20 April 2017

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

By email: Stapledstructures@treasury.gov.au

Dear Sir / Madam

Submission on the 'Stapled Structures' Consultation Paper

The Spark Infrastructure Group (**Spark Infrastructure**) welcomes the opportunity to make a submission to The Treasury in relation to the consultation paper for stapled structures (the **Consultation Paper**) released for comment on 24 March 2017.

Executive Summary

- Stapled structures have been used over many years for infrastructure privatisations. Such structures allow investors to reduce their cost of capital, and enable tax-rate parity between domestic and foreign equity capital. As a result, investors can optimise their valuations in bidding processes to the benefit of State and Territory Governments. Bidders are able to value the tax benefit of a stapled structure upfront to the selling government rather than paying tax over the relevant term of the investment. To materially change the tax assumptions underpinning the investment structure so soon after recent privatisations in effect means private investors would be paying the tax to government twice.

- The maximised proceeds received by State and Territory Governments recycling capital from infrastructure sales enables further investment into the community to fund important new infrastructure such as roads, hospitals, public transport and schools. The use of these stapled structures for privatisations is greatly beneficial to the funding of Australia's growing infrastructure demands.

- Successful bidders for privatised infrastructure assets have judged value on the reasonable expectation that Federal Government policy would allow for the continued use of stapled structures over the investment life. This expectation is supported by the fact the Australian Taxation Office (**ATO**) was and continues to be actively engaged in privatisation processes. In all recent cases, bidders have had transparent discussions with the ATO in relation to the use of stapled structures.

- Given the previous support for stapled structures for privatisations, it would be appropriate, fair and equitable for the Federal Government to exclude these recently privatised assets in any proposed reforms to stapled structures. Should full exclusion or grandfathering from any proposed reforms for these recently privatised assets not be achievable, then it would be imperative for any reforms to be implemented over as long a transition period as practicable.

- The uncertainty created by the current environment as to whether stapled structures are available is detrimental to current and future asset recycling programmes. Change to tax rules regarding stapled structures may have material detrimental impacts to the cost and availability of debt for these assets. This cost is ultimately borne via the regulatory regime by the end consumers.

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- Furthermore, the uncertainty created by poorly consulted, communicated and implemented changes of this nature will have material detrimental impacts on the costs of capital for these assets. This cost is ultimately borne, via the regulatory regime, by the end consumers.

- There is also a risk that changing the taxation rates applying to such structures could adversely impact the valuation of existing infrastructure assets held by Australian investors directly or indirectly via their investment in Australian superannuation funds. This could therefore impact the retirement savings of many Australians.

- The evidence has consistently shown that private investment in electricity transmission and distribution assets is good for consumers. Federal Government policy should continue to encourage State and Territory Governments to consider privatising further transmission and distribution assets in the interests of economic reform and the productive recycling of public capital.

Background

The Spark Infrastructure Group is an Australian Securities Exchange (**ASX**) listed specialist infrastructure fund, with a market capitalisation of around $4 billion as at April 2017. Spark Infrastructure has been headquartered in Sydney since its inception in 2005. Its objective is to invest in regulated utility infrastructure in Australia and provide a growing and sustainable distribution to its Securityholders. Spark Infrastructure has around 20,000 Securityholders, ranging from Australian superannuation funds, offshore pension funds and professional investment managers, to individual private investors both Australian and foreign. Approximately 80% of our current Securityholder base are Australian superannuation and retail investors.

Spark Infrastructure makes long-term investments in leading Australian electricity network businesses. Its investment portfolio includes 49% interests in SA Power Networks (South Australia), Victoria Power Networks (Victoria), comprising CitiPower and Powercor Australia, and a 15% interest in TransGrid (NSW). Through its investment portfolio, Spark Infrastructure supports well over 5 million customers across the National Electricity Market (NEM). Spark has partnered with sophisticated and patient long term domestic and foreign capital in all of its investments.

TransGrid, in which Spark Infrastructure together with its long-term domestic and international consortium partners invested via the NSW Government's privatisation program, is a stapled structure. Spark Infrastructure's investments in SA Power Networks and Victoria Power Networks are not stapled structures. These other assets were initially privatised by the relevant State Governments in the 1990s.

Spark Infrastructure itself is listed on the ASX as a stapled security with a unit trust stapled to a Loan Note. This type of stapled security is not the focus of the Consultation Paper. The focus of the Consultation Paper are stapled structures that comprise a trust that holds land assets and carries on a passive business and an entity that carries on a trading business. Spark Infrastructure's comments herein address these passive/trading business stapled structures.

Detailed comments

Privatisations and the need for private funding for infrastructure

Infrastructure investment is a significant priority for the Federal Government. The Federal Government has advised that significant investment in infrastructure is a crucial part of the Government's Economic Action Strategy to boost economic growth and prosperity, increase productivity and support thousands of new jobs[1].

The Federal Government including State and Territory Governments do not have sufficient financial capacity to fund (and continue to own) assets to meet Australia's infrastructure needs. Increasingly State and Territory Governments will need to optimise deployment of capital into infrastructure.

[1] *Department of Infrastructure and Regional Development http://investment.infrastructure.gov.au/*

The infrastructure needs of Australia can, in significant part, be met by private sector funding. The onus is therefore on State and Territory Governments to look for better and more effective ways to partner with the private sector to attract and retain sustainable sources of funding. Capital recycling (privatisations) can materially bridge the gap. In December 2013, Infrastructure Australia advised that:

> "*transferring existing infrastructure to the private sector would also likely* ***achieve significant broader economic productivity benefits from introducing private sector discipline****, improving the ability to finance the expansion of infrastructure as required, improved governance - where the government is no longer both the regulator and the owner, and greater transparency in the costs of community service obligations*"[2] [emphasis added]

A key strategy to recycle public capital is to sell brownfield infrastructure assets (e.g. electricity transmission and distribution assets) to the private sector at a market price under a competitive bid process. The capital released is then used by government to deliver critical new greenfield infrastructure investments for the community (e.g. roads, hospitals, public transport and schools).

Given the capital intensive nature of infrastructure, the bid price paid for infrastructure assets is heavily influenced by the cost of capital and the investment structure available to investors to acquire the asset. In particular, the use of stapled structures for privatisations rather than a corporate structure is a very common practice as it provides investors with an efficient structure that enables them to maximise their bid price (and ultimately increase the funds raised for critical infrastructure projects. The reasons for this are as follows:

- The optimisation of an asset's weighted average cost of capital (**WACC**) is generally achieved by optimising the level of project gearing. This is on the basis that project debt funds are cheaper than equity.

- To optimise the gearing and debt terms for infrastructure projects, the project needs to optimise various financial ratios including the debt service cover ratio (**DSCR**).

- The use of a stapled structure for infrastructure projects is beneficial from a debt perspective as an amount of the project's tax should be paid at the investor level rather than at the project level. This maximises the cash flows that may be used to support DSCRs and usually allows a greater level of gearing than otherwise would be the case. In addition, a lower equity contribution is required as the enhanced gearing level in the structure improves the value of the structure through a reduced cost of capital.

Stapled structures have been used over a number of years for privatisations. By using stapled structures for privatisations, governments are able to maximise the price that bidders are willing to pay and therefore raise the much needed funds for the government to reinvest into the community to fund vital infrastructure. If stapled structures were not available for privatisations, the proceeds to government would be materially diminished, thereby providing less funds available for recycling into vital new infrastructure for communities.

NSW Privatisations

The NSW Government has undertaken a significant asset recycling program over the past few years involving ports, the Sydney desalination plant and electricity transmission and distribution assets. In relation to electricity distribution and transmission, the asset class into which Spark Infrastructure invests, recent examples include the sale of interests in an electricity distributor (Ausgrid in 2016) and an electricity transmission business (TransGrid in 2015). The NSW Government has subsequently announced that it is undertaking a process to sell 50.4% of a further electricity distributor, Endeavour Energy.

Spark Infrastructure holds a 15.01% interest in TransGrid, which it acquired as part of an Australian led consortium with foreign investors.

2 *Australia's public infrastructure - Update Paper Balance Sheet Impacts of Sell to Build, Infrastructure Australia, December 2013, page 1*

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Stapled structures for privatisations have had full support from the Government and the ATO (which in most cases have engaged in transparent discussions with bidders including through the FIRB process). In particular, as part of the privatisation of TransGrid, our consortium was required to sign up to a Tax Deed with the ATO. The Tax Deed was intended to provide certainty to investors over the 99 year term of the project regarding the tax characterisation of certain arrangements pertaining to the stapled structure of the investment, which was the structure offered by the selling NSW Government.

On 31 January 2017, the ATO released Taxpayer Alert TA 2017/1 (the **Taxpayer Alert**) expressing concern over the use of certain stapled structures. However, in the Taxpayer Alert, the ATO stated that the Taxpayer Alert should not extend to privatisations which are effectively land and land improvements. Rather these structures would be subject to specific guidance set out in the draft Privatisation and Infrastructure – Australian Federal Tax Framework (the **Framework**) released by the ATO on the same day as the Taxpayer Alert. The release of the Framework and the comments in the Taxpayer Alert on privatisations further implies that the ATO was comfortable with stapled structures for privatisations provided that the structures were within the relevant ATO guidelines in the Framework.

Given such acceptance in the very recent experience of the use of stapled structures in the privatisation context, it is surprising to see Treasury raise broad-ranging concerns in relation to the use of stapled structures. This has resulted in increased uncertainty and raises the question as to whether the positions in the Tax Deed entered into for TransGrid might be unwound due to change of law. We would therefore suggest that any change to the taxation treatment of stapled structures should exclude land-based privatisations such as TransGrid.

Australia's electricity distribution and transmission more generally

Australia's electricity distribution and transmission assets are critical infrastructure assets in that they deliver vital energy to Australia's population. Private capital presently invested directly as equity or debt financing for Australia's transmission and distribution networks totals tens of billions of dollars.

In March 2015, the Harper National Competition Policy Review observed that outcomes achieved under private investment in Australia's energy infrastructure are more consistent with supporting the long-term interests of consumers than outcomes being achieved by state-owned energy infrastructure:

> "*The **increased role of the private sector in infrastructure has brought considerable public benefit**... Privatisation has also delivered more efficient management of assets and investments have been more responsive to changes in market demand...Well-considered contracting out or privatising remaining infrastructure assets is likely to drive further consumer benefits through comparatively lower prices flowing from greater discipline on privatised entities.*[3]" [Emphasis added]

Under Spark Infrastructure's ownership, the efficient operation of SA Power Networks, CitiPower and Powercor Australia has enabled their customers to benefit from some of the lowest network charges in the NEM[4]. In November 2016, the AER released its most recent performance reports for the electricity transmission and distribution networks under its jurisdiction. CitiPower, Powercor Australia and SA Power Networks were all ranked in the top five distribution networks (out of 13) for the AER's primary efficiency measure.

Since TransGrid's privatisation in December 2015, Spark Infrastructure and our co-owners have been working with TransGrid to improve its performance through active management and the application of the same principles and strategies, which have proven successful in SA Power Networks and Victoria Power Networks. This work will result in many long term price and service benefits for electricity consumers in both the ACT and NSW.

The privatisation of the remaining state owned electricity transmission and distribution assets would provide great benefit to Australian consumers into the long term. Such private investment in these assets requires very large amounts of patient long term capital seeking predictable returns from a stable investment environment. Stability of

3 *The Australian Government Competition Policy Review, March 2015, section 11.1*

4 *Oakley Greenwood - 'Value of grid connection to distributed generation customers', December 2014 and AEMC - 'Residential electricity price trends', December 2016 http://www.aemc.gov.au/Markets-Reviews-Advice/2016-Residential-Electricity-Price-Trends/Final/AEMC-Documents/2016-Electricity-Price-Trends-Report*

this environment has been paramount in attracting and retaining large amounts of domestic and foreign capital at the right price. A reduction in predictability, stability and certainty will have material adverse impact on the attractiveness of both equity and debt investment into privatised electricity and transmission assets.

Attracting foreign capital for privatisations and neutrality between domestic and foreign capital

Infrastructure assets such as electricity distribution and transmission typically attract investment from local superannuation funds, foreign pension funds, sovereign wealth funds, fund managers and entities which are looking for long term investments to fund long term liabilities. The more capital which is attracted, the more funds are available for Australian Governments to redeploy into productive infrastructure investment elsewhere and the lower the long run cost of capital for these businesses. Lower ongoing cost of capital feeds back into lower prices for electricity consumers via the regulatory regime used to determine tariffs for distribution and transmission businesses.

Whilst Spark Infrastructure is an Australian domiciled and invested organisation, it believes that the partnership of domestic and foreign capital in large critical infrastructure is unambiguously positive for Australian business and consumers. The sheer quantum of capital required in many infrastructure investments, especially electricity transmission and distribution assets, mean they are typically too large to be efficiently funded solely by a local investor. In many cases such consortiums will involve significant and sophisticated foreign investors such as foreign pension funds who are typically long term holders of such assets. Certainty of tax outcomes is a key qualitative factor in determining where to invest. Such global investors assess their investment in Australian infrastructure against a range of opportunities in other jurisdictions around the globe.

The use of stapled structures allows foreign investors to hold their passive investments via Managed Investment Trusts (**MITs**). One of the benefits of the MIT regime has been to assist in providing a level playing field for Australian superannuation funds and foreign pension funds when bidding for Australian assets.

This is achieved because, under the MIT rules a 15% withholding tax rate applies to fund payments made to foreign investors (effectively the same income tax rate applicable to complying Australian superannuation funds).

Where stapled structures are removed, the foreign pension funds could be subject to significantly higher income tax rates than the 15% MIT withholding tax.

This difference in treatment would put the foreign pension funds at a competitive disadvantage when bidding for Australian assets compared to Australian superannuation funds. The distortion of tax rates in this manner would increase the cost of capital for Australian infrastructure. It could also impact Australian holders of existing infrastructure assets as it could reduce the pool of investors they can sell to or reduce the price achieved on any secondary sale, given the increased cost of capital.

This would be contrary to the purposes of the MIT regime, which ordinarily neutralises Australian income tax differences between foreign pension funds and superannuation funds. This "level playing field" should be maintained as it makes Australia competitive in the global market for infrastructure capital.

Carve out for Critical Infrastructure

In the Consultation Paper, Treasury acknowledges that if it determines that tax law changes are required to effectively remove the tax advantages of stapled arrangements, some arrangements in respect of critical infrastructure may be especially adversely affected and that this may also deter future investment in critical infrastructure assets. In this context, the Consultation Paper provides that consideration could be given to other more targeted measures to support investment in critical infrastructure.

Spark Infrastructure's view is that any definition of 'critical' infrastructure for the purposes of this review should certainly include electricity transmission and distribution assets. By any objective measure, the cost effective investment of capital into these assets is of critical importance to Australia's economic performance.

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Impacts on debt financing of Electricity Transmission and Distribution Assets

As noted above, the Consultation Paper acknowledges that some arrangements may be adversely impacted if there is a change of tax law. A key example would be the impact on borrowing arrangements associated with a stapled structure if tax was suddenly paid "inside" the stapled structure rather than at the investor level. Borrowings have been sized on the basis that no tax is paid by the project vehicles themselves but rather tax is paid at the investor level. In the case of TransGrid, its funding entity successfully placed A$1bn of bonds into the US Private Placement market during 2016 with maturities ranging between 10 and 17 years. This money was borrowed at appropriate risk-adjusted market rates on the basis of a high degree of certainty regarding key tax assumptions amongst other things. Changing the tax rules regarding stapled structures that impact only very recently privatised businesses such as TransGrid could in certain circumstances result in significant cost and financing disruption, which in due course will manifest to electricity consumers by way of higher tariffs reflecting the higher cost of debt capital observed by the regulator.

To the extent that changes are put forward to the stapled structures regime, we would request that any transitional period be for as long as possible to minimise any adverse financing impact.

Further information

Should you have any questions in relation to the above or would like to discuss further, please do not hesitate to contact us.

Yours sincerely,

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