

# ***Draft Taxation Determination TD 2014/D8 –considerations for the infrastructure industry***

*16 April 2014*

*Income tax: can the exemption in section 820-39 of the Income Tax Assessment Act 1997 apply to the special purpose finance entity established as part of the ‘securitised licence structure’ used in some social infrastructure Public Private Partnerships?*

On 12 March 2014, The Commissioner of Taxation released draft [Taxation Determination TD 2014/D8](#) for public comment. Following are details from the PwC Australia submission to this draft Determination, commending the Commissioner for providing clarification on this very important issue for the infrastructure industry. The majority of the recommended changes are auxiliary in nature, and do not materially impact on the result of the Determination.

## ***Highlights from the submission:***

1. We recommend a number of auxiliary changes be made to the Determination to explain and describe “the securitised licence structure employed in social infrastructure PPPs” (Public Private Partnerships) to better reflect the breadth of legal structure used by social infrastructure PPPs. Suggested changes are described in detail below.
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 (Special Purpose Entities) 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:***

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.

### **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 PPPs.

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The Determination could better reflect some of the critical features of the securitised licence/lease structure that are commonly apparent and allow for the breadth of variations to the structure described in the Determination to enable its application to the majority of circumstances contemplated by the Determination.

We therefore submit that the Commissioner amend the Determination to better reflect the commercial and practical realities of the Structures used in social infrastructure PPPs as follows:

- We understand that the “securitised licence structure” is often referred to as the “securitised lease structure”, as noted in footnote 2 of the Determination. For consistency, and to clarify that the Determination also applies to securitised lease structures, we ask the Commissioner to amend the Determination 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.” In our view, this 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 established or owned by the project sponsors. In some circumstances, a charitable trust may be employed instead to hold the entire issued share capital of the SPE. Further, it is not clear that the identity of the party that establishes the SPE (Fin Co) is of any consequence to the application of section 820-39.

We therefore recommend that the description in paragraph 6 of the Determination be amended. This can be achieved by removing the reference to the project sponsors establishing the separate SPE (Fin Co). We suggest that the second bullet point in paragraph 6 be amended 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.” We recommend the last word of this point be amended to “concession period” instead of “licence”, as there may be more than one licence issued over the concession period e.g. one for construction and one for operations.
- We have observed some cases where the Receivables Purchase Price is paid in a lump sum at the conclusion of the construction phase instead of being paid in instalments over the construction phase. We ask the ATO to amend paragraph 6 in Appendix 1 (the fifth bullet point) of the Determination to reflect both so-called “lump-sum” and “progressive” securitisation arrangements.
- 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”. It may be the case that the cashflows generated from the assigned licence fees are applied to both expenses and senior debt. Therefore, 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 operations phase (post-construction), the Government commences to pay *periodic service* payments. These are not necessarily made on a quarterly basis, and we have seen 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:

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*“once the PPP moves into the operation phase (post-construction), the Government commences to pay Periodic Services Payments, typically 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. We ask the Commissioner to amend 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. car parks) as part of the procurement process. The Government 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.” We propose that “period of the PPP” be replaced with “concession period” for consistency (see our comments in relation to paragraph 6 above).

## **2. Insolvency-remoteness criteria**

With respect to the characteristics of the insolvency-remote criteria for project finance transactions as set out in paragraph 32 of the Determination, in making this assessment the weight attributed to each criterion will vary depending on the jurisdiction of the SPE’s incorporation and the law applicable to it. This aspect is not discussed in the Determination but is of critical importance given the rating agencies may not have specific guidance on the application of the criteria to Australian issuers.

Further, 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].

We submit that the use of the word ‘explicitly’ in this paragraph could lead to an undue emphasis on the criteria at the expense of the holistic approach adopted by rating agencies in determining an entity’s insolvency remoteness.

We hereby seek the Commissioner include commentary that the criteria carry different weight depending on the legal character and jurisdiction of the issuer and that the Commissioner remove “explicitly” from paragraph 36.

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]. We refer to the previous Draft Tax Determination TD 2012/D11. Therein, it was established that a legal opinion was a good factor in the positive examples in the TD 2012/D11.

We propose that “may give weight to a legal opinion” in paragraph 35 of the Determination be replaced with “will give weight to a legal opinion.”

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### **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.”

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.

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.

We therefore ask the Commissioner to clarify if 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.

### **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 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).

### ***Let’s Talk***

For a deeper discussion of how this issue might affect your business, please contact:

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