Deal Advisory Tax Insights

The Australian Tax Framework: What are the ATO's concerns on privatisation and PPP projects?

Minh Dao
Partner,
Deal Advisory – Tax

The Australian Taxation Office (ATO) has developed an Australian tax framework (Framework) which is meant to set out the ATO's overall position on standard-form infrastructure and privatisation transactions. It outlines what the ATO sees as the most common infrastructure and privatisation transactions, and considers how it sees the Australian tax system applying to them. However, as has been the experience on recent privatisations, there is nothing 'standard-form' when it comes to tax structuring for large scale infrastructure privatisations.

On 30 October 2015, the ATO released the first half of the Framework setting out it's views on the income tax law and the Goods and Services Tax (GST) applicable to 'social' Public Private Partnerships (PPPs) projects and the tax implications for the equity investors into social PPPs. The second half of the Framework is intended to cover privatisations and other related matters. Although the ATO has consulted with stakeholders, including KPMG on the contents of the second half of the Framework since March 2016, this part of the Framework has not been finalised by the ATO.

How does the Framework work?

The ATO has indicated that the Framework is intended to be a living document. As new transaction structures or tax compliance issues emerge, the Framework will be updated to reflect them.

The Framework intends to address the following transactions:

1. The tax implications of the construction of social infrastructure using the 'securitised licence' PPP model;
2. How the investors into PPPs will themselves be taxed, including what happens when an investor exits;
3. The tax implications of the privatisation of Government related entity (government) assets using a long-term lease; and
4. How the investors into infrastructure and privatisation will themselves be taxed, including what happens when an investor exits.

The Framework is not meant to explain the tax treatment of every type of transaction contemplated. Rather, the ATO intends for it to be a guide on how the tax law will apply to standard-form transactions. We note that the Framework does not bind the ATO to a particular view of the law, as only taxation rulings, taxation determinations or private rulings can do that. So, the difficulty we see in developing such a framework is that most large scale infrastructure transactions are unique, and although they may have certain characteristics in common, no two PPP or privatisation transactions are exactly the same.

PPP Framework

The first two chapters of the Framework set out how the income tax law and the Goods and Services Tax (GST) apply to a 'social' PPP and the tax implications for the investors into social PPPs.

Broadly, a social PPP involves a consortium and a government agreeing that:

- the consortium will construct and maintain some public infrastructure;
- the consortium will obtain the financing for that infrastructure; and
- the government will obtain title to, and repay the consortium for the infrastructure, plus interest, over a certain period.

The ATO has acknowledged in the Framework that it is generally comfortable with the standard-form PPP structure. However, the Framework does not provide details as to what constitute a 'standard-form PPP'. For example, the Framework does not consider if the ATO would treat the transaction differently depending on the effective life of the asset, the term of the project, or how the equity is to be funded through the project vehicles.

Privatisation and infrastructure

In March 2016, the ATO released a draft document, Privatisation and Infrastructure – Australian Federal Tax Framework (Chapter 4), for comment and consultation on the issues it raises relating to the taxation of income from privatisation and infrastructure activity. The ATO will incorporate this as a new Chapter 4 of the existing Framework document. Specifically, the Framework is intended to address the following:

1. Disguising a capital payment as a deductible outgoing;
2. Exploiting the tax benefits associated of staples structures inappropriately;
3. Negative control for the purposes of Division 6C and the Managed Investment Trust (MIT) rules;
4. Definition of associate entity under section 820-905; and
5. Factoring of control interests.

What is the ATO's concerns in relation to PPPs?

In the draft Chapter 4 of the Framework, the ATO has expressed concerns with the variation of the standard form securitised lease/license structure for PPP projects which involves the 'receivables purchase payment' not being used by the Government to finance the construction payment, and thus seeks to attack the deductibility of the license payments.

The Example provided in the Framework involves the 'receivables purchase payment' being retained by the Government instead of being applied to the construction costs. Where this occurs, the ATO is of the view that the 'receivables purchase payment' may, in reality, have been paid as part of the consortium's bid price to the Government for the grant of the right to operate and maintain the asset in question.

The ATO argues that the overall effect is to claim for the project trust a deduction for what is in reality part of the purchase price paid to the Government for the right to operate the asset, and therefore should be treated on capital account. In our view, the commentary in the draft ATO guidance does not provide sufficient information to identify when the issue of concern could arise. KPMG has requested the ATO provide more detailed commentary on its concern, including a more detailed example to demonstrate the circumstances in which they consider this issue applies and what the corresponding taxation adjustments would be.

What is the ATO's concerns in relation to privatisations and infrastructure?

The issues identified by the ATO in the draft Privatisation and Infrastructure paper have been articulated very broadly and so in many cases provide limited insight into the specific types of situations of concern to the ATO. Stakeholders have requested that any updated guidance provides a clearer context in which the issues of ATO concern have arisen.

Whilst the draft paper focuses on Privatisation and Infrastructure, the underlying issues identified by the ATO have the potential to be of relevance beyond these sectors. Providing greater context in relation to how these issues arise in for infrastructure and privatisations will assist investors in considering the relevance of these issues to transactions outside this sector. However, the potential flow on consequences of the ATO's views on other sectors could create uncertainty amongst investors. KPMG has requested that the ATO give consideration to the potential implications of the issues outlined in this guidance beyond the transactions involving infrastructure and privatisations.

The specific issues identified by the ATO include:

- investors attempting to disguise an outgoing made to obtain a benefit that is capital in nature under a PPP as a revenue outgoing;
- investors endeavouring to exploit the tax benefits of stapled structures inappropriately – this comprises investors using staples to shift profits across the staple so as to reduce the tax rate applicable to those profits and 'inappropriately' restructuring an existing arrangement so as to take advantage of a stapled structure;
- investors having negative control of infrastructure trusts for the purposes of Division 6C and the MIT rules;
- arguments that some investors are not associate entities for thin capitalisation purposes; and
- attempts to fracture control interests so as to enable an MIT to invest into a trading business and access the lower MIT withholding tax rates.

The rent charged under the sublease between Asset Trust and Operating Entity

The ATO is particularly concerned where the rent charged under the sublease is calculated to 'substantially capture the profits of the Operating Entity'. KPMG consider that is not a new issue from an infrastructure and real property perspective. The existing rules within the public trading trust provisions of Division 6C and the recent arm's length test applying to all MITs mean the rent charged in these situations is typically structured so as to reflect an arm's length amount. However, the increased ATO focus on the setting of the rent may lead the ATO to review the documentation supporting the setting of the rent.

Interest on a loan from Asset Trust to Operating Entity

The ATO consider that the interest charged should only reflect a small margin on funds borrowed from third parties. The proposed arm's length test for MITs will address this issue if the interest rate exceeds an arm's length rate. Although the Australian Managed Investment Trust (AMIT) provisions also contain some safe harbour interest rates, the ATO has indicated that even if the interest rate is within the safe harbour rates for the purposes of the AMIT arm's length rule, the ATO may still apply the general anti-avoidance provisions in Part IVA if the margin charged is within the 300 basis points safe harbour. It is prudent to review the factors influencing the setting of interest on such loans.

Unequal gearing between Asset Trust and Operating Entity

This concern specifically arises in a privatisation context and is understandable in that context. However, the relative requirements to fund the activities of the Asset Trust and the Operating Entity will vary on an on-going basis. As it is not realistic to maintain the relative levels of gearing, KPMG considers that the ATO draft guidance should differentiate between these two situations.

The allocation of the purchase price between Asset Trust and Operating Entity on a privatisation

The concern is that the purchase price allocation could be weighted to the Asset Trust and be disproportionate to the value of the assets in asset trust. This is an issue that will need to be considered in the context of specific fact patterns. However, KPMG is concerned that the ATO's approach on allocation of purchase price may be inconsistent with generally accepted valuation principles.

Conclusions

As noted above, the Framework does not bind the ATO to a particular view of the law, as only taxation rulings, taxation determinations or private rulings can do that. The framework may be seen as one of the mechanisms the ATO will use to give prospective investors a clear understanding of the key risk factors the ATO will consider when evaluating potential transactions.

The difficulty we see in developing such a Framework is that most large scale infrastructure transactions are unique, and although they may have certain characteristics in common, no two PPP or privatisation transactions are exactly the same. For example, where a staple structure is held by foreign investors that are subject to 30 percent tax on trust distributions on both sides of the staple, it is difficult to understand the ATO's concerns in respect of profit shifting across the staple. This really means that there will be no substitute for actively engaging with the ATO on the tax issues associated with potential projects, especially if Foreign Investment Review Board approval is required.

Contact us

Angus Wilson
National Lead Partner, Deal Advisory – Tax
+61 2 9335 8288
arwilson@kpmg.com.au

David Morris
National Lead Partner, KPMG Law
+61 2 9455 9999
davidpmorris@kpmg.com.au

Scott Farrell
Partner, Deal Advisory Tax
+61 2 9335 7366
spfarrell@kpmg.com.au

Michelle Bennett
Partner, Indirect Tax & GST
+61 3 9288 5910
mabennett@kpmg.com.au

Matt Birrell
Partner, Deal Advisory – Tax
+61 3 9288 5367
mbirrell@kpmg.com.au

Stephen Carpenter
Partner, Deal Advisory – Tax
+61 3 9288 5618
scarpenter@kpmg.com.au

Gary Chiert
Partner, Indirect Tax & GST
+61 2 9335 7350
gchiert@kpmg.com.au

Minh Dao
Partner, Deal Advisory – Tax
+61 2 9455 9655
mdao@kpmg.com.au

Steven Economides
Partner, Deal Advisory – Tax
+61 2 9335 8876
seconomides@kpmg.com.au

Brendon Lamers
Partner, Deal Advisory – Tax
+61 7 3434 9148
blamers1@kpmg.com.au

Tony Mulveney
Partner, Deal Advisory – Tax
+61 2 9335 7121
tmulveney@kpmg.com.au

Stephen Murphy
Partner, Deal Advisory – Tax
+61 2 9335 8873
sjmurphy@kpmg.com.au

Len Nicita
Partner, Deal Advisory – Tax
+61 2 9335 7888
lennicita@kpmg.com.au

kpmg.com.au