INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

10 August 2018

Mr Brendan McKenna
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: stapledstructures@treasury.gov.au

Dear Mr McKenna,

RE: Feedback on the Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax and Other Measures) Bill 2018 Exposure Draft and Explanatory Memorandum

Infrastructure Partnerships Australia (IPA) welcomes the opportunity to provide comments on the second stage of the draft legislation and stapled structures and other measures.

As an initial comment, the exposure draft (ED) legislation and explanatory memorandum (EM) indicate positive progress on the form of the measures. We note and thank Treasury for taking into account the feedback provided by Infrastructure Partnerships Australia's Tax Taskforce in our previous submissions and consultation sessions.

While we broadly support the direction taken, there are a number of issues with the current ED that would benefit from clarification or amendment, which we have outlined below.

1. Transitional provisions relating to MIT cross staple arrangement income

1.1 Inclusion of assets held under long-term leases

Section 10(2) of the ED sets out that a threshold requirement for transitional relief from the MIT cross staple arrangement income reform is if:

- "an entity has entered into a contract before 27 March 2018 in respect of the acquisition or creation of a facility; or
- an entity owns the facility at a time before 27 March 2018" (underlined for emphasis)

Most of the privatisations of large scale infrastructure assets have been through the long-term lease of land-based assets (and the transfer of associated chattels). Accordingly, in these cases the relevant entity will not, as a legal matter, own the facility nor have entered into a contract in respect of acquisition or creation of the asset.

We submit that, in order to avoid any doubt, the proposed legislation should clarify that a long-term lessee of a facility will also satisfy this threshold requirement.

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1.2 Extended 15-year transitional relief for an economic infrastructure facility

We welcome the replacement of the concept of an ‘economic infrastructure asset’ with an ‘economic infrastructure facility’. Specifically, the term ‘facility’ clearly encompasses a collection of one or more assets both, under its ordinary meaning, and as the term is used elsewhere in the *Income Tax Assessment Act 1997* (“ITAA 1997”)[1].

1.2.1 Factors indicating that a collection of assets comprise a facility

Paragraph 1.157 of the EM sets out a number of factors that should be considered when determining whether a collection of assets comprises a ‘facility’ in the context of the definition of an ‘economic infrastructure facility’.

We agree with the comments in paragraph 1.159 of the EM that “none of the factors are determinative. It is possible that in some cases one or more of the factors may not be present or do not assist in the relevant determination”. As a result, the examples in the EM play a critical role in indicating which of the factors are relevant in a particular case.

We submit that the following three factors, if present, should support the position that the relevant assets comprise a single facility, but their absence is neutral on that point:

- *Whether assets give rise to separately identifiable revenue streams*
  We agree that where a collection of assets give rise to a single revenue stream, this suggests that they together serve a common purpose and should be considered to comprise part of the same facility. However, the fact that a collection of assets (e.g. a port) may have separately identifiable revenue streams (such as port services revenue and third-party rental income) should be considered neutral on this point.

- *Whether the financial viability of assets that existed at the transition time is dependent on the expansions or enhancements*
  We agree that where enhancements or expansions to an existing facility are critical to its financial viability this indicates those new assets should be considered part of the existing facility. However, particularly where other factors are positive, the mere fact that an existing facility could continue to be viable without the expansion or enhancement should be considered neutral on this point.

- *The applicable regulatory framework*
  We agree that the same regulatory regime applies to both an expansion/enhancement as well as the existing facility, and this would indicate that those assets should be considered part of the same facility. However, the fact that a facility may not be subject to a regulatory regime should be considered neutral on this point.

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[1] Section 32-30, Item 1.5 of the ITAA 1997, and subsection 26-50(2) of the ITAA 1997.

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We submit that, in addition to illustrating these points through the examples, the above comments should be included in paragraph 1.159 of the EM to highlight and further elaborate the basis for the guidance provided.

1.2.2 EM Example 1.18 – Enhancements to an existing income producing facility

This example considers an enhancement to an electricity network arising in connection with the development of a new suburb by a state government.

The example should include an observation that the fact that both the existing facility and the expansion are subject to the same regulatory regime may indicate that they should be considered together as a single facility, however this factor in itself should not be determinative.

The reference to the sublease rent being calculated based on the "regulated facility base" (which appears to be an incorrect replacement of the word "asset" since it presumably originated from RAB) would be better expressed as being calculated by reference to the "value of the assets being leased cross-staple". There are a large range of formulae in cross staple agreements and this broader reference would provide appropriate comfort to a wider range of facilities. We note it is important to retain the words "(which includes the value of any enhancements)".

The "functionally interconnected" factor is important to the conclusion reached in this example. The principle behind this example could be further highlighted if the facts specified that the expansion to service the new suburb included the development of a depot that was physically separate to the existing network that is to be used in the operation and maintenance of the network expansion. The conclusion could then note that as the depot was "inherently linked to the delivery of the services" provided by the network expansion it would also be considered part of the facility.

This example could also be expanded to acknowledge land purchased in advance for the intended purpose of building a substation to service the new suburb. Such land may be purchased to ensure it remains available. That availability would similarly be "inherently linked to the delivery of the services". Expanding the example in this way would clarify that an asset is not prevented from being part of a "collection of assets that are connected and together perform a particular function" merely because the asset may not be put into use for some time.

In addition to the above, we query the relevance of the fact that the expansion was built to satisfy "obligations" of the relevant entity. Instead, referencing the "legal rights" factors in paragraph 1.157 of the EM, it would be more illustrative and have broader relevance to state that the expansion was built to deliver services under an electricity licence held by the entity that applied to a geographic area covering both the existing facility and the expansion.

Finally, whilst the EM has provided the above examples of what could constitute a facility, we consider that it would be prudent and useful if the ATO could also publish a Taxation Ruling on this as well. As a guide, this could be similar to what the ATO published in TR 94/11 with respect to "unit of property".

2. The interplay between economic infrastructure and agriculture for wind and solar farms

It is accepted that renewable energy facilities, such as wind and solar farms, meet the definition of an "economic infrastructure facility" in proposed section 12-450(4) and should, if they meet the criteria in section 10 of part 3, be eligible for the 15-year transitional period if they are held in a stapled structure. However, such facilities tend to be built on land that has been acquired, or leased, from a farmer and such land could meet the definition of agricultural land in proposed section 12-465.

With respect to wind farms, we understand that the developers/owners do one of two things:

- lease the whole land required for the wind farm and allow the farmer access; or
- lease only the area required for each turbine plus the access road and associated infrastructure.

The position can differ by project.

With respect to solar farms, we understand that the project will either lease or own the whole land but with no access to the farmer. This is because a solar farm is much more contained and avoids interference by livestock.

If the transitional provisions for agricultural land take priority, the transitional period will be seven years, as opposed to 15 years, which could have major impact on project economics.

In such circumstances, we understand that it is not the intention for the agricultural income transitional provisions to take priority over the economic infrastructure facility transitional provisions. Therefore, we suggest that the next proposed legislation clarify this by providing a provision which states that economic infrastructure facilities built on agricultural land are not subject to the agricultural land provisions.

3. Proposed section 25-115 and corresponding transitional provisions

We submit our residual concern regarding the deduction for payment of rent and turning off of Part IVA, as suggested in proposed section 25-115 of the ED. We are concerned that the ATO could still seek to apply Part IVA measures with respect to cross staple rent, because the current phrasing of this section does not explicitly provide the required certainty.

While the current phrasing states "the operating entity could otherwise deduct the amount under section 8-1 of the *Income Tax Assessment Act 1997"*, we are in fact aware of the ATO currently seeking to deny deductions under section 8-1 for cross staple rent.

Therefore, we suggest that the proposed legislation makes it explicit that Part IVA will not apply during the period the choice is in effect. This could be done, for instance, by way of a note to proposed section 25-115(2).

4. Proposed section 12-440 and "MIT cross staple arrangement income"

We note that it is possible that some taxpayers may seek to restructure their arrangements with customers. For example, taxpayer may separate rent from service charges, instead of having one composite charge,

such that part of their income meets the requirements of proposed section 12-440(3).

We recommend including a comment in the EM, which states that such restructures, with ongoing 15 per cent treatment for rent and no application of Part IVA, would be acceptable from a tax perspective as they would meet the principle of the provisions.

We note that a similar comment was included in the EM that accompanied the introduction of the hybrid mismatch rules, earlier this year. The EM in that instance recognised that "...many taxpayers will restructure out of hybrid arrangements and enter into alternative arrangements that do not attract the operation of the hybrid mismatch rules". Additionally, the EM stated that a restructure that, for example, "...could result in retaining a deduction [in Australia] with a greater amount being included in a foreign income tax base...would satisfy the objective of the hybrid mismatch rules".

5. Paragraph 1.70 of EM – When the facility is first put to use

Referring to the approved economic infrastructure facility, paragraph 1.69 of the EM refers the 15 years commencing "on the day on which as asset that is part of that facility is first put to use". The following provisions outlined in paragraph 1.70 of the EM then refers to the relevant 15-year period commencing when "the facility or an asset that is part of that facility will be first put to use when it becomes operational (even if it does not produce assessable income)".

We note that this could occur:

- before an asset has received engineering or vendor sign off – for example, a wind turbine can generate electricity before the constructor has handed it over to the facility owner; or
- an asset can be ready well before the project is open to the public – for example, the overhead toll machinery or toll booths on a toll road.

Accordingly, we would suggest that the provision be amended such that the time period commences when the entire facility is completed and ready for use.

6. Proposed section 880-105 – The need for a sovereign wealth fund to get a payment from a MIT for it to be NANE income

We note that it is unclear why, in proposed section 880-105(1)(e), the income needs to be derived from a trust that is a MIT. If a sovereign entity is only meant to derive income from a trust that carries on passive activities, we would recommend that the trust referred to in this sub-section be one that carries on an Eligible Investment Business within the meaning of Division 6C ITAA 1936.

7. Sovereign wealth fund (SWF) influence test

As currently drafted, the ED provides that "sovereign entities" will be aggregated with other sovereign entities even if one sovereign does not satisfy the requirements to be a "covered sovereign entity" for the purposes of determining whether the sovereign entity qualifies for sovereign immunity tax exemption.

We note that this can cause anomalous outcomes, where an entity does not benefit under the sovereign immunity rules (because it is not a "covered sovereign entity") but is nonetheless counted for the purposes of

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determining the total level of interest and influence of a sovereign entity group, under the portfolio and influence tests.

Accordingly, we submit that the proposed legislation be revised to:

- amend section 880-20 to carve out sovereign entities that operate an active trading business from the definition of "sovereign entity group); or
- alternatively, section 880-2- should include a statutory discretion for the Commissioner of Taxation to determine that a sovereign entity does not form part of a "sovereign entity group" with respect to specific matters (for example, where the sovereign entity operates an active trading business).

Moreover, in example 4.6 of the EM, the influence test is discussed such that an investor with an equity interest of five per cent or more, which is entitled to appoint a member to the Advisory Board of the investment vehicle, would be considered to have influence. This would have the consequence that any income from that vehicle would not be NANE.

We seek clarification on whether this would still be the case where:

- the investor, by way of side letter, agrees to give up their entitlement to a seat on the Advisory Board;
- as above, but the investor can be an Observer at Advisory Board meetings; and
- Advisory Boards are often limited to a set number of individuals. What if, as per example 4.6, not all investors could be on the Advisory Board?

The above comments apply to the influence test for foreign pension funds as well.

8. Student accommodation – exclusion from MIT residential housing income

We seek clarification on the circumstances in which facilities, such as student housing or student accommodation, which exist in stapled arrangements, would be included within the definition of "commercial residential premises".

Paragraph 1.128 of the EM states that "the definition of commercial residential premises expressly excludes premises to the extent that they are used to provide accommodation to students in connection with an education institution that is not a school". The provision then refers to the Goods and Services Tax Taxation Ruling GSTR 2012/6.

While GSTR 2012/6 provides certain commentary and examples (such as examples 6 and 7) of the circumstances in which student accommodation would properly be regarded as commercial residential premises, we request specific guidance and clarification be provided for certainty of tax treatment.

In this regard, we submit that student accommodation provided offsite from an education institution should generally be regarded as student accommodation not "in connection with an educational institution" and therefore the income from this should not be regarded as MIT residential housing income.

We also note that draft section 12-470(2) of *Tax Administration Act 1953* does not currently provide a comprehensive definition of "commercial residential premises", the income from which is excluded from the concept of "MIT residential housing income".

Paragraphs 1.126 to 1.129 of the EM specifies that commercial residential premises will be defined and have the same meaning as in section 195-1 of the GST Act. This definition includes, amongst other things:

- a hotel, motel, inn, hostel or boarding house;
- premises used to provide accommodation in connection with a school; and
- anything similar to residential premises described in the preceding dot points.

Finally, we submit that offsite student housing that provides some form of common facilities (for example, common recreational areas or laundry facilities) should properly be regarded as commercial residential premises and thus excluded from the concept of MIT residential housing income. We note that some of these issues are explored in more detail in the Urbanest case, which may be a useful point of reference for these purposes.

9. MIT agricultural income – proposed section 12-435 and 465 of the Taxation Administration Act 1953

We appreciate the Government's support of agriculture MITs by removing the previously proposed exclusion for agricultural land satisfying the "eligible investment business" definition, thereby now allowing to continue "flow-through" status for certain agricultural MITs.

However, the ED suggests that, after the transition period, the concessional withholding tax rate for all foreign investors in receipt of MIT agricultural income would effectively be removed. We believe this approach is too broad and captures all foreign MIT investors, including where investors have no control over the acquisition of agricultural land and have little if any influence over the MIT.

We see this approach to be in direct contrast to the well-articulated policy objectives of various recent legislative reforms including, the Investment Manager Regime (IMR, 2012-2015), Managed Investments Trusts (MITs, 2008-2018), Corporate Collective Investment Vehicles (CCIVs, 2017-2018) and the Asia Region Funds Passport (ARFP, 2017-2018).

These important tax reforms were introduced and specifically designed to attract foreign investment to Australia and to promote the use of Australian funds managers by removing or limiting tax impediments to investing in Australia.

We recommend some form of carve-out for listed (widely-held) independent Australian Funds Managers in the agricultural sector (which includes agricultural infrastructure for example transport, storage, packing and related facilities) to avoid presenting a significant disadvantage in attracting capital from both foreign and domestic investors.

10. Additional comments

We note that this may be the final opportunity for stakeholders to consider and comment on this aspect of the draft legislation. We also note that a separate draft legislation, related to the integrity measures for accessing the infrastructure concession and the transitional arrangements, was released recently with a very short period for consultation and feedback.

We would like to emphasise, given the complexity of the issues, it is crucial that the measures proposed across the package are considered by stakeholders in a holistic manner, before a bill is introduced in Parliament as planned.

In this context, we request that there is an opportunity for Infrastructure Partnerships Australia to consult with Treasury on the final complete package, including the ED on the integrity measures. This will allow stakeholders to carefully and deliberately consider the amendments before passage through Parliament.

As a final comment, we submit that the change in the title of the Bill ("*Making Sure Foreign Investors Pay Their Fair Share of Tax and Other Measures*") is unhelpful and inflammatory in the broader context of attracting foreign investment to meet the infrastructure requirements in Australia. While we acknowledge and understand the policy objectives behind the legislation, we note that the deviation from the title in the initial ED ("*Stapled Structures and Other Measures*") is unnecessary.

Conclusion

We trust the above comments and recommendations provide useful feedback to Treasury's current drafting of the proposed legislation.

If you have any questions in relation to the above, please contact Varsha Maharaj on +61 2 9152 6015 or at varsha.maharaj@infrastructure.org.au.

Sincerely,

ADRIAN DWYER
Chief Executive Officer