INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

20 April 2017

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

By email to: stapledstructures@treasury.gov.au

To whom it may concern,

RE: Feedback and comments on stapled structures consultation paper

Thank you for the opportunity to provide feedback and recommendations on the Stapled Structures Consultation Paper released by the Treasury on Friday 24 March 2017.

About Infrastructure Partnerships Australia

Infrastructure Partnerships Australia (IPA) is an independent public policy think tank and executive network, focused on excellence in social and economic infrastructure.

We bring together Australia's major public and private infrastructure organisations, harnessing deep industry knowledge and our policy expertise to shape government infrastructure policy toward the best possible economic and social outcomes.

High level comments and recommendations

Recent ATO and Government releases on stapled structures are causing uncertainty and confusion for the infrastructure sector.

Following the issue of the Australian Tax Office's (ATO) Taxpayer Alert 2017/1 ("**Taxpayer Alert**"), the ATO Privatisation and Infrastructure Tax Framework, and the Treasury Consultation Paper on Stapled Structures on 24 March 2017, the infrastructure community (investors, developers, construction companies, advisers, and other participants) are uncertain and there is resulting confusion as to which infrastructure assets will in the future be acceptable in stapled structures.

We strongly recommended that, the upcoming Commonwealth Budget formally and properly clarify that "traditional" or "critical" infrastructure assets, including road, rail, ports, utilities, water, communications, electricity generation, transmission and distribution (essentially all economic infrastructure) and related infrastructure continue to satisfy the requirements of and can be structured in stapled structures.

It is important to promptly distinguish "traditional" or "critical" infrastructure from other types of stapled structures which the Government may now seek to moderate through targeted legislative change.

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Given the history of long, protracted tax legislative reform(s) (including the Attribution Managed Investment Trust (AMIT) reforms and Collective Investment Vehicle (CIV) reforms, which have taken several years to implement), our strong preference is for a definitive and timely Government announcement in the upcoming Budget stating that stapled structures can continue to be used for land intensive asset classes such as real estate and "traditional" or "critical" infrastructure, thus permitting certainty, rather than awaiting a legislative reform/response.

If the Commonwealth chooses to pursue further legislative change to stapled structure arrangements, there will need to be detailed consultation with long-term infrastructure investors.

Australia is a net capital importer and has carefully maintained policies that reflect the importance and sustain the interest of foreign capital, even with our comparatively high corporate tax rate.

This means that Australia's tax policies must:

1. Provide an internationally competitive effective tax rate to attract infrastructure investment, noting that the corporate tax rate is comparatively higher than other markets; and
2. Be predictable and stable for foreign and local investors, noting the inherently (very) long-term nature of most infrastructure investments.

Investors in traditional infrastructure assets have adopted stapled structures, within a relatively stable legislative tax law and settled administrative environment, over many years.

The recent ATO Taxpayer Alert and particularly, concerns over the fragmentation of trading income - even in the context of vanilla rental staples - has unsettled investors and raised worrying questions over the status and criteria for stapled structures into the future.

Additionally, privatisations of land based infrastructure assets were specifically carved out of the ATO Taxpayer Alert subject to taxpayers staying "within the flags" prescribed in their Privatisation and Infrastructure Tax Framework. However, there has been significant industry concern about how much certainty this administrative approach could provide outside of legislative reform.

The timing of the consultation paper has caused enormous uncertainty for investors in Australian infrastructure.

Even if legislative clarification and change eventuates, the timing of the consultation paper has been unhelpful and caused material uncertainty for a range of recent, current and proposed transactions – such as:

- the lease of Endeavour Energy (NSW), which is at a critical stage and changes could have adverse effects;
- the forthcoming sale of the 'WestConnex' business, Sydney Motorway Corporation;
- among others.

The circa $80 billion in recent state government privatisations have effectively all been traditional infrastructure assets – largely ports and electricity transmission and distribution.

State government sellers and bidding consortia in these transactions had substantial engagement with the ATO and the Foreign Investment Review Board (FIRB) to confirm that their transaction structures were appropriate and stayed "between the flags".

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Bidding consortia and their financiers entered into those long-term transactions with a reasonable expectation that their structures were sound.

The scale of change contemplated in the consultation paper invites a continued and unhealthy perception of sovereign-type risk for Australian infrastructure investments – exacerbating the impact of other sovereign and political risks following the cancellation of contracts for road infrastructure projects in Victoria and now, Western Australia.

This is serious enough to warrant urgent clarification by the Commonwealth – giving both vendor state governments and investors comfort thereby avoiding major price discounts of state assets; and reducing the prospect of reputational damage to Australia through perceived sovereign risk.

That's why we again respectfully submit that the forthcoming Federal budget should confirm that traditional infrastructure assets – including recent, current and proposed state government privatisations – are carved out of any potential changes to the stapled structure arrangements.

If legislation is pursued, definitions become important.

If the Commonwealth does choose to pursue legislative change in the short to medium term, then a settled definition of "traditional" or "critical" infrastructure will be fundamentally important.

In this case we would recommend that you should use the definitions of '*infrastructure and related facilities*" in section 93L and 93M of the *Development Allowance Authority Act* 1992 (Cth), which covers land transport facilities, air transport and seaport facilities, electricity generation, transmission and distribution facilities, gas pipelines and various utilities like water and sewerage, among others.

This definition could be expanded to include certain renewable assets and the more recently expanded concepts of infrastructure facilities.

Alternatively, the Government could look to the definition of "infrastructure" included in the UK's Finance Bill 2017. Section 429 of the Bill defines infrastructure to include:

- Water, electricity, gas, telecommunications or sewerage facilities;
- Railway facilities [including rolling stock], roads, harbour or other transport facilities;
- Health or educational facilities;
- Training facilities for any of the armed forces or any police force;
- Court or prison facilities; and
- Waste processing facilities.

This later definition is more expansive, contemplating technological and other changes and thereby reducing the need to keep revisiting the meaning of 'infrastructure'.

This definition also picks up social Public Private Partnership (PPP) type investments – an increasingly large portion of greenfield activity in Australia.

Another option would be for new legislation to simply focus on the particular new, 'exotic' staples that the Commonwealth is trying to moderate.

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The existing MIT 'non arms' length' rule and 'debt/equity integrity' rules are sufficient to maintain the integrity of income earned through the active and passive sides of a staple.

We understand that potential change is being driven by a concern or perception that staples are being used to inappropriately re-characterise 'active' trading income as 'passive' income, to access concessional MIT withholding tax rates.

We submit that the existing MIT non arms' length income rule and the debt/equity integrity rules (including the proposed aggregated scheme rules) are sufficient to ensure that the profits earned by the active and passive sides of the staple are appropriate.

If the Commonwealth still feels that additional integrity rules are needed, deep consultation and careful reflection will be needed to ensure that we remain competitive and attractive as an investment destination.

While Australia has enjoyed a very high level of global infrastructure investment in recent years, this advantage can be easily squandered through poorly considered changes – or continued perceptions of sovereign-type risks.

Indeed, infrastructure is a highly global investment market and from a macroeconomic policy viewpoint, introducing a higher tax rate for Australian infrastructure, while the US is contemplating lower tax policies – could cause a switch of offshore capital investment to the USA – a case of US project investment opportunities trumping Australian projects.

If the Commonwealth pursues additional integrity rules, we note that extensive evaluation and consultation will be needed to ensure we do not lose our currently high level of investor appetite for Australian infrastructure projects.

The strict 'land' and 'rent' test in Division 6C needs to be appropriately widened, to properly cover infrastructure.

IPA submits that the critical limb of the current "eligible investment business" definition in Division 6C is overly legalistic and narrow being limited relevantly to:

"*Investing in land for the purpose, or primarily for the purpose, of deriving rent*"

Recent transactions involving electricity transmission and distribution networks and in the renewable energy sector have highlighted the inadequacies and uncertainty created by the current definition.

The safe harbours provided in sections 102MB and 102MC do not adequately address these shortcomings for infrastructure investment.

Accordingly, IPA submits that the concept should be expanded to cover arrangements involving the payment for use of or access to traditional infrastructure assets, which would not meet the strict legal requirement of comprising rent derived from land or an interest in land.

For example, the revised definition could make clear that investing in licences for access to traditional infrastructure assets that are attached to land (whether legal fixtures or not) for the purpose of deriving licence payments would qualify as an "eligible investment business" for these purposes.

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Modernising the "eligible investment business" test in this way would provide critically needed legislative certainty for investors.

In the event that a carve out of traditional infrastructure is not adopted in any proposed policy reform, IPA submits that comprehensive grandfathering is both feasible and essential to maintain confidence of long-term investors and avoid damaging sovereign risk.

We reiterate that traditional infrastructure should be carved out of any potential reform to the use of stapled structures.

If a carve out is not forthcoming, comprehensive grandfathering of existing investments is both feasible and indeed, is essential to maintain investment confidence and avoid the continuing spectre of political and sovereign risks over Australian infrastructure investments.

The consultation paper raised concerns with comprehensive grandfathering of existing investments, citing the experience in the US and Canada.

We submit that the context in the US and Canada was significantly different to Australia. For example, those jurisdictions did not have a provision equivalent to Division 6C, which strictly limited the types of activities and income that could be earned by the passive side of the staples.

IPA submits that if legislative change is to occur, a comprehensive and perpetual grandfathering of existing transactions must be available to existing stapled structures, provided they are able to satisfy a form of same business test. We would be able to provide detailed submissions on this point, if needed.

Potential new tax framework for infrastructure assets/projects

We strongly recommend against introducing a new framework for infrastructure projects, for example, a specific real estate investment trust (REIT) regime for, amongst other reasons, the long delays in implementation of significant reform legislation of this nature in recent years. Further, we believe the suggested examples in the consultation paper of REIT regimes utilised globally fail to recognise the significant use of limited partnerships and other structures globally in sophisticated and comprehensive jurisdictions with a strong infrastructure sector – e.g. USA, UK, China, Hong Kong, and New Zealand.

For your convenience, we have attached our submission to Treasury on March 2011 dealing with the Review of Tax Arrangements, applying to Collective Investment Vehicles (CIV) which provides several suggestions on CIV and related issues (including eligible investment business) and a comparative table/analysis on global limited partnership regimes.

Further, the possible restructure of existing infrastructure assets would require specific capital gains tax rollover relief and, not the least, state stamp duty concessions in order to address potential landholder duty issues and related matters.

Extensive consultation and evaluation is required.

Given the significant importance and complexity of the issues raised in the Treasury's consultation paper, extensive consideration, consultation and evaluation of any potential policy options will require time and significant input from relevant stakeholders.

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Any potential changes to Division 6C, Part IVA and related provisions, including MIT withholding tax, will need detailed consultation which will extend well beyond the Commonwealth Budget period. In this regard, we recommend a twelve-month consultation and evaluation period with the industry to carefully develop any response.

Conclusion and next steps

We hope that this submission provides a useful contribution to the Treasury's consultation process on stapled structures and we look forward to engaging further with Treasury as the consultation process unfolds.

If you require any further comments or assistance please contact Varsha Maharaj, Government Relations Adviser, on varshamaharaj@infrastructure.org.au or (02) 9152 6015.

Sincerely,

BRENDAN LYON
Chief Executive Officer

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