University of New South Wales
University of New South Wales Faculty of Law Research Series
2008

Year 2008 *Paper* 30

Infrastructure Taxation in Australia: Accessing losses and avoidances

Gordon MacKenzie*

*University of New South Wales

Infrastructure Taxation in Australia: Accessing losses and avoidances

Gordon MacKenzie

Abstract

Infrastructure in Australia is under strain from two influences. First, the existing limited infrastructure is unable to keep pace with economic growth and, secondly, the demand for health and welfare infrastructure because of an ageing population. Yet, there are no special rules for the taxation of infrastructure in Australian taxation law, except in very limited circumstances. However, taxation impacts on infrastructure in two important ways. First, accessing the early stage tax losses in infrastructure projects and, secondly, the number of anti tax avoidance rules that it has attracted

This paper proceeds by discussing the general tax rules that apply to typical infrastructure project financing such as leasing, managing pre-completion losses and transferring depreciation deductions to financiers. Next is a discussion of the two Government initiatives that have offered investors early access to tax losses from interest and capital allowance deductions and the methods now used by investors to obtain those losses. It also asks the question whether there is a need for new incentives to be reintroduced. Finally, the paper considers the anti tax avoidance rules that have grown up around some of the unique aspects of infrastructure financing.

INFRASTRUCTURE TAXATION IN AUSTRALIA
Accessing losses and anti avoidance

Gordon D Mackenzie*

INTRODUCTION

Infrastructure in Australia is under strain from two influences. First, the existing limited infrastructure is unable to keep pace with economic growth and, secondly, the demand for health and welfare infrastructure because of an ageing population.[i]

Yet, there are no special rules for the taxation of infrastructure in Australian taxation law, except in very limited circumstances. The taxation of infrastructure assets is governed by the general taxation rules that apply to all similar types of assets.

However, taxation impacts on infrastructure in two important ways. First, accessing the early stage tax losses in infrastructure projects and, secondly, the number of anti tax avoidance rules that it has attracted.

Early stage tax losses in infrastructure projects are generated from the typically large capital allowance and interest expenses deductions and, also, the delay in these projects commencing to produce income. Of course investors could wait until the project commences to produce income to utilise those tax losses. However it is more efficient to use them as soon as possible as that maximises their value. Government has had two attempts at allowing investors early access to the interest expense deductions, both of which have now been abandoned. In any case, investors now use existing tax law to obtain early access to both the capital allowance and interest expense deductions.

The large number of anti avoidance rules is a function of four unique aspects of infrastructure and the way that they interact with the taxation rules.

First, infrastructure is characterised by large initial capital expenditure and the use of leasing in financing structures. That raises tax issues about which party, either the project sponsor or the financiers, should be entitled to the tax deductions for that capital expenditure and, also, whether the lease is in fact a sale or a loan.

Secondly, seventy per cent of public infrastructure is used by State Governments in which case it was possible to create a tax deduction for the capital expenditure that would not otherwise have existed. [ii] State Governments could reduce their cost of funding by income tax deductions given by the Federal Government.

Thirdly, infrastructure projects typically use limited recourse debt, which is a form of financing that continually draws the suspicion of the ATO because of its use in aggressive tax avoidance schemes and also its ability to transfer the economic ownership of the asset to the lenders.

Finally, the long term nature of infrastructure projects created opportunities for the balance of the cash flows of the lease after the loans had been repaid, to be dealt with tax efficiently.

This paper proceeds by discussing the general tax rules that apply to typical infrastructure project financing such as leasing, managing pre-completion losses and transferring depreciation deductions to financiers.

Next is a discussion of the two Government initiatives that have offered investors early access to tax losses from interest and capital allowance deductions and the methods now used by investors to obtain those losses. It also asks the question whether there is a need for new incentives to be reintroduced.

Finally, the paper considers the anti tax avoidance rules that have grown up around some of the unique aspects of infrastructure financing. These include rules that limit the tax benefits when the user is Government, restrictions placed on limited recourse debt and preventing tax efficient assignment of a lease.

TAXATION OF INFRASTRUCTURE

Leasing taxation

As most infrastructure projects include a lease of the major asset in the project the general taxation rules for leases will apply.

Broadly, the lessee will be entitled to a tax deduction for the lease rental payments and the lessor will, correspondingly, be assessed on those lease rental payments.[iii] (The party entitled to the capital allowance deductions is discussed below.)

In the normal course of events a lease is a right to use an asset for a certain period after which it is returned to the lessor. It is possible, however, to structure the terms of the lease such that it is difficult to distinguish the arrangement from a sale of the asset and loan to the lessee.[iv] This can be achieved where, say, the rental payments over the period of the lease correspond to the cost of the asset or the period of the lease is equal to the period of the assets useful life. Also, the lessee can take on responsibility for the asset, such as repairs and maintenance. In addition, the lessee will usually acquire the asset at the end of the lease for its residual value that may be below its then market value.
In these cases the lease will be accounted for as a finance lease but for tax purposes will be treated no differently to any other type of lease.[v]

Structuring a lease in that way is attractive from a taxation point of view as the rental payments are fully deductible and the lessor is entitled to tax deductions for owning the asset, which it can share with the lessee in the form of reduced rental payments, thus reducing its cost of funds.

However, that raises questions of whether the arrangement is truly a lease or whether it is a sale of the asset or a secured loan.

Is it a sale of the asset?

Tax rulings have been issued by the ATO to ensure that the lease is, in fact, a lease and is not an in substance sale of the asset by the lessor to the lessee. Lease taxation depends on the residual value being a reasonable estimate of the value of the asset at termination of the lease and the lessee not having a right to acquire the asset at termination.[vi]

Is it a secured loan?

The ATO has challenged the sale and leaseback of a critical piece of machinery owned by the taxpayer that was integral to its business, had no market if it were sold and in all likelihood would be repurchased by the taxpayer at the end of the lease. The challenge was in effect, that the sale and lease back was a secured loan for tax purposes.[vii]

The court held that the lease payments were fully deductible even though the machinery was critical to the company's business operations, no one else could use it and it was inevitable that the company would repurchase it on termination of the lease. [viii]

Leveraged lease taxation

If the lessor has borrowed funds to acquire the asset, as in the case of a leveraged lease, it will be entitled to a deduction for the interest expense on the borrowed funds under the general deduction rules. [ix] Also the lease must comply with the tax ruling referred to above and also that the lessor has at least a twenty percent interest in the asset, that interest not be capitalised into the cost of the asset and that the pattern of rental payments is not weighted towards termination. [x]

Hire purchase taxation

Where the lessee has a right or option to purchase the asset at expiration of the lease and it is reasonably likely that that will occur the transaction is treated as a hire purchase arrangement for tax.[xi] In that case, the lessor is treated as having sold the asset and loaned the value of it to the lessee. The lessee, on the other hand is treated as having purchased the asset. The rental payments are then disaggregated between payments of principal and interest with only the interest component being deductible to the lessee and assessable to the lessor. The lessee is treated as being entitled to the capital allowance deductions.

Capital allowance (depreciation) deductions

Perhaps the most significant tax issue for infrastructure financing comes from the large up front capital expenditure in these types of projects. The question is, then, which of the two parties, the lessor or the lessee (assuming that lease financing is used), is entitled to the tax deductions for that capital expenditure.[xii]

The rules about deductions for capital expenditure recently changed from being "depreciation" deductions to "capital allowance" deductions and, at the same time, the entitlement to those deductions changed from being solely dependant on legal ownership of the asset to being dependant on either legal or economic ownership.[xiii]

The party now entitled to these deductions is the "holder" of the asset, which is defined in terms of both the legal owner and the economic owner of the asset.[xiv] In the case of a lease, including a leveraged lease, the lessor will typically be treated as the "holder" of the asset and thereby entitled to the tax deductions for the capital allowances.

Capital works deductions: building and structural improvements

Deductions are available for the cost of construction of a building used to produce assessable income.[xv]

Different rates of deduction (either 2.5% or 4%)apply depending on when the construction commenced and the purpose to which the building is put. Relevant buildings include industrial buildings and income producing structural improvements and industrial activities includes producing electricity, steam or hydroelectric power.[xvi]

The deduction also extends to cost of construction of certain structural improvements as if they were a building.[xvii]Examples of structural improvements are things such as sealed roads, bridges, airport runways, pipelines and so on.[xviii]

ACCESSING EARLY STAGE TAX LOSSES

Project sponsors will typically want to limit their credit exposure to the project and that means almost invariably each project asset will be owned by a new company or trust established for that purpose (called a Special Purpose Vehicle or SPV) and, as the SPV will not have any other income generating business or assets than the project asset, large up front tax losses will be generated from the tax deductible capital allowances and interest charges being incurred.

These tax losses may be carried forward and used in future years when the project begins to produce income. However, income from the project may not start to produce income until well into the future, say three to four years after the project is commenced.

Tax incentives for infrastructure

There have been two initiatives by Government to pass the tax losses from the interest expense deductions to investors earlier than would have otherwise have been the case. These were intended to make infrastructure financing more attractive, thereby lowering the cost of funds for the project sponsors.

The first initiative, which commenced in 1995 and finished in 1997, exempted from tax the interest, or interest equivalent payments, paid to investors on amounts that they had lent to the project. [xix] The project sponsor who had borrowed the funds was denied a tax deduction for that interest payment.[xx]

After submissions by interested parties that the tax exemption of the interest payments was not attractive to zero and low rate taxpayers, such as superannuation funds, the rules were modified so that investors could elect between the exemption from tax of the interest or, alternatively, including the interest in assessable income and claim a tax rebate equal to the general corporate tax rate.[xxi]

However, this initiative was withdrawn in 1997 as a result of aggressive tax planning.[xxii] The estimated revenue cost of the abandoned concessions over the period from 1996 until 1999 (assuming that all the projects which had applied for approval had been implemented) was $4bn, which was clearly unsustainable.

A more limited tax benefit was introduced that was far more controlled than the one that it replaced.

These replacement provisions allowed a tax offset (rebate) at the general company tax rate for interest (and interest equivalents) payments on borrowings for "land transport" assets only. To further protect the revenue this concession was limited to the first five years of the lending.[xxiii] (The 2004 Federal Budget announced that no new projects would be approved under these provisions.)

Passing tax losses to equity investors

In some cases the early stage tax losses generated in the SPV can be immediately grouped for taxation purposes with other tax paying entities in the corporate group of the sponsor. [xxiv]

In other cases the choice of SPV will be designed to facilitate the investors obtaining immediate value for these losses. For example, the project asset may be owned by a unit trust, the units in which are sold to retail and institutional investors who ultimately fund the asset's acquisition.

A unit trust is, in effect, able to pass the value of those tax losses to investors through distribution of income that is not assessable income to the unit holders because it is sheltered by those tax losses.[xxv] Those distributions reduce the cost base of the units to the investor for tax purposes. However, when those units are disposed of, or the cash returned exceeds the initial cost of the investment, the investors will be assessed on a capital gain based on the cost of the unit reduced by those distributions. In that regard, they are a deferral of tax, but a benefit to investors nevertheless.

Care needs to be taken if the SPV holding the asset is a unit trust because of tax rules that could cause the unit trust to be taxed as a company, rather than as a trust.[xxvi]

This risk of the unit trust being taxed as if it was a company can be avoided if the unit trust comes within one of the exemptions from application of these rules.[xxvii] Any part of the project that is not within that exemption must be then carried on in a separate vehicle, usually a company, to protect the unit trust's tax status as a trust.[xxviii]

Investors can then take an interest in both vehicles (units in the unit trust and shares in the company) and those interests can be stapled if the project' securities are listed on a stock exchange.[xxix]

Passing tax losses to lenders

What if the asset was financed by borrowed funds rather than by retail and institutional investors?

In that case, the tax deductions for the initial capital allowances and interest expenses can be transferred to the lender by way of a finance lease. The lender can then share the value of those deductions with the project sponsor by reducing the rental payments and, thereby, reducing their cost of funds.

In taxation terms this is called a "tax benefit transfer" or "tax preference transfer" transaction and is disliked by the ATO because it advances the use of the capital allowance deductions.[xxx]

Following recommendations from the Ralph Review of business taxation the re write of the tax laws for financial arrangements (TOFA) recently included proposals that would have treated finance leases as a sale of the asset by the lessor to the lessee and a loan of the cost of the asset to the lessee.[xxxi] However, the Government announced in the 2007 Federal budget that it had decided to not proceed with this to avoid difficulties for small and medium sized taxpayers.[xxxii]

Notwithstanding the ATO's dislike of finance leases it is argued that they are not disadvantageous to the revenue. The revenue would say that the rental payments in a finance lease are just disguised payments of the purchase price or repayments of a loan and, on that analysis should not be fully deductible to the lessee.

However, the counter argument is that even if they are considered to be repayment of the purchase price or of a loan those payments are fully assessable to the lessor and, because of that symmetry, the revenue is not disadvantaged.[xxxiii]

Another argument put forward in support of changing taxation of finance leases is that they are just transferring the capital allowance deductions from the true economic owner of the asset (the lessee) to the lessor who may have other income that it can shelter with those tax deductions (see tax benefit transfer discussion above). The cost to revenue is the cost to it of the advancement of the use of the capital allowance deductions.

In response to that it is said that the capital allowance deductions can be passed through to the ultimate owners of the asset through choice of the legal vehicle used to hold that asset, as in the discussion above about use of a unit trust to hold the asset. On that view a finance lease just facilitates transfer of the capital allowance deductions to the lender, rather than the investors. As there is only one amount of deductions the revenue should be indifferent whether the investors or the lenders use them.

New tax incentives?

Within that context and taking into account the massive need for upgrading and new infrastructure projects the question is whether there is any need for tax concessions similar to those that were available until 2004?

The answer is probably not. To the extent that those tax concession were intended to advance the tax losses from the interest expense in these projects, that is available through the (indirect) mechanism of unit trust distributions that have been discussed, as it is for the tax losses generated by the capital allowance deductions.

To the extent that funding for these projects is by way of debt funding from financial institutions, say, then mechanisms such as finance leases are available to transfer the capital allowance deductions to the financial institutions, thus having the same effect as using a unit trust.

ANTI AVOIDANCE RULES IN INFRASTRUCTURE TAXATION

Government as end user: deductions where none existed before

The most important anti avoidance rule impacting on infrastructure is that which limit the capital allowance deductions where the end user of the asset is a tax preferred entity, such as government.[xxxiv]

The problem

In the early 1980's large amounts of government infrastructure assets were being sold to the private sector and leased back.

The Federal Government's concern with this was that the private sector owner of the asset was entitled to deductions for the capital allowances from ownership of the asset, yet those deductions would not have been available to the State Government user had it continued to be the owner because it was not a tax paying entity. Of course, the private sector buyer would share the value of those tax deductions with the Government user by reducing the rental payments and, thereby, it's cost of funds.

Selling the asset to the private sector then, in effect, created tax deductions that would not otherwise have been available and, where the transactions involved very large public infrastructure assets, the Federal Government was at risk of losing large amounts of revenue from these deductions.

In addition to being a potentially very costly exercise for the Federal government through lost revenue, it also created other problems as these transactions amounted to a subsidisation of the State Governments by the Federal Government outside the normal Federal/State Government funding arrangements.

The solution

Two sets of rules were introduced to deny the capital allowance deductions where, amongst other things, the end user of the asset is government. [xxxv]

The first of the two sections, which only applied if the private sector participant had funded the acquisition of the asset with limited recourse debt, went much further than was reasonable in the circumstances.[xxxvi] In addition to denying the private sector participant the capital allowance deductions, it also denied maintenance expense and interest payment deductions and continued to assess the private sector participant on the rentals paid under the arrangement.[xxxvii] Importantly it applied where the asset Government had control "of use" of the asset as well as a lease, which caused difficulty in interpreting when it applies and that, in turn, caused delays in finalising projects as project sponsors sought ATO clearance.[xxxviii]

A second set of provisions was introduced shortly after the first and they applied in a slightly different way by recharacterising the transaction for income tax purpose in the same way that the accounting standards do if the lease is a finance lease.[xxxix] The asset was treated as having been sold to the private sector participant and the cash flows were divided between notional repayment of a loan deemed to have been made to the user and repayment of financing charges (interest) on that notional loan. The notional loan repayments are neither deductible nor assessable but the financing charges are deductible and assessable.[xl]

The capital allowances otherwise available to the private sector participant were also denied as, of course, that was the main purpose of the rules.

New rules: risk or control test?

The Ralph Review considered both these provisions and made recommendations that they be re written. [xli] Replacement rules for both were released in 2003 in an Exposure Draft, which was based on the broad design principles that had been announced by the then Minister for Revenue and Assistant Treasurer, Senator Helen Coonan. [xlii]

The new rules were to be based on concepts of risk transference between the parties in order to determine whether the private sector participant should be entitled to the capital allowance deductions.

However, the Exposure Draft that emerged and that was based on concepts of risk was not well received by industry because of its scope and difficulty of application.[xliii]

The new Assistant Treasurer advised that the risk based test that had been announced by his predecessor was to be abandoned because of "stakeholder concerns about the scope of arrangements affected by the reforms being broadened by the use of new risk based test."[xliv]

Legislation reflecting these new design principles was released on 16th August 2007 and it uses an "effective control of use" test and a "predominant economic interest" test, amongst other criteria, to identify transactions where capital allowance deductions will be denied when Government is the end user of the asset.[xlv]

Financing government assets: new rules

The new legislation will deny or reduce the capital allowance deductions that would otherwise be available to a taxpayer in relation to the asset if it were used by what is called "a tax preferred end user".[xlvi]

If the capital allowance deductions are denied by these provision the payments in relation to use of the asset are treated as a loan repayment in much the same way as the second of the provisions being replaced do and, also, the accounting standards do in the case of a finance lease, as discussed above.[xlvii]

In very broad terms the new rules will apply where Government effectively controls the use of an asset that is leased and which asset produces goods, provides services or facilities that is paid for by government and, also, where the economic nature of the arrangement is, essentially, a finance arrangement.

The operative provisions deny capital allowance deduction and recharacterise the arrangement, as a loan five things are present:

> Government uses the asset,
>
> The arrangement is for at least 12 months,
>
> Government pay for that use of the asset,
>
> The owner of the asset would have otherwise been entitled to capital allowances, and
>
> The owner of the asset does not have a 'predominant economic interest' in the asset.[xlviii]

The owner of the asset will not have a "predominant economic interest" in the asset where the arrangement is, essentially, a financing arrangement including:

Where the asset has been acquired with more than 80% of its cost by limited recourse debt. That level can be exceeded where it is a non-leased asset if there is no Government financial support or, if the asset is leased, it is real property where no ore that fifty percent of the projects area is leased to non-government tenants.

The Government has a right to acquire the asset,

The arrangement is effectively non-cancellable, or

The present value of expected rentals exceed 70 per cent of the market value or construction cost of the asset.[xlix]

There are five exclusions to application of the rules which are to ease compliance costs and these are:

For small business entity providers,

Where the nominal value of payments is less than $5M,

The arrangement is for less than five years if the asset is real property or three years for any other type of asset. That exclusion only applies if the arrangement is not a disguised loan,

The present value of the assessable income calculated under these rules is less than the net assessable income that would otherwise have been calculated, and

The Commissioner determines that the provisions will not apply.[l]

Effectively the re written rules should make it easier for taxpayers to self assess the determination if they apply to the transaction, unlike the provisions that they are replacing. Also, these provisions do not have the same severe effect as the first set of provisions being replaced as discussed above, where rentals continued to be fully assessable.

Limited recourse debt

Another typical characteristic of infrastructure projects is the use of debt financing to acquire the asset (leverage). For example, a lease may be a leveraged lease, where the lessor (the owner of the asset) acquires it with borrowed funds.

Where the asset is acquired with borrowed funds the lenders primary security for repayment will usually be the contracts giving rise to the cash flows from the project.[li] This type of security can be distinguished from the security offered in real estate project financing or equipment leasing where the lender's primary security is the capital value of the asset.[lii]

Leverage in these projects is most likely to be either non-recourse or limited recourse. Non-recourse is where the lenders can only have recourse to the project's cash flows at any time during the course of the project, including the pre-production period and limited recourse is where the lenders ability to look to the projects sponsor in the event of default is also limited, but to other than just the project cash flows.[liii] In either case the lender relies on the economics of the project and not the creditworthiness of the sponsor.[liv]

The benefits of non-recourse and limited recourse borrowing is that the sponsor of the project is able to isolate, either in whole or in part, the risk of the project from its other business and, also, it can also be used to shift risks of the project to the lender who may be better able to manage these risks, thus creating economic efficiencies.[lv]

Limited recourse debt is seen by the ATO as a transfer of the economic ownership of the asset to the lender from the borrower as in Tax Preferred Entity tax rules discussed above where the taxpayer is denied capital allowance deductions if, amongst the things, it has limited recourse debt of more than eighty percent of the value of the assets.

Nevertheless, the ATO has accepted the use of limited recourse debt in large scale infrastructure projects subject to the borrower satisfying certain requirements. However, where limited recourse debt is used to fund the acquisition of an asset there is potential for the debt not to be fully repaid. [lvi] This could happen when the financier has fully depreciated the project asset for tax, which, together with other repayments, reimburses the financier.

The problem for the ATO is that it will have allowed capital allowance deductions for the full value of the project asset, yet the owner of the asset may not have repaid in full the funds that it borrowed to acquire the asset.

To prevent this kind of behaviour a set of provisions was inserted into the tax law that recaptures capital allowance deductions if limited recourse debt is terminated before it is fully repaid.[lvii]

So, where limited recourse debt is used to acquire an income-producing asset and the limited recourse debt arrangement is subsequently terminated, any capital allowance deductions claimed in excess of the actual debt repaid is assessable as income.[lviii]

Lease assignments

The final anti avoidance rule considered relates to two of the financing aspects of infrastructure projects. The first is the early stage tax losses from the capital allowance deductions and interest expenses and the second is the long term nature of these arrangements.

In any arrangement the ATO, before issuing a ruling confirming the tax outcome, will want to ensure that the arrangement will be overall net tax positive. That means, essentially, that over the entire term of the arrangement the transaction will produce assessable income after taking into account the early stage tax losses.

However, even though it can be demonstrated at commencement that the project overall will be tax positive, it was possible for the project sponsor to transfer the balance of the lease to avoid tax on future rental payments, after fully utilising the tax deductions from the capital allowances from the project asset.

The net effect of transferring the balance of the lease rentals is that, at that stage, the project sponsor is relieved from paying tax on the remaining rentals. Instead, they will be paid a tax effective lump sum by the purchaser of the remaining rental payments.

A transfer of the remaining lease payments rentals would, in the normal course of events, create a tax liability equal to the difference between the tax depreciated value of the project asset and the amount for which it was transferred. However, it was possible to avoid that if the transaction was structured correctly.[lix]

The remaining lease rental payments would be sold to a taxpayer who was not concerned that they were taxable payments, such as a low rate or zero rate entity.

To counter this type of activity anti avoidance rules were inserted such that where an asset that had been leased, and for which capital allowances deductions have been claimed, is disposed of the difference between the money consideration and any other benefits obtained, such as the transferee assuming any debt associated with the plant, over the written down value of the asset, is assessable income of the transferor.[lx]

These provisions also extend to disposal of rights under the lease, as well as partnership interests in the asset and “downstream” interest in companies that belong to the lessors corporate group.[lxi]

If any of the consideration is assessable under the normal balancing adjustment rules mentioned above, they are ignored.

Conclusion

Except in very limited circumstances there is no separate set of rules for taxing infrastructure projects.

Infrastructure projects typically create large early stage tax losses from the capital allowance and interest deductions, which investors want to access as early as possible. The Government has, on two occasions, offered tax concessions for investors that advanced the use of interest expense deductions. However, as this can now be achieved, together with the capital allowance tax losses, under existing tax law through appropriate selection of the legal vehicle holding the asset or the use of a finance lease, it is not considered necessary for any new provisions.

Typical financing structures in these infrastructure projects can interact with the general tax rules in a way that leads to tax outcomes that require anti avoidance rules to address them.

First, lease financing and very large tax losses from the large capital expenditure is typical for infrastructure projects. This leads to some challenging taxation issues such as which of the two parties, the lessor or the lessee, should be entitled to the capital allowance deductions from those tax deductions.

The use of debt is another typifying characteristic of infrastructure projects and, in particular, limited recourse debt as it limits the credit exposure of the project sponsor and, also, provides economic efficiencies by transferring risk from the project to the lender who may be in a better position to manage that risk.

However, from a taxation point of view limited recourse debt is seen as an in substance transfer of the economic ownership of the asset to the lender, while the borrower is receiving all the tax benefits from ownership.

In that case anti avoidance rules have been inserted such that if the limited recourse debt is terminated before it is completely repaid, there is a reclaim of some of the capital allowance deductions that have been given.

Finally in this regard, infrastructure projects typically last for very long periods and, even though the ATO will ensure at commencement that the net cash flows over the life of the project will produce assessable income, it was possible for project sponsors to dispose of the future rental payments that would otherwise have been assessable, in a non-taxable way.

To combat such practices anti avoidance rules were inserted into the tax laws that reclaim capital allowance deductions to the extent that the lease transfer is not otherwise assessable.

---

[*] B Sc LLb (Mon) LLM (Syd) Grad Dip Securities Analysis FTIA F Fin Senior Lecturer Atax Faculty of Law UNSW

[i] Jeffreys et al, Critical success factors of the BOOT procurement system: reflections from the Stadium Australia case study, Engineering, Construction and Architectural Management 2002 9 p352. See, for example, Australian Financial Review front page of 30 July 2007 reporting that State Governments have $40bn of infrastructure planned.

[ii] Senator the Hon Helen Coonan, Assistant Treasurer Speech to AFR Infrastructure Summit 5 August 2002

[iii] Ss 6-5 and 8-1 ITAA1997

[iv] R Krever TOFA: the unfinished agenda p10 [2006] AT Rev 1

[v] The accounting standards (AASB 117) would require such a lease to be accounted for as a sale of the asset to the lessee and a loan from the lessor.

[vi] IT28 in particular Para 7

[vii] Metal Manufacturers Ltd V FC of T (2001) 46 ATR 497

[viii] The case resulted in the ATO releasing a Tax Ruling that now accepts sale and leasebacks done in these terms. IT 2006/13
[ix] S8-1 ITAA 1997
[x] IT 2051 and IT 2062
[xi] Div 240 ITAA 1997
[xii] Div 40 ITAA1997
[xiii] Div 40 ITAA1997 Major amendments, after the Ralph Review, aligned the economic ownership of assets to entitlement to this tax deduction - Div 40 ITAA 1997 from 1 July 2001. Previously, the entitlement to the deduction had been based on legal concepts of ownership of the relevant asset, which did not necessarily correctly reflect the economic relationship- s 54 ITAA 1936.
[xiv] S 40-40 ITAA1997
[xv] Div 43 ITAA 1997
[xvi] S 43-150 ITAA1997
[xvii] S43-20 (2) to (4) ITAA 1997
[xviii] S43-20 (3) ITAA1997
[xix] Div 16 L ITAA1936
[xx] ibid
[xxi] Rebateability was attractive to tax paying investors whose marginal tax rate was less than the general tax rate. For example, a superannuation fund's nominal tax rate is 15% so exemption from tax resulted in a net tax saving of 15%. However, a rebate at the general company tax rate (which initially was 36%, but is now 30%) resulted in a net tax saving of 21%, being the 15% nominal tax rate on the interest payment less rebate of 36% at the then corporate rate.
[xxii] Page 2 Senate Economics Legislation Committee Report on Taxation Laws Amendment (Infrastructure Borrowings) Bill 1997 Against that background, the Treasurer (Mr. Costello) announced on 14 February 1997 the cessation of the infrastructure borrowing tax concession."
The estimated revenue cost of the abandoned concessions over the period from 1996 until 1999 (assuming that all the projects which had applied for approval had been implemented) was $4bn, which was clearly unsustainable.
[xxiii] Div 396 ITAA 1997
[xxiv] This grouping has been made easier under tax consolidation rules. Division 701 ITAA 1997
[xxv] CGT Event E4 s 104-70 ITAA 1997
[xxvi] Division 6C ITAA 1936
[xxvii] That exemption is available provided that the unit trust is invested in wholly 'eligible investment business". That term is further defined as, amongst other things, "investing in land for the purposes, or primarily for the purpose, of deriving rent;" S102M ITAA1936
[xxviii] S 102M para (a) ITAA 1936
[xxix] The Federal Opposition has announced that they would simplify these rules. Speech by the hon Chris Bowen to IFSA 3rd August 2007
[xxx] Main Objectives of Tax-based Financing: Current Issues, Wiley M, in Krever R, Grbich Y, Gallagher P (eds) Taxation of Corporate Debt Finance (Melbourne: Longman Professional 1990)
[xxxi] A Tax System Redesigned Final Report (July1999) p392 para 10.9, Taxation Laws Amendment (Taxation of Financial Arrangements) Bill 2007
[xxxii] Press Release No 99
[xxxiii] R Krever, TOFA: the unfinished agenda 11 [2006] AT Rev 1
[xxxiv] These provisions have a broader scope than just assets used by Government as they also apply to tax exempt and non–resident taxpayers using the assets. However, given that Government is the main user of infrastructure assets they are the only taxpayers considered in this paper in the context of these rules.
[xxxv] S 51AD inserted in 1984 and Div. 16D ITAA 1936 inserted in 1985.
[xxxvi] S 51AD ITAA1936
[xxxvii] In technical tax language this is called an "annihilating" provision.
[xxxviii] TR 96/22
[xxxix] Div 16D ITAA 1936
[xl] S159K ITAA 1936
[xli] A Tax System Redesigned Final Report (July 1999) HTTP://www.rbt.gov.au/publications/paper/index
[xlii] New Business Tax System (Tax Preferred Entities-Asset Financing) Bill 2003, Exposure Draft
[xliii] The Exposure Draft included rules identifying at least seven elements before it applied.
[xliv] Press release 008
[xlv] Ss 250-15 and 250-50 Tax Laws Amendment (2007 Measures No 5) Act 2007
[xlvi] See definition of this term to be inserted into s 995 (1) ITAA That term includes non-resident and tax exempt taxpayers in general. However, as the focus of this paper is on infrastructure the rules are discussed solely in the context of the end user being Government.
[xlvii] Divs 250-C, 250-D and 250-D of Tax Laws Amendment (2007 Measures No 5) Act 2007
[xlviii] S 250-15 Tax Laws Amendment (2007 measures No 5) Act 2007 Within that schematic view of how the division is to apply there are a significant number of defined terms to ensure that the division operates effectively. For example, "government" is defined to include entities controlled by Government and the very broad term of "financial benefit" is used to capture effective payments. These are not discussed further here.
[xlix] S 250-110 to 250-135 Tax Laws Amendment (2007 Measures No 5) 2007 Act
[l] Ss 250-20 to 250-45 Tax Laws Amendments (2007 Measures No 5) 2007 Act
[li] Handbook of Australian Corporate Finance 5th Ed. Butterworths P 331
[lii] See footnote 1
[liii] Handbook of Australian Corporate Finance 5th Ed. Butterworths page 319-320
[liv] Ibid p 318
[lv] Ibid

[lvi] IT 2051
[lvii] Div 243 ITAA 1997
[lviii] The provisions include the notional loan in a hire purchase arrangement in the definition of limited recourse debt and have extended application to borrower partnerships and 100% owned borrowing subsidiaries – see Subdiv 243-D and s 243-70
[lix] Subdiv 40-D ITAA 1997
[lx] S 45-5 ITAA 1997
[lxi] S 45-10 and 45-15 ITAA 1997