20 April 2017

Division Head
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via Email: stapledstructures@treasury.gov.au

Dear Treasury,

Stapled Structures

The Australian Financial Markets Association (AFMA) represents the interests of well over 100 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets.

With the active participation of 25 member banks in Australia, the Australian Bankers' Association (ABA) provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy, and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

AFMA and the ABA are pleased to provide a submission to the Treasury Consultation Paper titled "Stapled Structures" (**the Consultation Paper**). Our submission focusses on issues arising from the Consultation Paper for those entities that provide debt finance to stapled structures, as opposed to the issues and perspectives of equity participants in such structures (i.e. the owners of the shares in the company or units in the trust that comprise the staple).

General Comments

Prior to addressing the relevant specific discussion questions embedded in the Consultation Paper, we have provided some general comments regarding the Consultation Paper and the context arising.

Firstly, given the gravity of the issues raised in the Consultation Paper, the consultation timeframe of less than four weeks is patently insufficient. As Treasury would be aware, the issues raised in the Consultation Paper affect a significant number of stakeholders and may potentially result in significant changes to the way that assets of national significance are financed and developed. As such, our comments below should be considered preliminary in nature, with the potential for them to be augmented through additional consultation. We are particularly concerned that the expiry of the consultation period on the Consultation Paper of 20 April 2017 is designed to facilitate an announcement by the Government as to its policy perspectives on the matters canvassed in the Consultation Paper in the 2017/18 Federal Budget, which in our view would be premature.

Secondly, the Consultation Paper focusses on the outcomes for the equity participants in the stapled structures, i.e. those entities that hold interests in the company and the trusts. Any consultation and policy response needs to take into account the importance of debt funding to these investments and the impact of any changes to the financing of such investments, particularly those that may be retrospective in nature.

Thirdly, and relatedly, any changes to the taxation treatment of stapled structures that are retrospective in application would result in significant compliance costs for those entities providing debt finance to the investment. It is important to note that a change to the taxation treatment of the stapled structure, particularly one that would increase the amount of tax payable by the staple, would impact the quantum of debt appropriate for the project, not just the cost of such debt. As such, our strong view is that grandfathering of existing investments is the only equitable mode of implementation of any new taxation rules that apply to stapled structures. Any new rules should only apply prospectively following a reasonable notice period.

2. What impact would the loss of an ability to make cash distributions at the early stages of a project have on the attractiveness of long-term infrastructure investment for investors?

The removal of the ability to make cash distributions at the early stages of the project would materially impact the net present value and the attractiveness of long term infrastructure investment. Generally such projects are in losses for the first five to seven years and given the constraints on companies paying dividends, the ability of trusts to distribute cash in the early stages allows for investors to receive cash earlier in the project life-cycle, thereby reducing risk.

6. What would be an appropriate mechanism to remove the tax advantages of stapled arrangements? and

8. What types of structures or arrangements, if any, should be excluded?

As set out below, from a debt finance perspective the most important factor in determining the appropriateness of any mechanism to remove the tax advantages of stapled arrangements is that it is prospective in application.

AFMA and the ABA would support an exemption for critical infrastructure on the basis that this is a term defined with appropriate specificity with reference to certain asset classes and does not require a specific application to be approved, such as in the context of the infrastructure loss rules. Asset classes that may be designated as critical infrastructure could include:

- Clean energy/renewables infrastructure;
- Electricity assets;
- Ports; and
- Roads and transport infrastructure.

13. If tax laws are amended to remove the tax advantages of stapled arrangements, what impact do you consider this would have on the Australian economy, including the cost of capital, level of investment or price of assets?

It is noted that it is very difficult to quantify with any specificity the impacts given the truncated consultation period.

The primary non-tax benefit arising from the use of the stapled structure in large-scale property and infrastructure investment is the ability for the debt finance appropriate for the investment to be determined with reference to pre-tax cash-flows, as there is no tax within the security net. This generally allows for a greater level of debt as there is a higher level of cash available to service interest, principal and lease payments. A key point to note is that any change to the tax treatment of the stapled structure will reduce the quantum of debt available for the investment, thereby necessitating additional equity that was not contemplated at the time of the acquisition.

An increase to the debt levels and hence the gearing of the investment reduces the overall cost of capital associated with the investment, thereby enhancing returns on equity and hence the consideration paid for the asset. As such, changes which result in tax being payable at the project level (i.e. within the security net) should result in lower asset prices.

17. What is the typical term of external third party finance for stapled groups?

Generally the term of the finance is three to seven years, with an opportunity to refinance at the end of the term. However (as is elaborated upon below) refinances assume the same debt service coverage ratios, such that any changes to the taxation treatment within the stapled structure, which cause changes to such ratios, will be outside the ambit of a normal refinance and will require changes to term sheets and result in unexpected increases to the amount of capital required from equity investors.

18. Should pre-existing structures and instruments issued prior to any new taxation laws be grandfathered?

It is AFMA and the ABA's strong view that the only appropriate commencement period for any new taxation laws that may apply to stapled structures is one that is prospective in terms of application. That is, pre-existing structures should be grandfathered, noting the comments below in relation to competitive distortions.

To the extent that a commencement period was to be retrospective in application, this may give rise to significant compliance costs to review existing structures and documentation to ascertain whether amendments will be required, including potential engagement of external lawyers and accountants. Further, given the debt coverage service ratios are determined at the commencement of the project and may not be re-negotiated at the time of any re-financing, it is not appropriate to phase the commencement of any new taxation laws over a time period given the implications will be beyond those generally considered at the time of a refinancing.

The Consultation Paper suggests that any grandfathering structures may give rise to competitive distortions and the inappropriate use of those grandfathered structures to acquire new investments. This concern may be addressed through ensuring that any grandfathering mechanism apply at the investment level as opposed to the structure level, thereby ensuring a level playing field in terms of new acquisitions.

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AFMA and the ABA welcome the opportunity to provide a submission on the Consultation Paper and look forward to further engagement as the scope of any policy response is refined. Please contact the signatories with any queries in the interim.

Yours sincerely,

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Tony Pearson
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