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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

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TAX LAWS AMENDMENT (2013 MEASURES No. 2) BILL 2013

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REVISED EXPLANATORY MEMORANDUM

(Circulated by the authority of the  
Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP)

THIS MEMORANDUM TAKES ACCOUNT OF AMENDMENTS MADE BY THE  
HOUSE OF REPRESENTATIVES TO THE BILL AS INTRODUCED

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## **Chapter 2**

# ***Tax loss incentive for designated infrastructure projects***

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### **Outline of chapter**

2.1 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to provide a tax incentive for entities that carry on a nationally significant infrastructure project that has been designated by the Infrastructure Coordinator (Coordinator).

2.2 The tax incentive:

- uplifts the value of such entities' carry forward tax losses by the long-term bond rate;
- exempts such entities that are companies from the continuity of ownership and same business tests; and
- exempts such entities that are fixed trusts from the trust loss and bad debt deduction tests.

2.3 All references to legislative provisions in this chapter are to the ITAA 1997, unless otherwise stated.

### **Context of amendments**

2.4 Investment in high quality infrastructure projects is critical to improving national productivity and underpinning economic growth. The Government is investing a record \$60 billion in nationally significant land transport infrastructure projects under the Nation Building Program.

2.5 Infrastructure projects often experience long lead times between incurring deductible expenditure in the construction phase and earning assessable income in the operational phase. Tax losses are therefore accumulated and carried forward to later income years awaiting the receipt of income.

2.6 As such, the present value of losses may be eroded over time, disadvantaging infrastructure investment compared to other types of investment.

2.7 Furthermore, infrastructure projects may move through a number of phases as they move from the construction phase to the operational phase, and the entity may have different owners as it moves through its different phases.

2.8 These changes could result in the entity no longer being able to use its tax losses to offset against future income, eroding the value of the losses altogether. Broadly, existing integrity rules in the income tax laws only allow the use of past tax losses where an entity maintains the same majority ownership (the continuity of ownership test) or is carrying on the same business (the same business test).

2.9 This measure will encourage private investment in nationally significant infrastructure projects by:

- ensuring that investors are not discouraged from investing in infrastructure because of the reduction in the present value of losses over time; and
- increasing the likelihood that the losses can be used to offset future earnings and benefit investors in the project, whether the original investors or new investors in the project.

## **Summary of new law**

2.10 This Schedule allows an entity that is carried on exclusively for the purpose of a 'designated infrastructure project' (DIP) to:

- uplift tax losses by the long-term government bond rate; and
- carry forward tax losses and claim bad debt deductions even though it does not satisfy the continuity of ownership and same business tests for companies and equivalent tests for trusts.

2.11 This Schedule allows the Coordinator to designate an infrastructure project of national significance to be a DIP on or before 30 June 2017 where:

- the project satisfies any requirements prescribed by the Minister; or
- if there are no prescribed requirements:
  - the project must be nationally significant; and

- the financing arrangements for the project must have been made or be imminent.

2.12 The Coordinator can only designate a project if the total capital expenditure of all designated projects (including provisionally designated projects) would not exceed \$25 billion (or a higher prescribed amount).

### **Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
<p>A company or fixed trust that solely carries on a single project designated by the Coordinator as a DIP can utilise prior year losses and deduct bad debts without needing to satisfy the continuity of ownership (including the 50 per cent stake test for trusts), the control test or same business test (if applicable).</p> <p>The Coordinator may designate a project as a DIP in prescribed circumstances or, if none are prescribed, where it is nationally significant and financial close has happened or is imminent and granting the project DIP status will not cause the estimated global expenditure cap to be exceeded.</p>	<p>An entity must satisfy a continuity of ownership test (including the 50 per cent stake test for trusts) or the same business test (if applicable) before it can utilise losses from past years or deduct bad debts.</p>
<p>The value of losses carried forward by an entity is uplifted by the long-term Government bond rate if the entity solely carries on a single DIP.</p>	<p>The value of carried forward losses is based on their nominal value.</p>

### **Detailed explanation of new law**

2.13 This Schedule allows an entity that is carried on exclusively for the purpose of a DIP to:

- uplift tax losses by the long-term government bond rate (paragraphs 2.15 to 2.30); and
- carry forward tax losses and claim bad debt deductions even though it does not satisfy the continuity of ownership and

same business tests for companies and equivalent tests for trusts (paragraphs 2.31 to 2.69).

2.14 These concessions are available to certain entities known as DIP entities (paragraphs 2.70 to 2.76). A DIP entity must carry on a project that has been designated by the Coordinator as a DIP (paragraphs 2.77 to 2.100). The Coordinator can only designate projects up to a certain capital expenditure cap (paragraphs 2.101 to 2.110).

### **Tax benefits for designated infrastructure project entities**

2.15 Companies and fixed trusts that carry on a DIP are able to uplift their tax losses from earlier years. These companies can also deduct those tax losses and their bad debts even if they do not satisfy the ‘continuity of ownership’ and ‘same business’ tests. These trusts can also deduct their tax losses and bad debts even if they do not satisfy the trust equivalent of those tests.

#### ***Uplifting losses***

2.16 A company or a fixed trust that is a DIP entity in an income year uplifts its unutilised tax losses from the 2012-13 and later income years before deducting them. *[Schedule 2, items 4, 47 and 48, subsection 415-15(1), paragraph 415-20(1)(a) and section 415-10 of the Income Tax (Transitional Provisions) Act 1997]*

2.17 Losses are ‘utilised’ when they are deducted against assessable income or exempt income (see subsection 707-110(2)). For the purposes of this measure, they are also utilised when the amount of forgiven commercial debts is applied to reduce them. *[Schedule 2, item 4, subsection 415-15(6)]*

2.18 This measure is intended to promote investment in *new* infrastructure. As such, the uplift is not available for losses incurred before the 2012-13 income year or for projects that commenced before making an application for designation. *[Schedule 2, items 4, 47 and 48, subsection 415-55(1) and section 415-10 of the Income Tax (Transitional Provisions) Act 1997]*

2.19 An entity will not be a DIP entity and will therefore not be able to uplift its losses if it carries on activities that are not for the purpose of the DIP. This single entity — single project approach is simpler for entities because they will not have some losses that are able to be uplifted and some that are not. *[Schedule 2, item 4, paragraphs 415-20(1)(b), (c) and (d)]*

2.20 An entity may qualify as a DIP entity when the project has not yet been designated, or the entity has not yet begun carrying on the

project, as long as the project becomes designated and the entity begins carrying it on. That means that an entity is able to uplift losses in relation to past years once it has qualified as a DIP entity. These entities would not need their past assessments amended (unless they have already utilised some of the losses), but should notify the Australian Taxation Office of the revised carry forward amounts. *[Schedule 2, item 4, paragraphs 415-20(1)(b) and (2)(a)]*

2.21 Those losses will continue being uplifted in future years until the entity either fully deducts them or stops being a DIP entity. After the entity stops being a DIP entity, the previous uplifts are retained; they are just not uplifted further. *[Schedule 2, items 39 and 40, subsection 995-1(1) paragraphs (a) and (d) of the definition of tax loss]*

2.22 The losses are uplifted by the income year's long-term bond rate, which is the year's average yield for 10-year non-rebate Australian Treasury bonds. This rate is chosen, rather than, say, the Consumer Price Index rate, to compensate the infrastructure entity for the cost of not being able to invest the tax saved from its loss in the most profitable investment available, adjusted for risk. In other words, the treatment is equivalent to the entity lending the money represented by the tax loss to the government for a long term. *[Schedule 2, item 4, subsection 415-15(1)]*

### **Example 2.1: Uplifting tax losses**

Wolf Transport Projects carries on a project that is designated as a DIP on 1 January 2016. The entity has no other business activities and qualifies as a DIP entity. The entity first incurred a loss of \$6 million in the 2013-14 income year.

In the 2014-15 income year it made a small profit that utilised \$1.5 million of its 2013-14 tax loss. The long term bond rate for 2014-15 is 5.5 per cent.

In the 2015-16 income year, the entity makes a loss of \$76 million and the long term bond rate is 5.8 per cent.

Wolf Transport Projects calculates its carry forward loss from the 2013-14 income year by uplifting it for the 2014-15 income year and then reducing it by the utilised amount (that is,  $\$6 \text{ million} \times 1.055 - \$1.5 \text{ million} = \$4,830,000$ ). The unutilised portion is then uplifted again for the 2015-16 income year ( $\$4,830,000 \times 1.058 = \$5,110,140$ ).

The 2015-16 loss was only incurred that year and so is not uplifted. The unutilised losses of \$5,110,140 and \$76 million will be uplifted before being applied against any taxable income and any net exempt income in the next income year.

2.23 If an entity is a DIP entity only for part of an income year in which the uplift occurs, the uplift is apportioned according to the number of days in the year for which it was such an entity. [*Schedule 2, item 4, subsection 415-15(1)*]

**Example 2.2: Apportioning the uplift**

In the previous example, if Wolf Transport Projects was only a DIP entity for 100 days during 2015-16, the uplift is adjusted according to the eligible portion of the income year ( $\$4,830,000 \times 0.058 \times 100/366 = \$76,541$ ), so the uplifted amount is  $\$4,906,541 (= \$76,541 + 4,830,000)$ .

***The uplift and consolidated groups***

2.24 When an entity joins a consolidated group, the part of the income year that ends just before the entity joins (the non-membership period) is usually treated as a whole income year (paragraph 701-30(3)(a)). The provisions ensure that a joining entity cannot get a full year's uplift for only part of an income year. Instead, the joining entity must pro rata the uplift as though it was only a DIP entity for that part (the non-membership period) of the income year. [*Schedule 2, item 4, subsection 415-15(4)*]

2.25 Usually, losses transferred from a joining entity to a head company are treated as being incurred by the head company in the transfer year (section 707-140). If this rule applied, then the head company would not be able to uplift losses in the transfer year even though the joining entity would have been able to uplift them if it had not joined the consolidated group. To avoid that, this measure allows the head company to treat previous years losses transferred from the joining entity as prior year losses. [*Schedule 2, item 4, subsection 415-15(5)*]

2.26 However, the head company must also apportion the uplift so that the transferred loss is only uplifted for the part of the income year after the transfer occurs. [*Schedule 2, item 4, paragraph 415-10(5)(b)*]

**Example 2.3: Tax losses transferred to the head company of a consolidated group**

Joseph Co (a DIP entity) is the head company of a consolidated group ('the Joseph Co consolidated group'). Alan Co is a DIP entity in relation to the same project as Joseph Co. On 1 January 2015 Alan Co becomes a member of the Joseph Co consolidated group.

In the 2013-14 income year, Alan Co made a tax loss of \$10 million and in the period from 1 July 2014 to 31 December 2014 (its non-membership period), it made a tax loss of \$4 million.

In the 2014-15 income year, the long-term bond rate is 5.5 per cent.

Alan Co uplifts its 2013-14 loss at the end of its non-membership period (which is treated as an income year). The uplift is pro-rated having regard to the number of days in the non-membership period.

The uplift is calculated as

$$\$10 \text{ million} \times 5.5\% \times 184/365 = \$277,260.$$

Therefore, when Alan Co becomes a member of the Joseph Co consolidated group, the following tax losses are transferred (noting that their subsequent utilisation by Joseph Co will not be subject to an available fraction):

- \$10,277,260 (from the 2013-2014 income year)
- \$4 million (from the non-membership period ending on 31 December 2014).

#### **Example 2.4: Subsequent uplift of transferred tax loss**

Continuing the previous example, at the end of the 2014-15 income year, Joseph Co (which remains a designated infrastructure project entity), uplifts the transferred tax loss actually made by Alan Co in the 2013-14 income year. The uplift is pro-rated having regard to the number of days from the time the loss is transferred. The uplift is calculated as  $\$10,277,260 \times 5.5\% \times 181/365 = 280,302$ .

The tax loss is increased to \$10,557,562 (before any utilisation in the 2014-15 income year).

The transferred tax loss of \$4 million was actually made by Alan Co in its non-membership period just before the transfer to Joseph Co. Therefore Joseph Co does not uplift this transferred loss at the end of the 2014-15 income year.

Joseph Co does not have any net exempt income or taxable income in the 2014-15 income year. The unutilised transferred tax losses from Alan Co of \$10,557,562 and \$4 million are carried forward and will be uplifted at the end of the 2015-16 income year before any utilisation of the losses in that year.

Any group losses made by Joseph Co have been ignored in this example in order to illustrate how the transferred tax losses are uplifted when the joining entity joins partway through the income year of the head company.

#### ***Notifying the Commissioner***

2.27 In order to access the uplift, the entity must notify the Commissioner of Taxation (Commissioner), in the approved form, that it

is a DIP entity. There are a number of things that must happen before an entity will know that it is a DIP entity and these things may happen in a different order depending on the particular circumstances. The day that notice must be provided by accommodate these different circumstances. The entity will be able to access the uplift as long as it provides notice before the latest day listed. *[Schedule 2, item 4, subsections 415-15(2) and (3)]*

2.28 Notice will generally be due by the time the entity first lodges a tax return seeking to uplift a loss. If the entity was not required to lodge a tax return then the entity must notify the Commissioner by the time it would have been required to lodge it. However, if the entity does not receive notification that a project has been designated as a DIP until after it lodged its tax return with the Commissioner, notice may be provided up to 28 days after the project has been designated as a DIP. *[Schedule 2, item 4, subsection 415-15(2) and paragraphs 415-15(3)(a) and (c)]*

2.29 In addition, an entity cannot be sure that it is eligible for the uplift until it commences carrying on activities for the purposes of the DIP. As such, if there is a gap between the entity incurring costs, in relation to applying for designation for example, and commencing carrying on activities in relation to the DIP, notice does not need to be provided until up to 28 days after the activities have commenced. *[Schedule 2, item 4, paragraph 415-15(3)(b)]*

2.30 In addition, the Commissioner may allow the notice to be lodged at a later time. *[Schedule 2, item 4, subsection 415-15(2) and paragraph 415-15(3)(d)]*

### ***Utilising past losses***

#### *Continuity of ownership test*

2.31 Companies are normally prevented from deducting a tax loss for an income year if they have not maintained a sufficient continuity of ownership from the start of the year the loss arose until the end of the year they want to deduct it. There will be a sufficient continuity of ownership if the same persons hold more than 50 per cent of the voting power in the company, and rights to more than 50 per cent of its dividends and capital distributions, throughout that period.

2.32 The amendments ensure that a DIP entity does not have to satisfy this test in order to deduct its tax losses from the 2012-13 and later income years as long as it remains a DIP entity. *[Schedule 2, items 4 and 47, subsection 415-35(3) and paragraph 415-10(a) of the Income Tax (Transitional Provisions) Act 1997]*

2.33 The amendments also do this by adjusting the test period used to work out whether the company has failed the continuity of ownership test.

Instead of the period running from the start of the loss year until the end of the deduction income year, the period runs from:

- the first time in or after the loss year that the company stopped being a DIP entity; or
- the end of the deduction year if it has not stopped being such an entity.

In either case, the period ends at the end of the deduction year. [*Schedule 2, item 4, subsection 415-35(2)*]

2.34 In the first case, the entity would only fail the continuity of ownership test if there was the necessary 50 per cent or greater change in rights *after* the entity stopped being a DIP entity. Changes before that time would be ignored.

2.35 In the second case, the test period would start and stop at the same moment, so the continuity of ownership test would always be passed. [*Schedule 2, item 4, subsections 415-35(2) and (3)*]

#### **Example 2.5: Adjusted continuity of ownership test period**

Brine Enterprises Pty Ltd (Brine), a DIP entity has carry forward losses from the 2013-14 income year. On 15 May 2014, the shareholders of Brine sell all their shares. Brine seeks to utilise some of the uplifted losses (after applying the uplift) at the end of the 2014-15 income year.

Brine would normally have failed the continuity of ownership test in 2014-15 because there was not a 50 per cent or greater maintenance in continuity of interest from the start of the loss years until the end of 2014-15. However, because it was a DIP entity, the test period collapses into a single point at the end of 2014-15 and Brine is deemed to satisfy the continuity of ownership test.

On 9 November 2015, Brine stops being a DIP entity. On 15 January 2016, the shareholders sell a 60 per cent stake in Brine.

In 2015-16, Brine again seeks to utilise some of the unutilised losses. Brine stopped being a DIP entity on 9 November 2015, so the ownership test period runs from that day until the end of 2015-16 (30 June 2016). Since there was a 60 per cent change in ownership during that reduced test period, Brine fails the continuity of ownership test in 2015-16 and can only utilise the losses if the same business test is satisfied.

2.36 Widely held companies and eligible Division 166 companies (companies in which more than a 50 per cent interest is held, directly or indirectly, by widely held companies, non-profit companies, charities, or

complying superannuation funds and similar entities) apply the continuity of ownership test in a modified way. Division 166 makes it easier for them to pass the test by only testing for continuity of ownership at the start of the loss year, at the end of each year up to the end of the deduction income year, and at each intervening time there is a substantial corporate change. Unlike other companies, these companies do not have to test for all intervening points.

2.37 The measure adjusts the start of the test period for these companies if they are DIP entities in the same way it adjusts it for other companies that are DIP entities. [*Schedule 2, item 4, subsection 415-35(2)*]

*Same business test*

2.38 If a company does not satisfy the continuity of ownership test or it is not practicable to demonstrate that the company meets the continuity of ownership test, it may still be able to deduct the tax loss if it passes the same business test by carrying on the same business throughout the deduction income year that it carried on just before it failed the continuity of ownership test.

2.39 The measure also adjusts the period used to test whether the company passes the same business test if it stopped being a DIP entity in the deduction year. Instead of testing for the whole of the deduction year, a company only has to test for the part of the year that it was not a DIP entity until the end of the income year in which it seeks to utilise the loss. It needs to be carrying on the same business that it carried on just before it stopped being a DIP entity if that time is later than the test time would otherwise occur. [*Schedule 2, item 4, subsections 415-35(4) and (5)*]

**Example 2.6: Same business test**

Following on from the previous example, to satisfy the same business test, Brine would need to show that it carried on the same business for the period from when it stopped being a DIP entity to the end of the income year (the same business test period) because, apart from the modification, the test would apply from an earlier time (the start of the income year). This business would need to be the same as the business carried on just before the ownership change on 15 January 2016 (the test time) because, apart from the modification, the test times would be just before the ownership change on 15 May 2014. So Brine would need to carry on the same business during the period 9 November 2015 to 30 June 2016 as it carried on just before the ownership change on 15 January 2016.

*Special control test*

2.40 Even if a company passes the continuity of ownership test or the same business test, it still might not be able to deduct a tax loss if

someone who did not, and could not, directly or indirectly control the voting power in the company during the loss year began to so control it, or became able to control it on or after the end of the loss year for the purpose of getting an income tax benefit (subsection 165-15(1)). In such a case, the entity must satisfy a modified same business test in order to deduct the loss (subsections 165-15(2) and (3)).

2.41 This special control test will also be reduced to a single point in time where the entity stays a DIP entity from the loss year to the end of the deduction year. In these circumstances the test will always be satisfied. [*Schedule 2, item 4, subsection 415-35(6)*]

2.42 Where the entity stops being a DIP entity between the loss year and the deduction year then not only are the ownership test period, same business test period and test times modified, but the loss year is also treated as modified to ensure that the test applies in relation to losses incurred while it was a DIP entity after it stops being a DIP entity. In particular, the loss year is treated as starting after the entity stopped being a DIP entity and as ending at the end of that income year. [*Schedule 2, item 4, subsections 415-35(4) to (6)*]

#### *Application of tests during year of ownership change*

2.43 The income tax law provides special rules for working out the taxable income or loss of a company that changes ownership during the income year. That year is divided into periods, each of which ends when there is a sufficient change of ownership. Broadly, the loss or gain for each period is worked out as if the period was a separate income year (but periods are treated as a single period if the same business is carried on throughout those periods). The company's taxable income for the year does not include deductions for the tax losses of any of those periods (see Subdivision 165-B).

2.44 However, if the company is a DIP entity from the start of that year, the first period cannot end before the company stops being a DIP entity. If it does not stop being such an entity during the year, the year would be treated as a single period and the normal rules would apply to work out its taxable income. [*Schedule 2, items 2 to 4, paragraphs 165-35(b) and (c), and subsection 415-35(7)*]

#### **Example 2.7: Application of tests during year of ownership change**

Tiny Town Pty Ltd is a DIP entity from the start of the income year (1 July 2013) to 10 April 2014. During the income year, Tiny Town changes ownership on 12 August 2013, 10 December 2013, and 5 June 2014. Tiny Town would need to divide its year up into parts and apply the continuity of ownership test (COT) and same business test (SBT) to each of those. The first period would start on 1 July 2013

and would end on 5 June 2014 and the second period would go from 6 June to 30 June 2014.

*Company losses and income injection*

2.45 The tax law includes anti-avoidance provisions that allow the Commissioner to disallow deductions for losses against income that the company would not have received but for a tax benefit unless the company satisfies the same business test or the benefit is received by the shareholders that allowed the entity to satisfy the continuity of ownership test (see Subdivision 175-A). This measure does not adjust those rules for DIP entities. *[Schedule 2, item 4, subsection 415-35(8)]*

*Capital losses and companies*

2.46 Rules similar to the rules for tax losses apply to the use of net capital losses by a company when there is a sufficient change in its ownership (see Subdivisions 165-CA, 165-CB and 175-CA). This measure only provides concessions in relation to tax losses and does not adjust those rules for DIP entities. *[Schedule 2, item 4, subsection 415-35(8)]*

***Deducting bad debts***

2.47 A taxpayer that derives an amount of assessable income because a debt is owed to the taxpayer can generally claim a deduction if it is unable to collect the amount it is owed. This deduction for a ‘bad debt’ reverses the original inclusion of the amount in the taxpayer’s assessable income. However, a company can only get the deduction if it satisfies continuity of ownership and same business tests similar to those that apply for deducting its tax losses.

2.48 If the debt goes bad in the same year the amount was derived, the company must satisfy the continuity of ownership test for the whole year. If the amount was derived in an earlier year, it must satisfy the test from the time the amount was derived until the end of the deduction year. If it fails that continuity of ownership test (or cannot work out if it can satisfy the continuity of ownership test), it can still deduct the bad debt if it satisfies the same business test. (See Subdivision 165-C.)

2.49 The measure provides that an entity that was a DIP entity when it derived the original amount does not normally have to satisfy this test in order to deduct its bad debts for so long as it remains a DIP entity. It does that by adjusting the rules that limit a company’s capacity to deduct a bad debt in a similar way to the way it adjusts its capacity to deduct tax losses. *[Schedule 2, item 4, section 415-40]*

2.50 For the purposes of the continuity of ownership test, the start of the test period is delayed until the company stops being a DIP entity. If it

has not stopped being such an entity, the start of the test period merges with the end of the deduction income year, so that the test is passed.

*[Schedule 2, item 4, subsections 415-40(2) and (3)]*

2.51 For the purposes of the same business test, the same business test period and test time are modified so that they cannot commence until the entity stopped being a DIP entity. The same business test period and the test time have their normal application if they would not otherwise overlap with a period when the entity was a DIP entity. *[Schedule 2, item 4, subsections 415-40(4) and (5)]*

### **Example 2.8: Bad debts and the same business test**

Roary Co is a DIP entity for the 2013-14 income year.

On 30 June 2013, Roary Co included an amount of \$1 million in its assessable income that was owed to it by another entity, Lightning Trust. On 15 July 2014, Roary Co included an amount of \$2 million in its assessable income that is owed to it by Lightning Trust.

On 10 December 2014 Roary Co stops being a DIP entity.

On 12 December Roary Co has a change of ownership.

On 20 December 2014, Roary Co includes an amount of \$4 million in its assessable income because of a debt owed by Lightning Trust.

Lightning Trust subsequently becomes bankrupt and Roary Co writes the three debts owed to it off on 30 June 2015.

In relation to the \$1 million and \$2 million debts, Roary Co must demonstrate that it carried on the same business during the period from 10 December 2014 to 30 June 2015 as it carried on just before the change of ownership on 12 December 2014.

In relation to the \$4 million debt, Roary needs to show that it carried on the same business in the period from when it stopped being a DIP entity on 10 December 2014 to the end of the income year as it carried on just before the change of ownership on 12 December 2014.

2.52 If a company deducts a bad debt only because it passes the same business test, and that deduction creates or increases a tax loss, then the tax loss (or the increase) can only be deducted in a later year if the company passes the same business test again for that later year (see section 165-132). The measure adjusts the test period used for that purpose in the same way. *[Schedule 2, item 4, subsection 415-40(4)]*

### **Example 2.9: Bad debts that become losses**

Following on from the previous example, Roary Co made a loss of \$6 million in the 2014-15 income year as a result of the bad debt deductions. Roary Co seeks to utilise some of those losses in the 2015-16 income year. Roary Co must show that it carried on the same business during the 2015-16 income year that it

carried on just before the change of ownership on 12 December 2014 before it can utilise the losses.

2.53 The operation of the continuity of ownership test and the same business test for widely held companies and eligible Division 166 companies, which is modified for DIP entities that are deducting a tax loss, is modified in the same way if they seek to deduct a bad debt. *[Schedule 2, item 4, subsections 415-40(2), (4) and (5)]*

2.54 Companies that are DIP entities are still subject to the integrity rules in Subdivision 175-C. These rules allow the Commissioner to disallow a deduction for a debt if income was injected in to the company that would not have been injected if the deduction was not available. *[Schedule 2, item 4, subsection 415-40(8)]*

*Bad debts and the special control test*

2.55 The special control test that can prevent a company deducting a tax loss even if it passes the continuity of ownership test or the same business test also applies for a company deducting bad debts (see section 165-129). The special control test usually looks at whether the people who controlled the voting power in the company, either when the debt was incurred (if the debt was incurred in the deduction year) or at the end of the year the debt was incurred (if it was incurred in an earlier year), also control it at the end of the deduction year.

2.56 This test is modified to ensure that the test is always satisfied if the entity is a DIP entity from when the debt is incurred until the deduction year. However, it is also modified to ensure that it will begin to apply to an entity that stops being a DIP entity before the deduction year. In such a case, the special control test can prevent the entity from deducting the debt if the people that control the entity at the end of the income year did not control it immediately after it stopped being a DIP entity. *[Schedule 2, item 4, subsection 415-40(6)]*

2.57 If the entity did not have the same controllers it may still be able to deduct the debt if it carries on the same business at the end of the deduction year (or the whole deduction year if the debt was incurred in an earlier year) as it was carrying on either just before the person started to control the entity or just before the entity stopped being a DIP entity, whichever is earlier. *[Schedule 2, item 4, subsections 415-40(2) and (3)]*

2.58 The tax law also has anti-avoidance provisions which permit the Commissioner to disallow a deduction for a bad debt if it is to be used against a capital gain or income that the company would not have derived if the deduction, loss or net capital loss was not available or where there was a scheme to receive a tax benefit (Division 175). The Commissioner

cannot disallow the deduction where the company satisfies the same business test. These income injection tests continue to apply to DIP entities. *[Schedule 2, item 4, subsection 415-35(8)]*

### ***Tax losses and bad debts of trusts***

2.59 Trusts that are not ‘excepted trusts’ for the whole income year also need to pass certain tests relating to ownership and control or abnormal trading in its units set out in Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936) before deducting prior year losses and debt deductions. The measure ensures that a DIP entity that is a trust does not need to satisfy these tests by making the entity an ‘excepted trust’. *[Schedule 2, item 1, section 272-100 in Schedule 2F to the ITAA 1936]*

2.60 However, a trust may stop being a DIP entity because, for example, it has stopped being a fixed trust, has stopped carrying on a DIP or has commenced other activities. If a trust stops being a DIP entity during the income year, then it will need to satisfy the tests relating to continuity of ownership (the ‘50 per cent stake test’) or abnormal trading in its units because it is not an excepted trust for the whole income year.

2.61 These tests are modified in a similar way to the modifications to the tests for companies. That is, generally, the test period starts just after the entity stops being a DIP entity. The test period is not changed if it would usually start after the entity stopped being a DIP entity. For example, if the test period was in the year after the entity stopped being a DIP entity because the loss was incurred in a later year. *[Schedule 2, item 4, sections 415-25 and 415-30]*

## **Consolidated groups**

2.62 The head company of a consolidated group may be a DIP entity only if none of the members of the consolidated group carries on, or has ever carried on, activities that do not relate to the same DIP. *[Schedule 2, item 4, subsection 415-20(1)]*

2.63 When an entity joins a consolidated group the head company is usually taken as having done everything that the joining member did at that time (see section 701-5). That means that, usually, activities done by the joining entity before it joined the group would affect whether the head company was a DIP entity in those years (that is, before the entity joined the group).

2.64 This measure ensures that the activities carried on by a joining member before it joined the group do not stop the head company from being a DIP entity before the entity joined the group. However, consistent with the policy that the entity has only ever engaged in activities that

relate to a single DIP, the head company will stop being a DIP entity from the joining time if the joining entity carried on activities that did not relate to the head company's DIP. The head company will not stop being a DIP entity if the joining entity has only carried on activities that relate to the same DIP as the head company. [Schedule 2, item 4, subsection 415-20(5)]

2.65 When an entity joins a consolidated group it generally transfers its tax losses, film losses and net capital losses to the group's head company but only to the extent that the joining entity could have used the loss itself if its income year had ended just after the joining time (and assuming it had enough income or gains against which to offset the loss).

2.66 Under the consolidation rules, it is possible for the head company to choose to cancel the transfer of a loss. A loss that is not transferred to the head company cannot be utilised by any entity for an income year ending after the joining time.

2.67 If a DIP entity joins a consolidated group then the joining entity's tax losses (including any uplifted amount) can be transferred to the head company without having to consider whether the joining entity could otherwise have used the losses itself. [Schedule 2, items 5 and 6, subsections 707-120(5) and 719-265(3A)]

2.68 The fact that a non-fixed trust joins a consolidated group will also not stop the head company from being a DIP entity provided that the trust has only carried on activities in relation to the same DIP. However, any losses of the trust will be subject to the ordinary transfer rules. As such, they can only be uplifted from the joining time and the head company will only be able to use the losses to the extent that the trust could otherwise have used the losses itself.

2.69 An entity that leaves a consolidated group can be a DIP entity even though it carried on activities that did not relate to the entity's DIP while it was a member of the consolidated group. Activities carried on by other members of the consolidated group will also not affect whether the leaving entity can be a DIP entity. [Schedule 2, item 4, subsection 415-20(6)]

### **What is a designated infrastructure project entity?**

2.70 A company or a fixed trust can be a **designated infrastructure project entity** (a DIP entity) if it carries on, or later begins to carry on, a single DIP. [Schedule 2, item 4, paragraphs 415-20(1)(a) and (b)]

2.71 The project does not need to have been designated at the time the entity engages in activities in relation to it as long as the project becomes designated. This ensures that an entity can access the uplift, for example, in relation to deductible expenses incurred in applying for

designation. However, designation can only apply in relation to a *proposed* project (that is, a project that has not yet commenced). This ensures that the tax concessions are only available for new projects.

*[Schedule 2, item 4, paragraph 415-20(2)(a) and subsection 415-55(1)]*

2.72 Each DIP entity can only carry on one single DIP. This is consistent with industry practice in which entities that carry on a DIP are generally special purposes vehicles set up to carry on a single project, and offers greater simplicity for taxpayers. However, some projects are conducted in stages. An entity may carry on more than one stage of a single infrastructure project that is listed on an Infrastructure Priority List made under paragraph 5(2)(b) of the *Infrastructure Australia Act 2008*.

*[Schedule 2, item 4, paragraphs 415-20(2)(b), (c) and (d)]*

### **Example 2.10: Single projects**

A motorway between two major cities is placed on an Infrastructure Priority List in July 2013. Road Co successfully tenders to construct the regional city bypass stage of the motorway in September 2013. The bypass stage of the motorway is then designated by the Coordinator as a DIP. Road Co engages Bridge Co to build a bridge in relation to the bypass. Bridge Co and Road Co are each carrying on part of a DIP.

After completing the regional city bypass, Road Co commences work on another stage of the motorway: the road joining the bypass to one of the major cities. This stage of the project is also designated as a DIP. Because the bypass and the road are both part of the motorway, which is listed on an Infrastructure Priority List, they will be treated as a single project and Road Co can still be a DIP entity as long as it does not carry on any other activities.

2.73 To ensure that the entity is not able to benefit from the uplift and modifications to the loss utilisation rules for activities that do not relate to the DIP, an entity cannot be a DIP entity if it has previously carried on activities that do not relate to the single DIP and the entity will stop being a DIP entity as soon as it starts carrying on other activities. *[Schedule 2, item 4, paragraph 415-20(1)(d)]*

2.74 This restriction reflects the fact that the concessional treatment of the entity's losses is only intended to encourage investment in infrastructure projects. If the entity were able to carry on other activities, it would be necessary to partition the entity's tax affairs into an infrastructure component and a residual component. That would create additional complexity and increase compliance costs, which is avoided by the 'single activity' approach. It would also be risky for the DIP entity because, if an entity could carry on more than one project and one project stopped being a DIP, then the entity would lose its access to the tax concessions. The chosen approach is also consistent with usual industry

practice in which infrastructure projects are typically conducted by special purpose vehicles.

2.75 Exactly what activities the entity can engage in will depend on the scope of the project designated by the Coordinator. The Coordinator may amend a designation in accordance with the infrastructure project designation rules. The Coordinator may make the amendment take effect retrospectively, for example where the applicant had assumed that the activities would be seen as carrying on the project and the Coordinator agrees. Alternatively, it may apply prospectively, for example, where the project needs to be carried on in a different way because of an unexpected change of circumstances. [*Schedule 2, item 4, subsections 415-65(3) and (4), and 415-70(4) to (6)*]

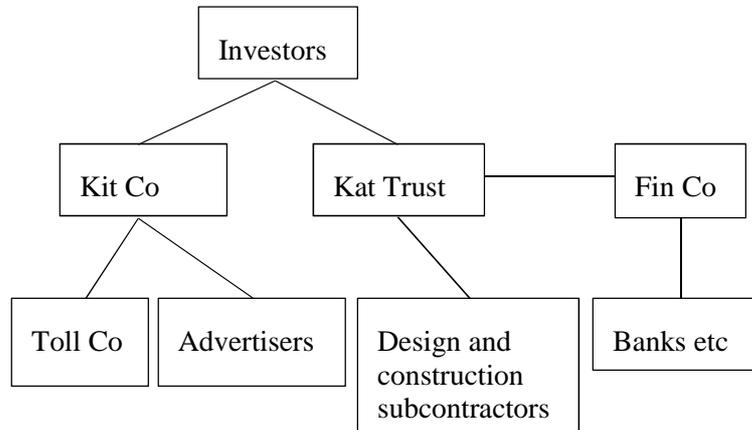
### **Example 2.11: Designated infrastructure project entities**

The Victorian State Government has applied for a major upgrade to an Interstate Highway to be designated as a DIP. The Coordinator provisionally designates the Interstate Highway Project. Kit Co successfully tenders for the project and applies to the Coordinator to finally designate the project. The Coordinator designates the project as set out in Kit Co's application for designation, including the design, construction, project management, holding assets for use in the design and construction of the upgrade to the Interstate Highway, financing through a related special purpose finance entity that will borrow money from a syndicate of third party banks, generating revenue through advertising along the road and operation and maintenance of the upgrade to the Interstate Highway as a designated infrastructure project.

Kit Co is responsible for the project management. Kit Co has secured finance from a number of lenders, including the Victorian Government and Farmer's Bank. Kit Co arranges for the loans to be made to a special purposes vehicle, Fin Co, which is set up to manage finance for the project, including applying for loans and on-lending to entities in the group and managing ongoing compliance with the requirements of the lenders under relevant facility documents (which Fin Co may arrange to be undertaken through the appointment of powers of attorney to other group entities). From time to time, Fin Co receives interest on the monies it holds prior to on lending the funds. Earning interest, while not a specifically listed activity in the project description, is incidental to the project's finance activities. Fin Co lends money to Kat Trust, which is stapled to Kit Co, to construct or purchase assets for the project and to lease them to Kit Co for the purpose of carrying on the project. During the course of the project, Kat Trust also engages a number of subcontractors to design and construct the project.

Kit Co earns revenue from the collection of tolls and engages Toll Co to collect tolls as agent on Kit Co's behalf. Kit Co also enters into a

subcontract with Toll Co to operate and maintain the road. Kit Co earns income to partially fund its operating activities by placing advertising billboards on the side of the road.



Kit Co and Kat Trust will both be DIP entities (as long as they do not carry on any other activities) because they are each carrying on the project as designated by the Coordinator, that is (1) the project management, operation and maintenance, and (2) the design and construction, and holding and leasing of assets respectively. The fact that Kit Co earns income from advertising along the road does not prevent it from being a DIP entity because that activity has been designated by the Coordinator as being a relevant activity in carrying on the project (as set out in the business case put forward in Kit Co's application for designation). The entities that pay Kit Co to advertise their products, however, will not be DIP entities because they are not carrying on the project or a part of it as designated by the Coordinator.

Fin Co will also be a DIP entity as Fin Co's activities amount to carrying on the project as designated by the Coordinator. In particular, it is a special purpose vehicle established to source project finance for the group and to manage ongoing finance obligations. The fact that Fin Co may do so through the appointment of powers of attorney to other group entities does not affect this position.

The shareholders of Kit Co and unitholders of Kat Trust, who are also effectively providing finance for the project, do not qualify as DIP entities because they are not carrying on the DIP as designated by the Coordinator. The mere holding of shares/units is not carrying on an activity for the purposes of the project.

The banks that lend to Fin Co are also not DIP entities because they are not carrying on the DIP as designated by the Coordinator.

Whether the design and construction subcontractor qualifies as a DIP entity will depend on whether the subcontractor carries on the project

or part of the project or is merely acting as agent for Kit Co (in addition, it could only be a DIP entity provided it is not carrying on, and has not carried on, other activities).

Toll Co will be a DIP entity, as it delivers project operation and maintenance services as subcontractor to Kit Co, provided it does not carry on, and has not carried on, other activities. The mere collection of tolls as agent on behalf of Kit Co would not itself qualify Toll Co as a DIP entity because those are legally the activities of Kit Co.

The Victorian State Government will not qualify as a DIP entity even if it is operating through a government enterprise that is a company or fixed trust because it carries on other activities and would not benefit from the concessions in any case.

### *Partnerships*

2.76 Partnerships are not legal entities and do not have carry forward losses. As such, they cannot benefit directly from the measure. However, the measure allows the partners in a partnership to be treated as DIP entities if they can satisfy the criteria for being a DIP entity after the activities of the partnership are attributed to them in their own right. That is, the partner must be a company or fixed trust, must carry on a DIP and must not engage in any other activities. The fact that one of the other partners is not a DIP entity (because it engaged in other activities or is not a company or fixed trust) will not prevent the other partners from being DIP entities. The draft legislation ensures that the carrying on of the DIP is attributed to the individual partners. *[Schedule 2, item 4, subsections 415-20(3) and (4)]*

## **Designated infrastructure projects**

2.77 A ***designated infrastructure project*** is an investment in, or enhancement to, infrastructure that is designated by the Coordinator. *[Schedule 2, items 4 and 35, section 415-70 and subsection 995-1(1)]*

2.78 The Coordinator is a statutory office created by section 27 of the *Infrastructure Australia Act 2008*.

### ***The designation process***

#### *Applications*

2.79 An entity must apply to the Coordinator to have a proposed infrastructure project designated. The application must:

- be in the form the Coordinator requires;

- be accompanied by any fee that has been prescribed; and
- include an estimate of the infrastructure project's capital expenditure.

*[Schedule 2, item 4, subsections 415-55(1), (2) and (4)]*

2.80 The Coordinator may designate projects as provisional or final DIPs before 1 July 2017 unless a later date is prescribed. This reflects that the measure is only intended to be a short term encouragement for infrastructure investments. *[Schedule 2, item 4, subsection 415-60(5)]*

2.81 The Coordinator will consider applications in the order prescribed or, if no rules are made for provisional designation, the order in which the applications are made. The rules may prescribe other requirements for dealing with applications, such as how quickly applications must be dealt with and how incomplete or otherwise inadequate applications should be dealt with. *[Schedule 2, item 4, subsections 415-60(1), (2) and (4)]*

2.82 The designation process would normally involve two stages: provisional designation if the project satisfies the necessary conditions; and final designation if the project continues to satisfy the conditions and financial close on it has occurred or is imminent. If financial close has occurred when the Coordinator considers the application, the project could go straight to final designation. *[Schedule 2, item 4, subsections 415-60(3), 415-65(1) and 415-70(1) and (2)]*

#### *Provisional designation*

2.83 Provisional designation is a process by which a project can secure its entitlement to the tax benefits provided by the measure even though it has not yet satisfied the financial condition. It also allows the entity to advise its potential financial backers that the project will obtain the tax benefits if they provide the necessary finance. An entity cannot, however, access the concessions unless the project receives final designation.

2.84 For the project to be provisionally designated, the Coordinator must accept the capital expenditure estimate in the application and that estimate must not breach the \$25 billion capital expenditure cap. The designation must be made in writing and provide prescribed details. The Coordinator may amend a provisional designation in prescribed circumstances. *[Schedule 2, item 4, paragraphs 415-65(1)(a) to (c) and subsections 415-65(2) to (4)]*

2.85 Any conditions prescribed by the infrastructure project designation rules must also be satisfied. If no conditions are prescribed,

the Coordinator must be satisfied that the project is of ‘national significance’. That is an expression from the *Infrastructure Australia Act 2008* that includes a transport, energy, communications or water project that will improve national productivity. [*Schedule 2, item 4, paragraph 415-65(1)(d)*]

2.86 If the project does not satisfy the required conditions, the Coordinator will refuse to designate it. The applicant can ask the Administrative Appeals Tribunal to review that refusal. [*Schedule 2, item 4, subsections 415-60(2) and (3) and paragraph 415-85(a)*]

2.87 The Coordinator will always revoke a project’s provisional designation when the project receives final designation. This ensures that the capital expenditure estimate for a project does not count towards the cap twice (once when it is provisionally designated and once when it is finally designated). If the Coordinator decides not to finally designate a project, its provisional designation will also be revoked [*Schedule 2, item 4, subsection 415-65(2)*]

2.88 A provisional designation can otherwise only be revoked in the circumstances prescribed in the infrastructure project designation rules. Those circumstances could include, for example, the entity failing to provide the Coordinator with the information it requires to make its decision about designating the project or failing to observe any conditions that attach to the project continuing to be provisionally designated. [*Schedule 2, item 4, subsections 415-65(5) to (7)*]

2.89 An entity can ask the Administrative Appeals Tribunal to review a decision to revoke its project’s provisional designation. [*Schedule 2, item 4, paragraph 415-85(b)*]

#### *Final designation*

2.90 A project will get a final designation if it continues to satisfy the conditions necessary for provisional designation plus any additional conditions that are prescribed in the infrastructure project designation rules. [*Schedule 2, item 4, subsections 415-70(1) and (2)*]

2.91 The rules may permit the Coordinator to impose rules on a project that must be met before the project receives final designation. The Coordinator may only impose conditions in accordance with the rules. [*Schedule 2, item 4, subsections 415-70(8)*]

2.92 If no additional conditions have been prescribed, final designation will depend on the Coordinator being satisfied that the applicant is legally able to access the funds required for the project (called ‘financial close’ on the project) or that its ability to do so is imminent (for example, because its bankers or investors have committed to providing the

money and only the formal execution of documents remains to be done).  
[Schedule 2, item 4, paragraph 415-70(2)(b)]

2.93 If the project does not satisfy the required conditions, the Coordinator will refuse to designate it. The applicant can ask the Administrative Appeals Tribunal to review that refusal. [Schedule 2, item 4, subsections 415-60(2) and (3) and paragraph 415-85(c)]

2.94 A final designation can only be revoked in circumstances prescribed in the infrastructure project designation rules. Those circumstances could include, for example, the entity failing to provide the Coordinator with any information required under the rules or breaching conditions set for the project to remain designated. [Schedule 2, item 4, subsections 415-70(6) and (7)]

2.95 When the Coordinator finally designates a project, or revokes a project's designation, the Coordinator must advise the Commissioner within 28 days. [Schedule 2, item 4, subsection 415-70(9)]

2.96 An entity can ask the Administrative Appeals Tribunal to review the Coordinator's decision to revoke its project's final designation. Section 27A of the *Administrative Appeals Tribunal Act 1975* provides for applicants to be notified about a decision to designate, not designate, or revoke the designation of a project and their rights of review. [Schedule 2, item 4, paragraph 415-85(d)]

### ***The infrastructure project designation rules***

2.97 The ***infrastructure project designation rules*** are legislative instruments Treasury ministers can make that provide subsidiary detail affecting the scope and operation of the DIP regime. [Schedule 2, item 4, subsection 415-100(1)]

2.98 In particular, the infrastructure project designation rules can:

- provide for, and set the amount of, application fees;
- provide for the order in which applications for designation are to be determined;
- set the conditions that must be satisfied for provisional or final designation of a project or for it to remain so designated;
- permit the Coordinator to impose additional conditions and to specify what those conditions might include;

- set the conditions for amendment to or revocation of a provisional or final designation;
- set the conditions for the Coordinator accepting an application's estimate of a project's capital expenditure;
- set the requirements for an applicant amending its capital expenditure estimate;
- modify what counts towards a capital expenditure estimate;
- increase the size of the capital expenditure cap; and
- set the requirements for publishing information about infrastructure projects and the capital expenditure cap.

*[Schedule 2, item 4, subsections 415-55(4), 415-60(1), 415-65(2), and (3), 415-70(4) and (8) and 415-80(1), (3), (4) and (5) and sections 415-65, 415-70 and 415-90]*

2.99 Because the infrastructure project designation rules are legislative instruments, they are subject to the *Legislative Instruments Act 2003*. In particular, they only become enforceable once they are registered on the Federal Register of Legislative Instruments and they cease to apply if they are disallowed by either House of Parliament under a notice of motion made within 15 sitting days after the instrument is tabled in that House (which must occur within 6 sitting days after it is registered).

2.100 The operation of the *Legislative Instruments Act 2003* is modified in one respect for the infrastructure project designation rules. The rules are permitted to incorporate other documents issued by Infrastructure Australia as they exist from time to time. The *Legislative Instruments Act 2003* provides a default position that disallows the incorporation of certain documents unless the contrary intention appears. Expressly permitting that to be done provides that contrary intention. This capacity could be used, for example, to allow the rules to incorporate Infrastructure Australia's published list of nationally significant projects, which is available on the internet. *[Schedule 2, item 4, subsection 415-100(2)]*

## **The capital expenditure cap**

2.101 The tax benefits available for DIPs are deliberately limited in order to contain the overall cost to the Commonwealth revenue. The Minister may prescribe rules about how projects that will qualify for the tax concessions will be selected. Otherwise, projects will be selected on a first come-first served basis. While capping total estimated capital expenditure does not directly limit the cost to Commonwealth revenue, it

does so indirectly because it effectively limits the total magnitude of projects that are able to access the concessions. *[Schedule 2, item 4, paragraphs 415-65(1)(c) and (d), and 415-70(1)(c) and (d)]*

2.102 In some cases, part of a project on an infrastructure priority list will be designated as a project in its own right. This might occur, for example, because financial close has occurred in relation to that part of the project while other parts of the project are not ready to commence. However, when other parts of the project are ready to commence it may be appropriate to have the whole project designated, rather than just the remaining parts. In order to ensure that the capital expenditure in relation to the same infrastructure is not counted twice, the capital expenditure estimate of the larger project is reduced by any amount that relates to the smaller project. *[Schedule 2, item 4, subsection 415-75(3)]*

**Example 2.12: Calculating the cap for overlapping projects**

In 2013 the Coordinator grants provisional designation to an infrastructure project ‘The ‘East-West Corridor’ that is listed on an Infrastructure Priority List. The estimated capital expenditure for the East-West Corridor at the time of the application was \$4 billion. In 2014, Phoenix Company agrees to take on half of the project. Phoenix Company estimates that the capital expenditure on its part of the project will be \$2.5 billion. This may happen because, by the time the projects reach financial close, the estimated capital expenditure has increased.

The total estimated capital expenditure for the three projects is \$6.5 billion. However, in determining whether the capital expenditure cap has been breached, the Coordinator may disregard the part of the estimate for the listed project (that is, the East West Corridor) that relates to another designated project. In this case, the \$2 billion (that is, half) of the original \$4 billion can be disregarded because that is the portion of the original estimate that relates to the other project. So then, the total amount that counts towards the capital expenditure cap is \$4.5 billion ( = \$2 billion + \$2.5 billion).

2.103 A project cannot be designated, or provisionally designated, if the designation would mean that the total estimated capital expenditure on all designated and provisionally designated projects would exceed the cap. *[Schedule 2, item 4, paragraphs 415-65(1)(c) and 415-70(1)(c) and subsection 415-75(1)]*

2.104 The cap is set at \$25 billion but this can be increased by the infrastructure project designation rules. *[Schedule 2, item 4, subsection 415-75(2)]*

2.105 If a designation, or provisional designation is revoked, the expenditure estimate for that project would no longer count against the cap, freeing up an amount that could be used to designate another project.

#### *Capital expenditure estimates*

2.106 An application to have a project designated must be accompanied by an estimate of the infrastructure project's capital expenditure. This is the total expected capital expenditure on the project unless otherwise prescribed. *[Schedule 2, item 4, subsection 415-55(2) and 415-75(4)]*

2.107 The capital expenditure estimate does not include an amount that is paid for by an Australian government agency because the cap is intended to be limited to private investment. So, for example, a capital expenditure estimate should be reduced by an amount of a government grant or an amount that is directly paid for by a government agency (such as where the government agency pays a subcontractor to conduct part of the project). *[Schedule 2, item 4, subsection 415-55(3)]*

2.108 The Coordinator must accept that estimate if it complies with the conditions in the infrastructure project designation rules (if any). If the rules contain no such conditions, the Coordinator has to be satisfied that the estimate is acceptable. *[Schedule 2, item 4, subsection 415-80(1)]*

2.109 Applicants can amend their estimates at any time before the project is finally designated if the Coordinator, having regard to the prescribed circumstances, requests an amendment. The Coordinator can prescribe circumstances in which it can request the applicant to amend their estimate. An amended estimate is treated as though it was the original estimate. *[Schedule 2, item 4, subsections 415-80(5) and (6)]*

2.110 The Coordinator can only revoke an acceptance of an estimate before the project is finally designated and only in accordance with the prescribed rules. *[Schedule 2, item 4, subsections 415-80(2) to (4)]*

### **Publishing information**

2.111 The Coordinator can, and must, publish information about provisionally and finally designated infrastructure projects and about the capital expenditure cap if required to do so by the infrastructure project designation rules. *[Schedule 2, item 4, section 415-90]*

### **Delegating the Infrastructure Coordinator's powers**

2.112 The Coordinator is empowered to execute a written delegation of his or her powers to an officer who is, or is acting as, an SES employee

in the staff provided by the Department of Infrastructure and Transport to assist the Coordinator. *[Schedule 2, item 4, section 415-95]*

## **Application and transitional provisions**

2.113 The measure applies to tax losses for the 2012-13 and later income years and to debts that were originally incurred in those years and later became bad debts of the entity. *[Schedule 2, items 47 and 48, section 415-10 of the Income Tax (Transitional Provisions) Act 1997]*

2.114 The measure uplifts *unutilised* tax losses and relies on the existing meaning of the term ‘utilise’ in doing so. It extends that meaning to include reducing losses because of forgiven commercial debts. The definition of ‘utilise’ is being amended in a similar way by the loss carry-back measure in the Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013 (see item 34 of Schedule 6 to that Bill). When that Bill is given the Royal Assent, this Bill’s extension of the meaning of the term is repealed and the term will take the meaning that then applies throughout the ITAA 1997. If that Bill were not given the Royal Assent, the extension would not be repealed. *[Schedule 2, item 66 and clause 2 (table item 3)]*

## **Consequential amendments**

### **Definitions**

2.115 A number of defined terms are created for the purposes of this measure. The Dictionary to the ITAA 1997 is amended to include references to each of those definitions. *[Schedule 2, items 35 and 37, subsection 995-1(1) (definitions of ‘designated infrastructure project’, ‘designated infrastructure project entity’, ‘infrastructure project capital expenditure’, ‘infrastructure project designation rules’ and ‘provisionally designated infrastructure project’)]*

2.116 The use of one of those terms in the ITAA 1936 is defined to have the same meaning as it does in the ITAA 1997. *[Schedule 2, item 16, subsection 272-140(1) in Schedule 2F to the ITAA 1936 (definition of ‘designated infrastructure project entity’)]*

2.117 Some other definitions are amended to reflect changes made by the DIP regime. *[Schedule 2, items 17 and 36 and 38 to 42, subsection 272-140(1) definition of ‘tax loss’, subsection 995-1(1) definitions of ‘ownership test period’, ‘same business test period’, ‘test period’, ‘tax loss’ and ‘test time’]*

## Guide material

2.118 Guide material is inserted to give readers an overview of what the provisions do. [Schedule 2, item 4, sections 415-1, 415-5, 415-10 and 415-50]

2.119 A number of non-operative tables, which are designed to point readers to relevant provisions, are updated to reflect the addition of this measure. [Schedule 2, items 18 to 23, tables in sections 12-5 and 36-25]

2.120 Notes are added to provisions about deducting tax losses, bad debts and trust losses to alert readers to the fact that the conditions for those deductions do not apply to a designated infrastructure entity. [Schedule 2, items 7 to 14, 14A, 14B, 14C, 24, 28 and 32, sections 266-15, 266-30, 266-65, 266-80, 266-100, 266-115, 266-140, 266-155, 267-15, 267-55 and 267-60 in Schedule 2F to the ITAA 1936, and sections 165-5, 165-117 and 707-300 (notes)]

## The role of the Infrastructure Coordinator

2.121 The provisions of the *Infrastructure Australia Act 2008* that establish the role of the Coordinator are amended to reflect that its role includes functions conferred on it by other laws. This reflects the fact that this measure relies on the Coordinator designating infrastructure projects as eligible for the special taxation treatment the measure provides for. The amendments provide that the Coordinator's role includes all legislative extensions (rather than just this particular extension) so that any future legislative extension does not require further consequential amendment of the *Infrastructure Australia Act 2008*. [Schedule 2, item 43, subsection 28(2) of the *Infrastructure Australia Act 2008*]

2.122 The existing power of the Minister for Infrastructure and Transport to extend the Coordinator's role by written direction is retained but is located in a differently numbered provision. The validity of those existing directions, which may refer to the provision's previous numbering, is preserved as if they had been made under the new provision. [Schedule 2, items 43 to 46, subsections 28(2) to (4) and 40(1) of the *Infrastructure Australia Act 2008*]

## Other

2.123 Subsection 268-20(4) in Schedule 2F to the ITAA 1936 has been re-worded to clarify that, for the purposes of applying the trust loss provisions, a period that might otherwise constitute multiple periods may be treated as one period if the same business test is satisfied. This may be relevant to an entity that stops being a DIP entity during the test period. [Schedule 2, item 15, Subsection 268-20(4) in Schedule 2F to the ITAA 1936]

2.124 Section 707-120 has also been reworded to make the meaning clearer and to fit in with the DIP regime. Consequential amendments are made to reflect the re-numbering of the section. *[Schedule 2, items 29 to 31, subsections 707-120(1), and 707-130(1) and paragraph 707-125(1)(b)]*

2.125 Other changes are also made to insert references to new sections. *[Schedule 2, items 33 and 34, paragraph 707-265(1)(a), and subsection 719-265(7)]*

2.126 The terms ‘start’, ‘starts’ and ‘starting’ have been replaced with the words ‘begin’, ‘begins’ and ‘beginning’ respectively in parts of the trust loss provisions to provide more consistent terminology across the provisions. *[Schedule 2, items 49 to 65, subsections 266-185(1), 267-90(1), 268-10(2), 268-15(2), 268-20(2), 268-25(2), 268-75(1), 268-85(5), 269-65(1), 269-25(1) and paragraphs 269-25(1)(a), 269-100(4)(a), 271-80(a), 272-80(6B)(a) and (b) and 272-85(5C)(a) and (b) and subparagraph 272-80(6A)(i) of Schedule 2F to the ITAA 1936]*

## **Regulation impact statement**

### **Introduction**

2.127 This Regulation Impact Statement, which was prepared by the Department of the Treasury at the original decision-making stage, was assessed as adequate by the Office of Best Practice Regulation and publicly released on 23 May 2011.

2.128 After the RIS was published, a discussion paper ‘Tax loss incentive for designated infrastructure projects’ was released for six weeks consultation, closing on 9 December 2011. The exposure draft legislation and accompanying explanatory material was available for consultation from 18 April 2013 to 30 April 2013. A private consultant was engaged to advise on the design of the measure and face to face consultations were also conducted with key stakeholders.

### **Background**

2.129 Well-targeted investment in physical infrastructure can play an important role in the economy by facilitating other productive activities. For example, port infrastructure allows Australian production to be moved around the country or exported, as well as providing a means for inputs to reach producers.

2.130 However, governments' abilities to finance new infrastructure are constrained by competing demands on public finances within the overarching constraints of desired budget outcomes.

2.131 Consequently, progress in addressing infrastructure bottlenecks will depend significantly on private financing being attracted to projects. Private financing depends on the expected commercial return from the project being sufficient relative to the risks involved.

2.132 In recent years there have been increased opportunities for private investment in infrastructure, in particular where the private sector can anticipate an acceptable return on its investment (for example, airports and ports).

2.133 Because private financing depends on the expected commercial return from the project being sufficient relative to the risks involved, it is important the government creates an environment conducive to well targeted infrastructure investment. In particular, this includes ensuring impediments — whether they are tax, regulatory, or market imperfections — do not prevent or distort private investment in infrastructure where it would otherwise have taken place.

2.134 Infrastructure projects are typically long term, highly risky investments, that can often have a long lead times between when expenditure is incurred and when a project starts earning income. One way that infrastructure projects typically deal with these risks is to allow different entities that specialise in different aspects of infrastructure (for example, construction, operation, maintenance) to deliver different stages of a project. However under current tax arrangements there is a risk that, if there is a substantial ownership change in the project and a change in business operation, then the new owners may be unable to access previous years' losses.

2.135 The private return on investment in infrastructure can also be reduced if the tax system does not adequately recognise costs. Under current arrangements the tax value of expenditures is reduced by the delay in being able to use them as tax deductions against project income, because of inflation and the time value of money.

## **Objectives of government action**

2.136 To remove barriers to efficient private investment in public infrastructure of national significance caused by the operation of the tax system consistent with the Government's fiscal strategy.

## **Options that may achieve the objective**

2.137 The identified problems suggest two broad approaches.

2.138 One approach would be to specifically address the problem of not being able to immediately use potential tax deductions relating to project expenditures.

2.139 The other approach would be to provide tax allowances or explicit subsidies that effectively reduce the rate of return required for a project to proceed — reducing the impact of the distortion arising from the current restrictions on loss utilisation. Although this approach would not directly address the distortion, it could provide a benefit that offsets its impact.

2.140 These approaches are overlapping, in that increasing the present value of tax deductions may improve the effective return from the project, while tax allowances and explicit subsidies could provide a benefit that may offset the impact of the current loss restrictions.

2.141 Direct Commonwealth Government subsidies to projects would not be consistent with the objective.

2.142 Within these two broad approaches there is also a question around what projects and what quantum of investment should receive the new tax treatment. To manage the potential cost to revenue and ensure that the highest value projects are supported it is proposed that measure focus on projects of national significance up to \$25 billion of capital investment for five years (2012-13 to 2016-17).

2.143 Given this constraint a number of factors are important in order to maximise value for money, including that:

- the absolute size of the net gain to the community from the projects is of national significance;
- the benefit to the community from the new tax provision is maximised by choosing between competing projects;
- projects have appropriate corporate governance arrangements in place; and
- the project is available to multiple users and benefits the broader community.

2.144 In the absence of a cap, one option would be to let infrastructure projects self-assess against such criteria. However, to manage the

potential cost to revenue while ensuring that the highest value projects are supported, it is proposed a decision maker be established to deem certain projects as Designated Infrastructure Projects (DIPs).

2.145 A clear and objective process for selecting DIPs will be important for the initiative to meet its objective.

2.146 To ensure that only nationally significant projects are considered a pre-condition would be that they must be listed on Infrastructure Australia's (IA) National Priority List of projects considered 'Ready to Proceed' or 'Threshold'. In addition to meeting this pre-condition a decision maker and set of criteria will be established to decide whether a project should be a granted DIP status for the purpose of the new tax treatment.

2.147 Governance arrangements for the decision maker and more detailed criteria will be developed through further consultation with industry and other stakeholders. Issues likely to be canvassed in that process include:

- the relationship between the decision maker and Infrastructure Australia (in particular their ability to share information);
- the process of appointing a decision maker and what skills and qualifications they should have; and
- the specificity of the selection criteria (for example, should the criteria include a 'hurdle' rate of return to the economy as a whole).

#### ***New Tax Treatment Option 1 — Loss maintenance***

2.148 This option directly targets the concerns that early stage tax deductions (which in the first instance feed into carry forward losses) might not ever be used due to changes of ownership, or if used will have declined in value due to inflation and the time value of money.

2.149 Under this option, DIPs would enjoy maintenance of the value of carry forward losses and increased flexibility in utilising those losses.

2.150 Before being applied to the entity's income for an income year, any prior year losses would be uplifted at the government bond rate.

2.151 Losses attributable to the DIP would be exempted from the continuity of ownership test (COT) and same business test (SBT). That is,

any uplifted losses would still be deductible against future income if the entity experienced a change in ownership or business.

2.152 Although consultation will be undertaken on the design and implementation of the proposal, the simplest approach would be to require the DIP to be held by a separate entity, which would work out its income and deductions (that is, calculate its losses) under the ordinary income tax law, subject to any special rules that may be required. This would avoid the need to identify which part of the assessable income and allowable deductions for an entity (worked out under the ordinary income tax law) are directly attributable to the DIP for an income year.

2.153 The entity would (in principle) work out its income and deductions — and hence any eligible losses — under the current income tax law. Any exceptions or variations to the ordinary rules would be reflected in the enabling legislation, not subject to the decision maker’s discretion.

2.154 Loss integrity rules other than the COT and SBT would still be applied. In addition, specific integrity rules may be required to ensure that the amounts taken into account are at arm’s length.

2.155 Overall, this option has the potential to reduce the weighted average cost of capital for eligible projects and hence, relative to the status quo, more projects should go ahead. Compliance costs will be reduced by the removal of the COT and SBT, although there would be a cost in meeting other integrity rules and seeking DIP status. However, these costs are likely to be small relative to the size of the DIP and the sophisticated nature of the players involved. Since this option eliminates the risk that losses are trapped and maintains their value until they can be utilised, the end result is that the project will pay the intended rate of tax on its profits, which represents an appropriate cost to revenue.

#### ***New Tax Treatment Option 2 — Flow through shares***

2.156 This option would allow tax losses from DIPs to flow through to Australian resident investors.

2.157 Allowing investors direct access to losses (to be used immediately to offset income from other sources) will effectively increase potential private (after tax) returns of eligible projects and hence make them more attractive to investors.

2.158 By bringing forward, rather than merely ensuring access to and preserving the value of potential deductions, this option would also have a significant, near-term revenue impact. Since the marginal tax rates of

potential investors cannot be predicted with any real accuracy, the fiscal cost of a flow through shares scheme is also highly uncertain.

2.159 This option would also require strong integrity rules to prevent projects from becoming vehicles for tax avoidance. Such integrity rules are likely to make compliance costs high, particularly as some of the compliance is likely to fall on smaller investors.

2.160 The AFTS Review examined a flow through shares scheme for mining exploration. The Review found that such a scheme would be complicated and therefore likely to result in high administration and compliance costs. The Review also noted it would not assist in attracting investment from non-resident investors.

2.161 Overall, a flow through shares scheme would be expected to have a positive impact on private investment in infrastructure relative to the status quo. However, a flow through shares scheme would impose an onerous compliance burden on business and investors as well as having a significant, but highly uncertain, impact on revenue.

#### ***New Tax Treatment Option 3 — Infrastructure subsidy***

2.162 This option would provide a ‘bonus tax deduction’ to eligible projects to increase the potential private returns and hence make them more attractive to investors.

2.163 The entity conducting a DIP would be able to claim a bonus deduction of the lesser of actual project expenditure and approved project expenditure. Approved project expenditure could be less than the expected actual project expenditure, reflecting the national priority the decision-maker attributes to the project.

2.164 In general terms, expenditure would need to be directly attributable to the DIP to be eligible for the investment allowance. Generally, eligible expenditure would be limited to capital expenditure for which a deduction is available under the income tax law. However, financing costs, such as interest payments, would be excluded.

2.165 The investment allowance would have no impact on deductions for expenditures incurred or on the timing or amount of capital allowance deductions for depreciating assets, the timing and amount of deductions for capital works, or on any balancing adjustments when such assets are sold, scrapped or abandoned.

2.166 It is expected that the bonus deduction would be claimable on completion of project milestones (such as when sections of the infrastructure come into public use) specified in the instrument conferring

DIP status on the project. The relevant project milestones would be specified in the instrument approving the project as a DIP. There would be a mechanism for amending project milestones in light of unforeseen events and developments.

2.167 Overall, providing a subsidy that reduces the weighted average cost of capital for eligible projects should, relative to the status quo, mean more projects go ahead. Compliance costs would arise from meeting integrity rules and seeking DIP status. However, these costs would be relatively small compared to the size of the DIP and the sophistication of the players involved. Because this approach does not directly address the distortion arising from the current restrictions on loss utilisation it has a higher cost to revenue.

## **Consultation**

2.168 On the broad issue of restrictions on the use of tax losses, the AFTS Review undertook extensive consultation to develop the principle that ‘the treatment of business losses should reduce biases against risk taking by treating income and losses symmetrically. This must be balanced against problems arising from the mismeasurement of losses from difficulties in measuring economic income, artificial loss creation schemes or from other forms of tax avoidance.’

2.169 In the context of infrastructure, confidential consultation with selected industry stakeholders was undertaken in March and April of 2011 on the three options that were identified as potentially capable of meeting the objective of removing barriers to efficient private investment in public infrastructure of national significance caused by the operation of the tax system consistent with the Government's fiscal strategy.

2.170 This consultation suggested that industry's preference was for a flow through shares scheme that would allow tax losses from DIPs to flow through to Australian resident investors. Some stakeholders considered that if this was not possible, then their preference was for a combination of option 1 and option 3 that would deliver both certainty of losses and a subsidy for DIPs.

2.171 Eliminating uncertainty around the ability to utilise future losses (that is, removing the COT and SBT) was considered valuable. If implemented correctly, participants considered this had the potential to reduce the weighted average cost of capital for eligible projects. That is, the losses option would more clearly reduce the risks of investing in selected projects.

2.172 While uplifting losses or an investment allowance was also considered desirable, some participants expected these benefits to be competed away through the bidding process for a project, and others highlighted that without certainty around access to future losses, uplifts or allowances were of limited value.

2.173 Consultations reinforced that tax structures involved in infrastructure projects are often complex and that ongoing consultation during the development and implementation of the tax measure will be crucial.

## **Implementation and review**

2.174 Implementation will proceed in a number of stages.

2.175 A consultation paper will be issued shortly after the measure is announced in the 2011-12 Budget.

2.176 A period of between four and six weeks will be provided for interested members of the public to make a submission on the consultation paper. Meetings with key stakeholders may also occur during the consultation period.

2.177 Responses to the consultation paper will inform further policy decisions by the Government (on issues like the decision maker and selection criteria) and the preparation of draft legislation. Subject to Government's overall drafting priorities, the draft legislation could be exposed for public comment by the end of 2011.

2.178 As with the consultation paper, interested members of the public would have between four and six weeks to make a submission on the exposure draft legislation. Meetings with key stakeholders may occur during the consultation period.

2.179 Responses to the draft legislation will determine how quickly the legislation could then be finalised for introduction in the Parliament. However, the implementation process would be undertaken with a view to the legislation being introduced in the first half of 2012.

2.180 It is expected that a post-implementation review of the measure would be conducted once the legislation has been in place for at least two years. This would provide an opportunity to review both the implementation process and the preliminary evidence on the efficacy of the legislation and the effectiveness of the measure.

## **Conclusion**

2.181 Based on an assessment of the costs and benefits of each option, the ‘loss maintenance’ approach appears most like to deliver a net benefit to the Australian economy. In the current budgetary environment, it is appropriate to place a cap on the quantum of capital investment that is supported by the incentive. The decision maker will effectively be asked to construct a portfolio of infrastructure projects that will deliver the maximum possible benefits for the nation as a whole. In this way, the incentive will be focussed on ensuring that private investment in public infrastructure of national significance is not deterred by impediments in the tax system.

## **STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS**

### **Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

#### ***Incentives for designated infrastructure projects***

2.182 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Overview**

2.183 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* to provide a tax incentive for companies and fixed trusts that carry on a nationally significant infrastructure project.

2.184 The tax incentives uplift the value of such entities’ carry forward tax losses by the long term bond rate; and exempt them from the loss and bad debt utilisation rules (sometimes referred to as the continuity of ownership and same business tests).

#### **Human rights implications**

2.185 This Schedule does not engage any of the applicable rights or freedoms. The measure has a concessional retrospective element.

**Conclusion**

2.186 This Schedule is compatible with human rights as it does not raise any human rights issues.

**Assistant Treasurer, the Hon David Bradbury**

