The perfect match?

Are superannuation and infrastructure investment a perfect couple? CHRIS MCLEAN explores the relationship between the two and the Australian taxation system, and suggests a new, coordinated policy approach.

SETTING THE SCENE

The Australian taxation system and its administration could be compared to Robert de Niro's character in *Meet the Parents*, trying to break up the supposed 'perfect couple': superannuation and infrastructure investment.

At least this is the case as far as the fastest growing and largest single sector of Australia's superannuation savings – self-managed superannuation funds (SMSFs) – is concerned.

The Australian-listed equity market is an important facilitator for investment by the SMSF sector. There has been a dramatic decline in infrastructure ownership by the Australian-listed equity market during the period of 30 June 2007 to January 2014.

Limiting the ability for SMSFs to efficiently and cost-effectively invest in infrastructure as an asset class:

- adds to the States' and the Commonwealth's fiscal pressure to finance infrastructure investment
- places greater risk on retirement savings (SMSF concentration risk in real property investment has been cited by ASIC, Treasury and the Reserve Bank of Australia as an area of concern).

	June 07 Market capital ($ trillions)	January 14 Market capital ($ trillions)	% change	June 07 No. of listed vehicles	January 14 No. of listed vehicles*	% change
Australian-listed infrastructure	0.65	0.46	**(30)%**	20	12	**(40)%**
All ASX-listed securities	1,597,794	1,506,483	**(6)%**	2,089.0	2,173.0	**4%**

**Excludes three entities that are listed but that have been suspended from trading over three months.*

BACKGROUND

The competitive market for infrastructure investments

An SMSF has limited (or no) ability to invest directly in infrastructure as an asset class. The capital requirements are too large for a single SMSF, and due diligence is too complex. The listed-infrastructure market represents one of the few opportunities for SMSFs to invest in infrastructure as an asset class.

In recent years, infrastructure asset ownership has been dominated by large foreign superannuation/pension funds and Australian industry superannuation funds.

Why is the listed-infrastructure market in decline?

To be competitive, an Australian-listed vehicle needs to attract capital from a variety of sources. However, in the infrastructure sector, foreign superannuation is a critical source of capital.

Foreign superannuation – income preferences

All things being equal, a foreign superannuation fund has the following income preferences:

- interest income, because it is typically exempt from Australian interest-withholding tax
- tax-deferred cashflow, because tax is generally deferred until the sale of the asset and may be exempt from Australian capital gains tax altogether.

These income preferences can theoretically be satisfied by listed and unlisted-vehicles. However, the Australian tax system and its administration have made this difficult, if not impossible, in practice for listed vehicles.

As a consequence, Australian-listed infrastructure vehicles find it difficult to attract foreign capital and are less competitive in the bidding process for new assets.

HOW INVESTMENT VEHICLES ADDRESS THE INCOME PREFERENCES

Listed-infrastructure vehicles are typically organised as a share in a company 'stapled' to a unit in a flow-through (or fiscally transparent) trust (stapled securities). This has commercial advantages and enables one security to be traded on market. It also maximises returns to investors in the form of interest income and tax deferred cashflows.

In contrast, unlisted vehicles can directly issue a debt instrument and unit in a flow-through trust to investors. This delivers the preferred forms of income to them. There is no need for stapled instruments as trading in the investment is not a priority.

AUSTRALIAN TAXATION LAW AND APPLICATION TO LISTED-VEHICLES

Section 974-80

The ATO is currently applying a strict interpretation of section 974-80 of the *Income Tax Assessment Act 1997* (Cth). This has the effect of disallowing deductions for loans from a stapled trust to a stapled company. When compared to an unlisted vehicle with a similar capital structure, the application of section 974-80 can increase the tax rate payable by a listed-infrastructure vehicle by at least 14 per cent.

The ATO interpretation of section 974-80 has not yet been challenged in court. However, it has created sufficient uncertainty for this to be a deterrent to listed-infrastructure investment. In the last 12 months, SP Ausnet, Sydney Airports and Spark Infrastructure have announced advanced audits or disputes with the ATO in relation to section 974-80 (this is 3 of the remaining 12 listed infrastructure vehicles in Australia).

TAX-DEFERRED DISTRIBUTIONS

From mid-2011, the ATO has considered that tax-deferred distributions should be taxed as ordinary income on a receipts' basis (that is, tax is not deferred) for certain taxpayers, such as superannuation funds. Again, the ATO's view has not been subject to any judicial review or interpretation.

If the ATO applies its interpretation of the nature of tax-deferred distributions and section 974-80 at the same time as, the effective tax rate of the listed-infrastructure investment can increase by between 55 and 140 per cent. The ATO interpretation of tax deferred distributions can apply equally to listed and unlisted-investment vehicles.

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WHAT COULD BE DONE?

There should be a coordinated policy approach between:

- the ATO: its administration of ambiguous income tax laws to infrastructure investments and its impact on the listed infrastructure market needs to be considered
- Treasury: promoting private sector investment in infrastructure is seen as a means of addressing Australia's productivity decline and budgetary problems
- ASIC: diversification, or rather the lack of diversification, has been identified as a risk for the largest proportion of Australia's superannuation savings, namely SMSFs
- departments such as Foreign Affairs and Trade, which are attempting to attract foreign capital and promoting Australia as “an attractive place to invest” for infrastructure.

Australia has the majority of the top ten infrastructure fund managers in the world (with Macquarie Bank being the largest per Towers Watson, *Global Alternatives Survey 2013*). However, none of these fund managers have an Australian-listed infrastructure fund.

Australia's taxation regime could be interpreted in a manner that allows for greater investment by SMSFs in Australian infrastructure and which promotes a competitive advantage in infrastructure fund management. If that were to occur, we would be a step closer to the perfect match between Australian superannuation and infrastructure investment. SF

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