



Deal Advisory Tax Insights

Infrastructure investments and stapled structures

Insight and clarity at a time of uncertainty

There is considerable debate and discussion within the infrastructure and real estate industries following the recent release of the *Taxpayer Alert 2017/1* ("Taxpayer Alert") and the *Privatisation and Infrastructure – Australian Federal Tax Framework (January 2017 Draft)* (the "Framework") by the Australian Tax Office ("ATO").

Whilst these publications are informative in highlighting the ATO's concerns, there is uncertainty surrounding what this means for current and future infrastructure investments.

KPMG hosted a number of forums with representatives from the ATO, Treasury and industry to facilitate the sharing of perspectives and concerns regarding infrastructure investments. The following key themes emerged:

- Use of stapled structures and specifically the lack of clarity regarding the expected tax treatment of infrastructure investments.
- Need for Government to confirm its tax policy settings.
- Impact on future infrastructure investment decisions in Australia.
- Treatment of existing stapled structures, and impact on transactions in other sectors such as finance and real estate.

It is clear from these discussions, and from KPMG's recent interactions with the ATO through the Foreign Investment Review Board, that the ATO needs to further articulate its views on the use of stapled structures through further written guidance, in conjunction with clarification from the Government of its tax policy settings.

What does this mean for me?

Based on this limited information one could argue that this will result in the death of stapled structures in the infrastructure and renewable energy industry, irrespective of whether such structures are owned by Australian or non-Australian investors. This, however, would be an overreaction based on the limited guidance provided by the ATO to date.

Stapled structures have been used for the past 29 years, predominately for real estate and infrastructure investments. In our view, the continued use of stapled structures is still appropriate but will be heavily dependent on the facts and circumstances of the specific investment. We hope that the ATO will provide clearer guidance in the finalised Taxpayer Alert and Framework.

Where to from here?

It is critical to review existing positions adopted in your current investments in light of the ATO's draft guidance. Please call your KPMG adviser to discuss and consider:

- what this means for your current investments using stapled structures
- the impact on both potential consortium partners and the structure of prospective future investments, in light of the ATO's input into the FIRB approval process
- issues of concern that you wish to raise in submission to both the ATO, in respect of the Taxpayer Alert and Framework and Treasury, in respect of the appropriate future tax policy settings to facilitate future Australian infrastructure investment.

The Taxpayer Alert and Framework are currently subject to a consultation period with the ATO which concludes on 28 April 2017. KPMG is preparing a submission as part of this consultation process and looks forward to discussing any issues or insights you may like to include.

Taxpayer Alert and Framework Forums

KPMG hosted two discussion forums, 14 February 2017 in Sydney and 22 February 2017 in Melbourne, to discuss the Taxpayer Alert and Framework.

In attendance were KPMG, representatives of Treasury, ATO (notably Peter Maher, James Beeston, Fiona Knight and Rhys Manley) and KPMG clients within the infrastructure sector (both investors, advisors and asset operators). Set out below are the key messages that arose from the discussions.

Key messages

FIRB/Treasury

- Foreign investment into Australia is still encouraged and the Federal Government still encourages foreign investment into Australia. Further, the current FIRB process with regard to foreign investment has not changed as a result of these documents.
- Tax remains one of five national interest factors FIRB will consider when considering foreign investments.
- The ATO provides a risk rating to FIRB to consider. The board will then give a recommendation to the Treasurer who ultimately makes the decision.
- If there is an investment proposal that is within the scope of the Taxpayer Alert, the ATO will rate it high risk accordingly.
- The ATO considers that special conditions do not adequately deal with this risk and therefore would not advise on a special condition to deal with this risk post transaction. The ATO has acknowledged, but not provided a response as to whether this placed foreign investors at a disadvantage to domestic investors who did not need to seek FIRB's approval.

Taxpayer Alert and Framework

- The ATO felt the benefit and the need to issue the Taxpayer Alert as a reaction to:
 - increased volume of infrastructure transactions in recent years
 - increase in the number of rulings in this area (including two Part IVA rulings which have been considered at the GAAR panel)
 - Recent rise of the '4th wave' of staples for non-traditional businesses (further explanation below).
- The ATO process has moved away from "sitting back and reading about deals in the AFR" and auditing taxpayers 2 years later, to getting involved as early as possible in transactions with advisors and investors prior to the structures being put in place.
- The ATO's practice is to put out the Taxpayer Alert and follow up with further guidance. The Framework is not a binding document but it is expected that ATO officers will follow the guidance set out within. The Framework acts as one form of guidance. It is a document that is both for ATO's internal use to serve as instruction, but also provide guidance to industry stakeholders (which is seeking for consultation and submission until end of April).
- The Taxpayer Alert was discussed with Treasury prior to its release. The Framework has not been discussed with Treasury in detail as it is still in draft but the expectation is it will be discussed with Treasury prior to being finalised.
- Once the Framework is finalised, only incremental changes are expected. If there are to be substantial changes, these will reflect new issues or structures that emerge in the future rather than significant change to the chapters already drafted.
- The Taxpayer Alert has four examples to illustrate the types of structures causing concern and these are not intended to be exhaustive. The fact that a structure is not covered does not mean it is not a concern. Whilst stapled structures are identified in the Taxpayer Alert, these are not the only type of structure that are of concern.
- Where a concern is covered in the Taxpayer Alert, it is excluded from the Framework. This is the reason that the Chapter in the previous draft of the Framework on restructuring of assets out of a corporate group has been excluded.
- The Taxpayer Alert is not just about stapled structures and the ATO sees the key risk area being re-characterising income from an integrated business to a lower taxed entity (could be staple, but can also be vertical structures) with common investors and cross staple transactions. The ATO is concerned with the erosion of the corporate tax base through the fragmentation of integrated trading businesses, where business, land or other assets within an integrated business are bifurcated.
- The ATO considers there to have been four waves of staples:
 - 1) REITs – these were the initial staples that were implemented and are generally excluded from the Taxpayer Alert as they are considered a genuine business where the Asset Trust is deriving rental income on land from third parties.
 - 2) Finance staples – the concerns with these structures have been addressed through previous Alerts and enforcement action by the ATO.
 - 3) Privatisation staples.
 - 4) Specialised assets, which has also seen the re-emergence of some finance staples.
- The ATO is concerned with the surge of stapled structures under the fourth wave within the last 12–18 months which in practice include finance staples, synthetic staples and combinations of all the different examples noted in the Taxpayer Alert. The ATO considers that these structures have been implemented with the intention of re-characterising trading income to passive income and accessing a lower tax rate.

- Where transactions between stapled entities are at arm's length, the ATO will still assess whether an identifiable market for bifurcating the assets exists and whether unrelated parties would enter into similar transactions. If there is no identifiable market for bifurcating the assets, the ATO has concerns with such structures even if the individual transactions to implement the transaction occur on arm's length terms.

Part IVA and rulings

- Whilst the Taxpayer Alert talks about substantive provisions such as Division 6C and the 'arm's length' measures in the MIT rules, the ATO sees the fundamental provision applicable being Part IVA.
- The ATO is also preparing a ruling on the application of Part IVA to stapled structures as further guidance. The ruling will use the basis and positions from two recent real-life cases that have been tested at the GAAR Panel. The ruling is expected in rough timing during the 2017 calendar year.
- For the two Part IVA ruling examples that went to the GAAR panel, both involved existing structures/operations that were seeking to restructure into a staple, rather than historic staples. The panel concluded the dominant purpose of a restructure was for tax purposes and reasons for restructure such as obtaining better financing terms were not accepted in these cases.

Privatisations

- Privatisations are specifically carved out from the Taxpayer Alert, which the ATO acknowledges is not necessarily because the application of the law differs. More so because of ATO's internal administrative procedures to privatisations are different. The ATO had worked very closely with bidders in the privatisation processes to be comfortable with certain structures (set out in the Framework). As long as the privatisations are within the Framework parameters (e.g. price allocation across staple, gearing and financing), the ATO will devote less compliance resources.
- The ATO explicitly stated that whilst agreeing cross-stapled pricing was central to their low risk assessment on privatisations, it is not accepted that a private sector staple was capable of being priced appropriately.
- The ATO will consider litigating a test case in circumstances where there is a material uncertainty in the way in which the law should be interpreted. When asked whether the ATO would consider a test case on stapled infrastructure transaction, that the ATO felt there would be limited appetite, or value, in litigating a test case on these issues.
- Whilst land-rich privatisation transactions are currently excluded, the ATO did confirm that this position could change in the future.

Example scenarios

- Stapled structures including hotels and student accommodation may be a concern to the ATO, however such structures will be considered on a case by case basis to determine if they give rise to concerns of the type outlined in the Taxpayer Alert. The ATO have conceded that the concerns in the Taxpayer Alert 'might not' apply to student accommodation or hotels. In the case of student accommodation, whilst the legal form of the income is a license fee and not traditional rent, it is still fundamentally a rental business. The ATO has similar views on structures with respect to petrol stations.
- The ATO does have a concern with stapled structures that are commonly used in the infrastructure sector (for example with toll roads, solar farms and wind farms), except for those used in land-rich privatisations.
- In the ATO's view, Part IVA can still apply in scenarios where all investors are residents. The purported tax benefit is the deduction to the operating entity, rather than the availability of concessional MIT withholding (for example) from the asset trust. Tax deferred distributions were cited as another example of a tax benefit to resident investors.

- Even in full resident cases where there are no tax savings at the time, the ATO may consider Part IVA applying by looking through to the potential upside on future sale value.
- In an example where a stapled structure is set up for a future spin-off, the ATO doesn't necessarily see the need to set up a stapled structure to facilitate the spin-off (i.e. can be part of the TCG). Whilst there might be duty reasons/benefits of setting a spin-off structure up on day 1, ATO acknowledged that this needs to be looked at on a case by case basis. Practical examples here would be service stations, logistics or healthcare.
- In cases where investment or acquisition is made into an existing staple (i.e. secondary trade), the ATO is of the view that if the structure is within the descriptions in the Taxpayer Alert, the Taxpayer Alert principles could apply. The ATO is also of the view that secondary transfers of privatised businesses could potentially be captured and would not be 'grandfathered'.
- The ATO acknowledges administrative difficulties for an investor to obtain a private ruling in respect of a potential investment into a staple. The ATO has suggested that investors talk to the ATO in those circumstances.
- Stapled style structures are common in agriculture businesses and could arguably be captured within the Taxpayer Alert. The ATO is of the view that they do not expect to challenge 'mum and dad' type structures, but would consider the Taxpayer Alert in other circumstances, such as foreign investment.
- The Taxpayer Alert is not intended to apply to structures where there is not common ownership of the business assets and passive assets. It applies where there is common ownership of such assets. The example used to highlight this principle was a situation where a company undertakes an active business and holds significant land assets. Where a company sells its interest in this land to third parties or as part of an IPO, such that the land has different ownership to company, the ATO is of the view that this does not fall within the scope of the Taxpayer Alert. However, if the company created a stapled group as a result of the disposal of the land, this would fall within the Taxpayer Alert.

Application to existing structures

- The ATO has checked its internal administrative procedures to confirm it can apply the Taxpayer Alert to existing structures. Despite the perception that the structure creates advantages to potential foreign investors relative to Australian investors, the ATO is of the view that Part IVA can still apply to stapled structures that are implemented that are wholly owned by a group of Australian investors.
- In respect of existing structures:
 - Where the taxpayer has a ruling, the ATO would continue to respect that decision.
 - Outside of that, the ATO would apply the Taxpayer Alert's view equally to existing and new stapled structures, subject to amendment periods.
 - The ATO understands that unwinding a stapled structure and making historical adjustments is very difficult, in particular with retrospective franking balances, and withholding tax payments. Accordingly, the ATO's clear preference is to ensure these structures are not established in the first place.
 - Often the case, ATO audits in this regard were concluded in settlements rather than restating historical positions.

Other side topics:

- Negative control
 - The ATO accepts there is currently an impasse with industry as regards to 'negative control'. Whilst the ATO acknowledged that there is a disagreement with industry more generally over the concept of 'negative control', it was hopeful that the parties could 'agree to disagree' on this issue so that there could be substantive discussion on the factors that could give rise to negative control. The ATO would like to reach a compromise and agree on factors that may determine negative control - the intention being the finalisation of the table within the Framework to create certainty for Investors as to the factors of concern when they are drafting shareholder agreements.
 - Minority shareholder protections should generally be acceptable.
- Treatment of government grants or contributions
 - The ATO acknowledges the timing mismatch between grants assessed on receipt and associated expenditure over long run.



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