

17 April 2014

Ms Sharon Murray
Australian Taxation Office
GPO Box 9977
MELBOURNE VIC 3001

By email: sharon.murray@ato.gov.au

Dear Ms Murray,

Re: Comments on draft tax determination TD 2014/D8

Infrastructure Partnerships Australia (IPA) welcomes the opportunity to provide comments on draft tax determination TD 2014/D8 (TD 2014/D8 or the Determination), released by the Australian Taxation Office (ATO) on 12 March 2014.

About IPA

Infrastructure Partnerships Australia is the nation's peak infrastructure body – formed in 2005 as a genuine and enduring policy partnership between Australia's governments and industry.

IPA's formation recognises that through innovation and reform, Australia can extract more from the infrastructure it's got, and invest more in the infrastructure we need.

Through our research and deep engagement with policymakers and industry, IPA seeks to capture best practice and advance complex reform options to drive up national economic prosperity and competitiveness.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how Australia does 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 draws together the public and private sectors in a genuine partnership to debate the policy reforms and priority projects that will build Australia for the challenges ahead.

Introduction

The Determination makes a ruling that the exemption in section 820-39 of the *Income Tax Assessment Act 1997* can apply to the special purpose finance entity established as part of the 'securitised licence structure' used in some social infrastructure Public Private Partnerships (PPPs).

IPA welcomes this ruling, and the release of the Determination, which will bring much needed certainty to this area of the law.

However, IPA recommends that TD 2014/D8 be amended to better reflect the commercial realities of a “securitised licence structure” that are typical of infrastructure PPPs. These recommendations – prepared by members of our Taxation Taskforce – are detailed in our submission included at Appendix A. The majority of the recommended changes are auxiliary in nature and do not adversely impact on the result of the Determination.

Further, we submit that the Determination be amended to address uncertainty surrounding the conditions set out in subsection 820-39(3), in particular whether an “off the shelf” entity can be treated as having been “established for the purpose of managing some or all of the economic risks”.

Should you wish to discuss the contents of this submission, please do not hesitate to contact our Manager, Policy, Zoe Peters, on (02) 9240 2064. Furthermore, we are happy for the below comments to be included in the edited version of the compendium.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'B. Lyon', written in a cursive style.

BRENDAN LYON
CHIEF EXECUTIVE OFFICER

APPENDIX A – IPA comments on Draft Taxation Determination TD 2014/D8

This document sets out the submissions of IPA in relation to Draft Taxation Determination TD 2014/D8 (Determination), released by the ATO on 12 March 2014.

Statutory references are to the *Income Tax Assessment Act 1997 (ITAA 1997)*, unless otherwise indicated. References to the EM are references to the Explanatory Memorandum to the *Tax Laws Amendment Bill (No.5) 2003* (Cth), unless otherwise indicated.

EXECUTIVE SUMMARY

1. We submit a number of auxiliary changes be made to the Determination to explain and describe “the securitised licence structure employed in social infrastructure PPPs” to better reflect current structure models used by social infrastructure PPPs. The proposed changes are described in detail below under the “detailed submission” section.
2. We request that the Commissioner provide further clarity regarding the characteristics of insolvency-remoteness in accordance with our comments below.
3. It is not clear whether the “off the shelf” entities, which are commonly used as SPEs for their cost-effectiveness and ease of setting up, can satisfy the condition in paragraph 820-39(3)(a) which requires the “entity is one established for the purposes of managing some or all of the economic risks”.
4. We seek clarity around the timing of satisfying the condition in paragraph 820-39(3)(b).

DETAILED SUBMISSION

1. Some auxiliary changes should be made to the description of the securitised licence/ (lease) structure (Structure) in the Determination.

The Determination considers the application of the thin capitalisation exemption rules found in section 820-39 to securitised licence structures. Appendix 1 of the Determination explains the key features of a securitised licence structure generally used in social infrastructure Public Private Partnerships (PPPs).

Despite its attempt to explain the structure in a concise manner, the Determination fails to reflect some of the critical features of the securitised licence/lease structure that are commonly apparent in a typical Structure. IPA’s infrastructure industry members have observed variations to the illustrated Structure and, as it is the policy intent to apply section 820-39 to a broader range of structures, we request that the Determination be amended to better reflect the commercial and practical realities of the Structures used in social infrastructure PPPs. IPA’s proposed amendments are as follows:

- The “securitised licence structure” is sometimes referred to as the “securitised lease structure”, as noted in footnote 2 of the Determination. For consistency, and to confirm that the Determination also applies to securitised lease structures, the Determination should be amended so that all references to “securitised licence structure” are replaced with “securitised licence/lease structure”, and all references to “licence” are replaced with “licence/lease”.

We note that the EM at paragraph 1.14 states that “the three conditions in subsection 820-39(3) seek to cover a broad and ever expanding range of securitisation activity and structures,” and it is our view that the above amendment would reflect the intention of the legislature to cover a wide range of securitisation activities and structures.

- Paragraph 6 in Appendix 1 of the Determination states that project sponsors establish a separate SPE (Fin Co). However, this may not be an appropriate statement as Fin Co may or may not be owned by the project sponsors. In some circumstances, a charitable trust, established by a third party, may be employed instead to hold the entire issued share capital of the SPE.

IA therefore recommends that the description of the securitised licence structure in paragraph 6 of the Determination be amended to encompass a wider range of structures in line with the policy intent. This can be achieved by removing the reference to the project sponsors establishing the separate SPE (Fin Co); that is, by amending the second bullet point in paragraph 6 to read “*a separate SPE (**Fin Co**) is established to obtain the senior debt for the project. Fin Co may or may not be owned by the project sponsors.*”

- Paragraph 6 in Appendix 1 of the Determination states “the Government grants a licence to the Project Vehicle to allow the Project Vehicle to access the relevant Crown land to construct and then operate the asset during the concession period. The Project Vehicle is required to pay licence fees to the Government in respect of the operating phase of the licence.” IPA recommends the last word of this point be amended to “concession period” instead of “licence”.
- IPA’s infrastructure industry members have observed some cases where the Receivables Purchase Prices are paid in a lump sum at the conclusion of the construction phase instead of being paid in instalments over the construction phase. The ATO confirmed the existence of such arrangements in its previous draft taxation determination TD 2012/D11. We ask the ATO to amend paragraph 6 in Appendix 1 (the fifth bullet point) of the Determination accordingly.
- Paragraph 6 in Appendix 1 of the Determination states that “Fin co uses the licence fees assigned to it by the Government to repay the senior debt”. For clarification purposes, we request the Commissioner to amend the relevant paragraph to read “*Fin Co uses the cash generated from the licence fees assigned to it by the Government to repay the senior debt.*”
- Once the PPP moves into the operational phase (post-construction), the Government commences to pay *periodic* service payments. These are not necessarily made on a quarterly basis, and there are many examples where periodic service payments are made on a monthly basis. Further, the Determination does not specify when the periodic service payment liabilities arise. Therefore, we propose the following words to be adopted to describe this in paragraph 6 in Appendix 1 of the Determination:

“once the PPP moves into the operation phase (post-construction), the Government commences to pay Periodic Services Payments, e.g. Quarterly Service Payments (QSPs) to the Project Vehicle. The QSPs are payable where Project Vehicle meets its service standard obligations, and may be “abated” wholly or partially where the service standards are not satisfied.”

In addition, the statement made in the last bullet point of paragraph 6 in Appendix 1 of the Determination is somewhat ambiguous. IPA therefore seeks amendment of the said bullet point to read as follows:

“The QSPs are the sole Government source of revenue cash flows for the Project Vehicle in the project and if paid in full should satisfy all of the costs of delivering the PPP including the payment of the licence fees (footnote 6)” and to include the following footnote 6 “The private sector may be required to procure and construct complementary assets that drive commercial third party revenues (e.g. carparks) as part of the procurement process. The Government generally does not provide revenues to the Project Vehicle for these assets.”

- Paragraph 18 in Appendix 1 of the Determination states “the securitised licence structures are established to perform the role of procuring project finance for the project and managing the risks associated with this role throughout the period of the PPP.” IPA proposes that “period of the PPP” be replaced with “concession period” for consistency (see our comments in relation to paragraph 6 above).

2. Further clarity required regarding the characteristics of insolvency-remoteness

Paragraph 35 of the Determination states “...the Commissioner **may** give weight to a legal opinion addressing whether Fin Co is an insolvency-remote SPE” [emphasis added]. In the previous Draft Tax Determination TD 2012/D11, it was established that a legal opinion was a good factor in the positive examples in the TD 2012/D11. If the Commissioner agrees, we propose that the phrase “may give weight to a legal opinion” be removed from paragraph 35 of the Determination and replaced with “will give weight to a legal opinion”.

In addition, paragraph 36 of the Determination states “provided an entity satisfies what are **explicitly** set out as the ‘characteristics’ of insolvency remoteness in the applicable criteria of an internationally recognised rating agency, then it will satisfy the requirements of paragraph 820-39(3)(c)” [emphasis added]. It is unclear what is intended by the use of the word “explicitly” in this paragraph, and we ask the Commissioner to remove “explicitly” from the paragraph.

Paragraph 820-39(3)(c) introduces two concepts:

- The subjective consideration of the “entity’s circumstances”, and
- The objective assessment of whether an internationally recognised rating agency would consider that the entity is an “insolvency-remote special purpose entity” in those circumstances.

The criteria set out by each credit rating agency are expressed as being a guide, as opposed to a prescriptive checklist. The S&P criteria as mentioned in the Determination also suggest that the relevant SPE can achieve Bankruptcy Remoteness by adopting some form of the above characteristics (i.e. it is not a bright line test).

Therefore, the criteria need not be satisfied “explicitly” per se, but are required to be considered in such a way that upholds the entity’s insolvency-remoteness.

3. The Determination should provide clarity regarding whether “off the shelf” entities can satisfy the condition in paragraph 820-39(3)(a).

The condition in paragraph 820-39(3)(a) requires that the entity which may be eligible for the exemption is “one established for the purposes of managing some or all of the economic risk associated with assets, liabilities or investments”. Paragraph 15 in Appendix 1 of the Determination states that paragraph 820-39(3)(a) is intended to be an exclusionary definition which seeks to exclude entities that are *established* with an identifiable purpose other than that relating to “managing some or all of the economic risk associated with the assets, liabilities or investments”.

The Determination is silent on whether this test – the “established for a purpose” test – can encompass “off the shelf” entities that generally are incorporated (in the case of a company, or otherwise “established”) at an earlier point in time, and later acquired and utilised as an SPE in an infrastructure PPP as depicted in the Determination. IPA therefore seeks clarification as to whether an “off the shelf” entity can be treated as having been “established” for the requisite purpose, or otherwise fails this condition on the basis that it was initially established for some other purpose.

It is often the case that in a securitised licence/lease structure as so described in the Determination, “off the shelf” entities are used for convenience reasons (ease of use and low set up costs). These “off the shelf” entities carry on the same activities that would otherwise have been carried on if the entity has been established by the relevant parties. The only difference would be in the circumstances existing at the time of its incorporation (in the case of a company, or its establishment).

As noted in the Determination, the High Court in *Brookton Co-operative Society v FCT* held that in ascertaining the purpose for which a company “is established” it is necessary to look not only to the circumstances existing at the time of its incorporation, but also the activities carried on by the company at the time its status is to be determined. The Determination notes at paragraph 13 that it is possible that an entity will satisfy paragraph 820-39(3)(a) for the requisite purpose at one particular time (for example, at the time of its establishment) but not another.

We therefore seek the Commissioner to confirm that an “off the shelf” entity can be treated as having been established for the requisite purpose, so long as it meets the purpose test at the time it first commences carrying on a business activity. If the Commissioner is of the view that an “off the shelf” entity cannot satisfy this condition, we ask the Commissioner to provide a detailed explanation.

4. The Determination should clarify the test times for the condition in paragraph 820-39(3)(b).

With respect to paragraph 820-39(3)(b), the Determination states that “if the relevant debt interest are at least 50% of the total value of the SPE’s assets, then it will satisfy paragraph 820-39(3)(b)”. We note that subsection 820-39(1) specifies the conditions under s820-39(3)(b) must be met “throughout the income year”. “Throughout” is defined to mean “from beginning to end of” in the Oxford Dictionary. It is unclear whether this means conditions for subsection 820-39(3), and in particular, paragraph 820-39(3)(b) must be met “at all times” during the income year. We therefore request the Commissioner provides further clarity in respect of the timing of the test in paragraph 820-39(3)(b).

In addition, if paragraph 820-39(3)(b) is to be satisfied “at all times” during the income year, guidance is sought as to how the SPE would practically evidence that this condition has been met without any additional and unreasonable compliance costs (for example, would the Commissioner accept that if this condition is satisfied at the beginning and end of the income year, the SPE has satisfied this condition “throughout” the income year).