastructure projects, aimed at encouraging private sector investment in nationally significant infrastructure.

The introduction of the new incentive will preserve the economic value of early-stage tax losses throughout an infrastructure project, and will provide much needed certainty to investors with respect to the recoupment of such losses.

Specifically, the new incentive will uplift the value of carry forward losses by the 10-year Government bond rate, and exempt the losses from the continuity of ownership test (COT) and the same business test (SBT).

Infrastructure Partnerships Australia (IPA) congratulates the Government on the progress of this important measure so far, and welcomes the opportunity to provide comments on the exposure draft, explanatory memorandum and guidelines, thereby helping to ensure the measure is implemented effectively.

On 30 April 2013, IPA was involved in a consultation with Federal Treasury regarding the measure, and this submission will focus on issues raised at that meeting. Specifically, Treasury requested that IPA provide the following:

1. Examples of companies that are affected/would be affected by not being included in the incentive, as a result of being part of a consolidated group;

2. Examples (to be included in the Explanatory Memorandum) of ancillary activities that occur as a normal part of a project, and therefore shouldn't cause an entity to fall outside of the criteria for eligibility; and

3. Suggested wording that could clarify section 415-15 to ensure that finance and stapled entities are not excluded from the incentive.

1. CONSOLIDATED GROUPS

The current exclusion of certain consolidated groups from the incentive (as detailed in the exposure draft legislation) should be addressed to better reflect industry practice.

We understand that the rationale behind the exclusion of consolidated groups is that the Government considers the incentive unnecessary in these circumstances. Specifically, under the existing consolidation regime, expenditure incurred by a subsidiary member of a consolidated group can immediately be applied against income derived elsewhere in the group. As such, it is argued, there is no need to preserve the present value of the losses.

However, there could be circumstances in which a subsidiary suffers losses at a time when there is no income derived elsewhere in the consolidated group to offset those losses against. For example, an infrastructure fund that holds multiple PPPs, all in the construction phase, could experience losses across all projects for several years before projects commence operations and generate revenue. It would provide certainty for investors as to the recoupment of their losses, and therefore be in line with the objectives of the incentive, for entities in such circumstances to be able to quarantine the losses within the project, to be offset against future income from that same project.

Additionally, it would be in line with the incentive's objective of encouraging private investment in infrastructure, by supporting efficient secondary market transactions. An entity that is part of a consolidated group may wish to sell a project after construction, and the project losses remaining in the project is important for project liquidity.

Examples of companies that would be affected by the exclusion of consolidated groups include a superfund or infrastructure focussed managed fund that invests in a number of DIPs. Such entities would have to keep their investments separate.

2. ANCILLARY ACTIVITIES

There are a number of activities that entities undertake as a normal part of an infrastructure project that may cause a project entity to fall outside of the eligibility criteria, as currently drafted.

Section 415-15(c) of the Exposure Draft requires that to be deemed a *designated infrastructure project entity* (DIPE), *"the only activities in which the entity engages at the relevant time, or engaged before the relevant time, are or were for the purposes of the entity carrying on the infrastructure project."*

IPA considers that this requirement may be too restrictive if interpreted narrowly. Specifically it is not clear that the drafting will cover activities which are ancillary but nonetheless integral to "*carrying on the infrastructure project"* (see examples below).

We understand that Treasury agrees with IPA that ancillary activities that are part and parcel of the normal commercial operations of an infrastructure project shouldn't cause a DIPE to become ineligible for the incentive. Accordingly, in order to provide certainty for the industry, we consider that examples of allowable ancillary activities should be included in the Explanatory Memorandum.

Such examples include:

- Investing surplus cash held by the entity, either due to short-term liquidity issues or cash reserved for a longer period to, for example, fund asset upgrades, constitutes a valid and ancillary activity of the DIPE;

- It is possible that during construction of the asset, there will be changes in scope that will amend the asset from what was originally agreed. Further, whilst the entity remains in tax losses, there may be an economic need to expand the asset to deal with increased usage. In each of these cases, provided the purpose of the asset does not change (e.g. adding an extra lane to a road does not stop it still being a road) there is no change in the activity undertaken by the DIPE;

- Financing activities including securitisation, hedging of foreign currency borrowings and floating to fixed swaps are all valid ancillary activities of the DIPE;

- Activities associated with secondary market transactions, as a project progresses from construction to operations phase and the long-term investors enter a project, are valid ancillary activities of a DIPE;

- Acting as a holding company of other entities that are "*carrying on the infrastructure project";* and

- Commercial development opportunities undertaken as part of construction of the relevant project (for example rental from a café at a port) or other private elements (for example roadside advertising) are often used to bring value to certain projects and could be seen as relevant for an assessment under section 415-15(c).

This is not intended to be an exhaustive list. The list of examples included in the Explanatory Memorandum should be comprehensive enough to provide clear and unambiguous guidance to investors, yet flexible enough to allow for new developments in the space (for example, in days gone by, entities took out residual value insurance, illustrating that what constitutes normal commercial activities will continue to evolve).

3. STAPLED GROUPS AND SPECIAL PURPOSE FINANCE ENTITIES

It is important that stapled entities and special purpose finance entities aren’t excluded from the DIPE eligibility criteria and the current wording of section 415-15 should be amended to make this clear. A suggested revised wording of section 415-15 is included at Annexure A.

4. ANNEXURE A – SUGGESTED REVISED SECTION 415-15

415-15 *Designated infrastructure project entity*

(1) An entity is a ***designated infrastructure project entity*** at a time (the ***relevant time***) if:

(a) at the relevant time, the entity is:

(i) a *fixed trust or a company;

~~(ii) not a *member of a *consolidated group;~~

Note – A designated infrastructure project may be carried out by multiple entities – each performing a specific role in the infrastructure project. In this case, each entity may qualify as a designated infrastructure project entity provided the other requirements of this section are met.

This may include, for example, partners in a partnership, entities that form part of a stapled group, a special purpose finance entity for the infrastructure project or a special purpose holding company which wholly owns another ***designated infrastructure project entity.***

If each entity's activities only relate to the infrastructure project, then each entity will be treated as a ***designated infrastructure project entity.***

(b) [the entity is engaged in activities that are connected with an ~~*carries on a single~~ investment in, or enhancement to [***Comment – it is not clear what this "enhancement to" means***], the infrastructure project (the ***infrastructure project***) at the relevant time or a later time; and

(c) the only activities in which the entity engages at the relevant time, or engaged before the relevant time, are or were for the purposes of the entity carrying on activities relating to the infrastructure project; and

(d) the infrastructure project:

(i) is a *designated infrastructure project at the relevant time; or

(ii) becomes a designated infrastructure project at a later time.

(2) An entity cannot be a designated infrastructure project entity where it is a member of a tax consolidated group, unless the head company of the tax consolidated group is a *designated infrastructure entity.*

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