

Tax Update

Tax loss incentives for designated infrastructure projects

Treasury has released a discussion paper on the Government's proposed tax loss incentives to promote investment in infrastructure projects designated of national significance.

The changes, announced in the 2011-12 Budget, are two-fold:

- the value of carry forward tax losses that are attributable to designated infrastructure projects to be

uplifted by the 10 year Government bond rate; and

- such tax losses will be exempt from the current company and trust loss recoupment rules, which only allow losses to be used in a future tax year.

The discussion paper forms the basis for consultation on the proposed design of the new incentive and the way the proposal may be implemented.

Rationale for incentives

The incentives are intended to address problems with the recoupment of tax losses generated by infrastructure projects. Typically, early stage losses arise due to significant capital allowance and interest expense deductions incurred during the construction phase. However, infrastructure projects have an inherently long lead time before income is generated in the operational phase.

The risk of trapped losses is a significant factor in increasing project financing costs, and a major disincentive to infrastructure investment. The trapping of losses effectively increases the effective tax rate on the infrastructure project. This contrasts with the treatment of early life-cycle deductions of major mining projects, which are written off against current income as they are incurred or as capital is depreciated.

By exempting qualifying entities and projects from onerous loss recoupment rules, the incentives should remove this risk and reduce the project finance cost.

Uplift of carry forward tax loss

The first incentive allows the value of carry forward tax losses attributable to designated infrastructure projects to be uplifted by the 10 year Government bond rate at the relevant income year. The current Government bond rate is 5.75%. This incentive seeks to preserve the time value of tax losses given the long lead time before an infrastructure project moves from the construction phase to the operational phase.

Exemption from loss recoupment rules

The discussion paper recognises that most infrastructure investors are companies, trusts or both (i.e. stapled securities), so the second incentive will exempt relevant losses of such investors from the loss recoupment rules.

Tax losses can only be carried forward and utilised by a company in a future income year if the company passes either the continuity of ownership test (COT) or, failing that, the same business test (SBT). Broadly, the COT requires majority (that is, over 50%) continuity of ownership and control from the start of each loss year to the point

of testing, tracing through to the ultimate beneficial shareholder. If the COT is not passed, the SBT requires the taxpayer to have carried on the same business at all times throughout the relevant tests period as it did at the time that it last failed the COT.

Similarly, trust losses can generally only be recouped in a future tax year by a trust if the relevant tests are satisfied. In the case of a fixed trust, it must satisfy the 50% stake test, which is similar to the COT for companies. A non-fixed trust must satisfy the 50% stake test (if applicable), the pattern of distributions test and the control test. The SBT is not applicable to trusts unless they are widely held trusts. In practice, these tests can be difficult to satisfy.

This incentive will remove the risk of infrastructure losses getting trapped, thus reducing project financing costs and rectifying an inefficiency in the taxation of infrastructure projects.

Qualification for the incentives

The new incentive will apply to an entity or consolidated group whose sole business consists of an infrastructure project that is

designated of national significance and listed on Infrastructure Australia's National Priority List. A project will be listed if:

- the capital expenditure on the project exceeds \$100 million; or
- the project is a Regional Infrastructure Fund project, a flagship project or a project that demonstrates unique national interest qualities.

In determining which projects qualify, projects will be ranked within a global capital expenditure cap of \$25 billion over the period from commencement of the incentive to 30 June 2017. Once the cap is reached, no further projects will be added.

This incentive will be subject to integrity provisions. In particular, the new tax loss rules will stop applying where a qualifying entity carries on activities that are unrelated to the designated infrastructure project. Special rules will apply to losses of entities that join a consolidated group.

Submissions

RSM Bird Cameron can assist any interested parties with comments and submissions to Treasury as part of the consultation process. The closing date for submissions is 9 December 2011.

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