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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT (INFRASTRUCTURE BORROWINGS) BILL 1994

REVISED

SUPPLEMENTARY EXPLANATORY MEMORANDUM

Amendments to be moved on behalf of
the Government

(Circulated by the authority of the Treasurer,
the Honourable Ralph Willis, M.P.)

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TAXATION LAWS AMENDMENT (INFRASTRUCTURE BORROWINGS) BILL 1994

General Outline and Financial Impact

The amendments to the Bill will:

(a) introduce a recoupment charge in those cases where a certificate has been cancelled under new sections 93Z, 93ZA or 93ZB of the DAA Act;

(b) amend the definition of "Crown lease" proposed for section 93D of the *Development Allowance Authority Act 1992* (the DAA Act) (clause 7) to extend the term to include easements and other interests in land that are granted by Commonwealth, State or Territory governments or tax-exempt authorities of those governments;

(c) amend section 159GZZZZG to make it clear that even when a lender elects to claim a rebate (thus making the interest assessable) the borrower is still unable to claim the interest payment as a deduction; and

(d) amend clause 26 (the application provision) to provide that infrastructure borrowings made in response to a prospectus that issued before the day the Bill receives Royal Assent will be infrastructure borrowings to which Division 16L of the *Income Tax Assessment Act 1936* (the Tax Act), as it stood before the amendments proposed by the Bill, applies.

Date of Effect: The Amendments do not change the date of effect as set out in the Bill as introduced. The Amendments will take effect on the day the Bill receives Royal Assent.

Financial Impact: The amendments to introduce the recoupment charge will reduce the potential for revenue losses. The other amendments are likely to have a negligible impact on revenue.

Explanation of the Amendments

Amendment 1 Recoupment Charge

The infrastructure borrowings legislation currently contains no sanction or provision to recoup revenue lost by the Commonwealth when the conditions presently imposed (under Division 16L of the *Income Tax Assessment Act 1936*) or intended to be imposed, under the new arrangements by the Development Allowance Authority are breached by infrastructure borrowers.

This proposed amendment is designed to introduce a recoupment charge to provide a deterrent to infrastructure borrowers accessing the infrastructure borrowing concession and subsequently breaching the conditions within the required ownership period so as to obtain tax benefits.

Under the proposed amendment, if the DAA cancels a certificate the holder will be liable to pay an amount approximately equal to the tax benefits of the certificate.

Amendment 2 Definition of "Crown lease"

The current definition of Crown lease is considered to be restrictive in that it unnecessarily limits the scope of leases which can be classified as 'Crown leases' and therefore has the potential to impede some private sector investments in infrastructure. As currently drafted, the Bill limits leases to leases of land which will prevent infrastructure borrowings being used to finance projects such as a light rail system where part of the track runs over a public road. It is not possible, currently, for a lease to be granted over a public road as the road must be available for use by the general public.

The term "Crown lease" is defined in new section 93D(1) of the DAA Act as a lease granted by the Commonwealth, a State or a Territory or a lease granted by a tax exempt authority of the Commonwealth, a State or a Territory. The term includes leases granted by municipal corporations and other local governing bodies as such bodies have been held to be an emanation or an authority of the relevant State or Territory government: *The Municipal Council of Sydney v the Commonwealth (1904) 1 CLR 208.*

"Crown lease" is defined for the purposes of subsection 93D(3). That subsection treats the holder of a Crown lease of land as the owner of the facilities that are, or are intended to be, a fixture on the land. Thus, a borrower who intends to construct an infrastructure facility on a Crown lease is able to satisfy the requirement that it must intend to own the facilities for a borrowing to be an infrastructure borrowing (new subsections 93K(2), (3) and (4) of the DAA Act).

If the definition of "Crown lease" is limited to *leases* of land, infrastructure borrowings will not be able to be used to finance an infrastructure facility that is to be constructed on an easement of land (as might be the case for a gas pipeline) or where all that is necessary for the facility to operate is a licence or some other interest less than a lease (as might be the case for a light rail system).

This new definition of "Crown lease" will extend beyond leases and include easements and other rights, powers or privileges over or in connection with land (such as licences and "rights of way") that are granted, whether by statute or under a contract, by the Commonwealth, a State or a Territory or by a tax exempt authority of the Commonwealth, a State or a Territory.

The term will also include "sub-interests" in land such as sub-leases and licences in relation to easements. For example, a Commonwealth authority may hold a lease of land granted by a State and a sub-lease of that land granted by the authority would constitute a Crown lease.

Similarly, a State authority may hold an easement over private lands, for example for the purposes of installing water or gas pipes. A licence or other right in relation to that easement granted by the authority will again constitute a Crown lease.

Amendment 3 Water Supply via Bores

This amendment is required to extend the eligibility of Infrastructure Borrowings to include bores drilled for the purpose of providing water for public consumption, or other use by the public, at a charge to them.

Amendment 4 Pumps and Associated Structures

This amendment is required to extend the eligibility of Infrastructure Borrowings to include pumping equipment and associated structures used to extract water from bores drilled for the purpose of providing water for public consumption and for pumping the water along channels or pipelines.

Amendment 5 Infrastructure Period

This amendment is required to calculate the amount of tax that is required to be paid following the cancellation of a certificate by the DAA.

The length of the infrastructure period depends on the type of borrowing. It is the period for which conditions under section 93R of the DAA Act will have applied to the certificate holder, if the certificate had not been cancelled.

PERIOD	BEGINS	ENDS
Direct infrastructure borrowing	Time of borrowing	End of 25 year period from first use of asset
Indirect infrastructure borrowing	Time of borrowing	When the borrowed money is lent to the direct infrastructure borrower
Refinancing infrastructure borrowing - direct infrastructure borrowing	Time of borrowing	End of 25 year period for the direct infrastructure borrowing
Refinancing infrastructure borrowing - indirect infrastructure borrowing	Time of borrowing	When the borrowed money is lent to the direct infrastructure borrower

Amendment 6 Tax Benefit Amount

This amendment is required to calculate the amount of tax that is required to be paid following the cancellation of a certificate by the DAA.

The tax benefit amount will be calculated for each year of income before the year in which the first act or omission occurred that was a ground for cancelling the certificate and for each subsequent year of income until the borrowings are repaid (see below).

The tax benefit amount for any year is the total of the interest, amounts in the nature of interest, and accrued amounts under section 159GT that would have been deductible to the borrowers of infrastructure borrowings used to finance the construction of the facility and the acquisition of any related facilities during the that year but for the relevant certificate. The amount will be calculated in relation to each certificate cancelled.

Amendment 7 Non-deductability of Payments Where Rebate Election is Made

This technical amendment applies to a lender choosing the option of a tax rebate of 33 per cent as an alternative to the non-assessable income arrangement for Infrastructure Borrowings. It is necessary that the legislation be amended to make it clear that even if a lender has chosen to include interest payments received in assessable income the borrower is still excluded from claiming the interest payment as a deduction.

The amendment adds a new subsection to clarify this point. The inclusion of an Infrastructure Borrowing amount in the assessable income of a person under this section does not affect the denial of allowability of a deduction to another person in respect of the same amount under subsections 159GZZZZG(1) or(2).

Amendment 8 Assessment of Tax on Cancelled Certificate

This proposed amendment explains how the amount of tax payable on the cancellation of a certificate is calculated.

If the DAA cancels a certificate (under new sections 93Z, 93ZA or 93ZB of the DAA Act) and there is a **tax benefit amount** (see below), the holder of the certificate is liable to pay tax imposed by the *Infrastructure Certificate Cancellation Tax Bill 94* on that amount. Assessments will be issued on the tax benefit amount for each year since the borrowing commenced up to and including the year of income in which the first act or omission occurred that was a ground for cancelling the certificate. For each future year of income, until the borrowings are repaid, there will be a further tax benefit amount and assessments will be issued on the tax benefit amount for that year (see below). ***[New section 159GZZZZH]***

The provisions of the income tax law dealing with the issue of notices of assessment, amendment of assessments, refunds of amounts overpaid, various provisions relating to the collection and recovery of income tax, and miscellaneous provisions relating to agents, trustees, person receiving or controlling a non-resident's money, recovery of tax paid on behalf of someone else, contribution by joint taxpayers, and relief in cases of hardship, will apply to the charge as if it was income tax. ***[New subsection 159GZZZZH(4)]***

Assessment of Tax When a Certificate is Cancelled

If the DAA cancels a certificate and the DAA provides the Commissioner with all the information necessary to calculate:

- the interest, payments in the nature of interest or section 159GT amounts which would, but for subsections 159GZZZZE(1) and (2), have been allowable deductions during the 15 year exemption period (tax benefit amount); and

- the infrastructure period and the part of that period that occurred before the certificate was cancelled;

the Commissioner will calculate the amount of the tax liability on the cancellation of the certificate. The tax will be calculated for each year of income up to and including the year of income in which the first act or omission occurred that was a ground for cancelling the certificate, and for each year of income until the borrowings are repaid. ***[New subsection 159GZZZZH(1)]***

The tax will be calculated as 15 per cent of the tax benefit amount times a factor. For the year in which the first grounds for cancelling the certificate occurred and all previous years, this factor will be equal to the number of years remaining in the infrastructure period at the time of the first act or omission that was a ground for cancelling the certificate, divided by the total number of years in the infrastructure period. So the later the default on which cancellation is based, the smaller the proportion of the 15% of tax benefits obtained to and including the year of default that will be recovered by the tax. The charge levied on the certificate holder would be equal to the amount generated by the following formula:

$$15\% \times \text{Tax Benefit Amount} \times \frac{\text{Part of the Infrastructure Period Occurring After the Act or Omission}}{\text{Infrastructure Period}}$$

For any years following the first default in which infrastructure borrowings remain outstanding, this factor will be equal to 1. So, wherever the default leads to a certificate being cancelled, all tax benefits obtained for years after the default will be subject to a 15% tax.

In the case of "tax benefit amounts" received following the breach, there will be no scaling down of the recoupment charge according to the proportion of the total infrastructure period following the breach. Effectively the formula will be "$15\% \times \text{Tax Benefit Amount} \times 1$" (that is, the charge will apply to the full "tax benefit amount").

If the infrastructure borrowings have not been repaid at the time the default occurs that leads to the certificate being cancelled, the formula effectively applies to the accumulated interest, amounts in the nature of interest, and accrued amounts (from when the borrowing commenced) that would have been deductible to the borrower up to the end of the year of income in which the default occurred. For those years, the formula scales down the 15% tax in proportion to the part of the infrastructure period remaining after default. In each future year of income, until the borrowings are repaid, the formula would apply to the tax benefit amount for each year, which is the annual interest, amounts in the nature of interest and accrued amounts (that continue to be non-deductible to the borrower). For those years, the formula does not reduce the 15% tax.

Example

A direct infrastructure borrowing is raised in the year in which construction commences (year 1). Construction is completed in year 5 and the facility becomes income producing during that year. The infrastructure period will therefore end in year 30 (25 years after the first use of the facilities after their construction under the borrowing). The certificate is cancelled because of a default that occurred in year 13 and the infrastructure borrowings will be repaid in year 15. The tax benefit amount, being the total of the deductions that would have been allowed to the borrower and its predecessors from when the borrowing commenced, is $81,000 up to and including year 13, $12,000 for year 14 and $7,000 for year 15.

Charge assessed for year 13 and previous years is:

$$15\% \text{ of } \$81{,}000 \times \frac{17}{30} = \$6{,}885$$

Charge assessed for year 14 is:

$$15\% \text{ of } \$12{,}000 \times 1 = \$1800$$

Charge assessed for year 15 is:

$$15\% \text{ of } \$7{,}000 \times 1 = \$1050$$

Amendments 9 and 10 Application Provision

As the Bill is currently drafted where a prospectus is issued before Royal Assent and the closing of that prospectus was after Royal Assent, the borrowing could not be an infrastructure borrowing. In these cases where the closing date for the prospectus is after Royal Assent the effect of the application provisions is that the borrowing would have been made after Royal Assent: the consequence is that such borrowings could not be made under the existing (pre-Royal Assent) arrangements. On the other hand, such borrowings could not be an infrastructure borrowing under the new arrangements because the borrower cannot obtain a certificate from the DAA until the amendments are enacted, ie. until after Royal Assent.

The new infrastructure borrowings arrangements proposed by the Bill will apply to infrastructure borrowings made on or after the day the Bill receives Royal Assent. Division 16L of the Income Tax Assessment Act as it stood before the amendments proposed by the Bill will apply to infrastructure borrowings made before Royal Assent.

The seventh and eighth amendments provide a transitional arrangement to ensure that companies are not deterred from raising infrastructure borrowings because of the uncertainty as to the time of Royal Assent.

The application provision will be amended to provide that where a prospectus inviting subscriptions for infrastructure borrowings issued before the date of Royal Assent, borrowings raised under that prospectus will be treated as infrastructure borrowings raised before Royal Assent. The effect of this provision is that Division 16L as it stood before the amendments proposed by the Bill will apply to such borrowings.