

THE PARLIAMENT OF THE COMMONWEALTH OF
AUSTRALIA

SENATE

**TAXATION LAWS AMENDMENT (INFRASTRUCTURE
BORROWINGS) BILL 1994**

EXPLANATORY MEMORANDUM

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

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

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General Outline and Financial Impact

The Taxation Laws Amendment (Infrastructure Borrowings) Bill 1994 will amend the *Income Tax Assessment Act 1936* (the Tax Act) and the *Development Allowance Authority Act 1992* (the DAA Act) to extend the range of eligible sectors and introduce the new taxation and administrative arrangements relating to the category of borrowings known as "infrastructure borrowings".

Date of Effect: The new arrangements will apply to infrastructure borrowings undertaken on or after the date the Bill receives Royal Assent.

Proposal announced: "Working Nation" Statement of 4 May 1994.

Financial Impact: The cost to revenue is expected to be nil for 1994-95, \$9 million for 1995-96, \$18 million for 1996-97 and \$34 million for 1997-98.

Clauses Involved in Proposed Amendments

Clause 1: Specifies the short title of this Act.

Clause 2: Provides for this Act to commence on the date the Bill receives Royal Assent.

Clause 3: Specifies the Principal Act, which is the subject of the amendments in Clauses 4 to 17, as the DAA Act.

Clause 4: Specifies the omission of the Heading to Part 1 of the Principal Act and the substitution of a new heading.

Clause 5: Inserts new headings after Section 2 of the Principal Act.

Clause 6: Amends Section 6 of the Principal Act by omitting definitions of "AAT", "documentation certification provision", "prosecution provision", "reviewable decision" and "State taxation officer disclosure provision".

Clause 7: Inserts a new chapter after Part 10 of the DAA Act. The new chapter is titled "Chapter 3 - Infrastructure Borrowings". This includes parts on:

the interpretation of the criteria and conditions relating to infrastructure borrowings;

the application to the DAA for certificates and the issue, variation, transfer and cancellation of certificates by the DAA; and

the provision of information to the DAA.

Clause 8: Defines a number of expressions for the purposes of the DAA Act, including "document certification provision", "prosecution provision", and "State taxation officer disclosure provision" with reference to the Taxation Administration Act 1953, and defines "partnership" as having the same meaning as in section 6 of the Tax Act.

Clause 9: Repeals section 98 of the DAA Act. This section has provided that there will be no substantive appointment of the DAA on or beyond 1 January 1997. In effect this section has provided the Government with the ability to wind up the operations of the DAA.

The infrastructure borrowing measure will operate on an ongoing basis and the DAA's new role in administering the concession will continue beyond 1 January 1997. Therefore, section 98 of the DAA Act is repealed.

Clause 10: Amends section 106 of the DAA Act, which provides for the appointment by the Minister of an acting DAA in certain circumstances, including the period after 31 December 1996 and before 1 July 2002, and the period after 1 July 2002. This section is amended by omitting subsections (2), (3) and (4) which provide for acting DAA arrangements during the phasing-out periods.

Clause 11: Amends section 111 of the DAA Act to extend the provision relating to applications for protection of commercial-in-confidence information .

Clause 12: Amends section 113 of the DAA Act, which provides the circumstances by which the DAA can revoke the commercial-in-confidence status previously granted to information and/or documentation supplied to the DAA. The term "entity" is replaced with "person".

Clause 13: Amends section 114 of the DAA Act. The term "the entity" is replaced with "the person".

Clause 14: Amends section 115 of the DAA Act, which requires the DAA to provide the Minister with quarterly reports about registrations under the development allowance. The amendment broadens the scope to include the requirement for the DAA to report on the number and type of certificates granted for infrastructure borrowings in each quarter.

Clause 15: Amends section 117 of the DAA Act, which requires the DAA to submit annual reports to the Minister. Subsection 117(3), which limits the application of this provision to financial years ending before 1 July 1997, will be omitted.

Clause 16: Amends section 119 of the DAA Act, which provides for an applicant to request the DAA to reconsider a reviewable decision, by substituting "an entity" with "a person", and "entity" with "person". This broadens the scope of application of this provision to include the

reconsideration of reviewable decisions taken by the DAA in relation to infrastructure borrowings

Clause 17: Amends section 121 of the DAA Act by replacing "an entity" with "a person", and "entity" with "person" wherever occurring. This broadens the scope of application of this provision to include the reconsideration of reviewable decisions taken by the DAA in relation to infrastructure borrowings.

Clause 18: Specifies that further amendments to the DAA Act are set out in the Schedule to this Bill.

Clause 19: Specifies the Principal Act, which is the subject of the amendments in Clauses 20 to 26, as the Tax Act.

Clause 20: Amends section 16 of the Tax Act by inserting "Chapter 4 of" before "that Act" in paragraph (4)(hba). This amendment will allow the Commissioner of Taxation to disclose certain information to enable the DAA to discharge its administrative responsibilities and to take prosecution action to provide for the administration of infrastructure borrowings.

Clause 21: Repeals Subdivision A of Division 16L of the Tax Act for infrastructure borrowings raised on or after the date the Bill receives Royal Assent. Subdivision A of Division 16L of the Tax Act contains the interpretation provisions in the income tax law that define infrastructure borrowings and related concepts.

Clause 22: Omits the heading to Subdivision B of Division 16L of the Tax Act as a consequence of repealing Subdivision A of Division 16L of the Tax Act.

Clause 23: Inserts section 159GZZZZD before section 159GZZZZE of the Tax Act. The new section introduces the definitions of "certificate", "DAA", "DAA Act", "direct infrastructure borrowing", "exemption period", "IB amount", "indirect infrastructure borrowing", "infrastructure borrowing" and "refinancing infrastructure borrowing".

Clause 24: Amends section 159GZZZZE of the Tax Act, so that it will not apply to interest, payments in the nature of interest and

accrued interest in a year of income if the taxpayer exercises the rebate option.

Clause 25: Inserts new section 159GZZZZG after section 159GZZZZF of the Tax Act. Section 159GZZZZG allows a taxpayer who derives interest income from infrastructure borrowings, whether from a direct investment or indirectly through a partnership or trust, the option of claiming a rebate, rather than treating the interest income as exempt. Inserts new section 159GZZZZH to provide that where the DAA cancels a IB certificate a tax may be payable.

Clause 26: Specifies that Subdivision A of Division 16L of the Tax Act will continue to apply to a refinancing infrastructure borrowing raised on or after the date the Bill receives Royal Assent to repay a direct or indirect infrastructure borrowing raised before that date.

Clause 27: Specifies the Principal Act, which is the subject of the amendments in Clauses 28 and 29, as the *Taxation Administration Act 1953* (the Administration Act).

Clause 28: New paragraphs 93ZC(b) and (c) of the DAA Act will allow the DAA to make written requests for documents and certified copies of documents from a person who is applying for a certificate or is a certificate holder. Paragraph 8J(2)(ga) of the Administration Act will be amended to ensure that, in the event that a statement made in a document furnished to the DAA under these paragraphs is false or misleading in a material particular, it will not give rise to an offence for the purposes of the Administration Act. This approach is consistent with that adopted under the various taxation statutes in relation to documents that taxpayers furnish under notices to the Commissioner of Taxation.

Clause 29: Where a court is satisfied that a false or misleading statement or incorrectly kept accounting records has resulted in a decreased tax liability, section 8W of the Administration Act enables the court to order a person convicted of offences under Part III of the Administration Act to pay an amount to the Commissioner of Taxation that is in addition to the penalty imposed upon the person for the offences. The Bill will amend section 8W to enable a court to have regard to a decision made by the DAA in relation to the issue,

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variation or transfer of a certificate (Division 1 of Part 3 of Chapter 3 of the DAA Act) as if that decision were part of the process of making an income tax assessment of a taxpayer.

CHAPTER 1

Summary of Proposed Amendments

1.1. From the date the Bill receives Royal Assent, the Development Allowance Authority (DAA) will be responsible for the approvals, management and monitoring functions relating to "infrastructure borrowings". Under the new administrative arrangements, prospective borrowers will need to apply to the DAA for eligibility to issue "infrastructure borrowings".

The application will set out details of the proposed borrowing, expenditure and other relevant details.

- When the DAA is satisfied that the applicant has met all eligibility criteria, the DAA will issue a certificate in relation to the borrowing.

The DAA may cancel a certificate if the conditions attached to it are breached.

1.2. "Infrastructure borrowings" will be borrowings by:

companies, limited partnerships and unit trusts that are taxed as companies under the Tax Act, which intend to spend the funds borrowed on financing the construction of specified infrastructure facilities they intend to:

- own, use and control for a period of 25 years from the time the facility becomes income producing;
- sell upon completion of construction; or
- own, use and control for some period less than 25 years from the time the facility becomes income producing and then sell.

companies whose sole purpose is to invest in infrastructure borrowings.

1.3. However, infrastructure borrowings will not include borrowings by companies which are:

borrowing in partnership with another person (except for limited partnerships that are taxed as companies); and

government bodies, unless they are, in accordance with certain criteria, deemed to be bodies that operate on a commercial basis.

1.4. The tax preferred treatment on infrastructure borrowings will be for a maximum period of 15 years.

1.5. There will be three kinds of infrastructure borrowing:

direct infrastructure borrowing - this will be a borrowing by a company, limited partnership (that is taxed as a company) or relevant unit trust to spend on constructing an infrastructure facility that it intends will be operated and controlled by the private sector for the purpose of deriving assessable income for a period of at least 25 years;

indirect infrastructure borrowing - this will be a borrowing by a company to lend to another person for whom the borrowing will be a direct infrastructure borrowing;

refinancing infrastructure borrowing - this will be a borrowing to refinance a direct or indirect infrastructure borrowing or a previous refinancing infrastructure borrowing.

1.6. An infrastructure facility will be a:

land transport;

air transport;

• seaport;

electricity generation, transmission or distribution;

gas pipeline;

water supply; or

sewage or wastewater

facility in Australia used by the public at a charge.

1.7. The tax effects of infrastructure borrowings on borrowers and investors will be:

interest derived under infrastructure borrowings will be either non-assessable or rebatable (at 33 per cent) to investors;

interest paid on infrastructure borrowings will not be an allowable deduction to borrowers;

any profit of a trading, revenue or capital nature derived on disposal or redemption of any debt instrument that constitutes an infrastructure borrowing will be tax exempt;

any loss of a trading, revenue or capital nature incurred on the disposal or redemption of any debt instrument that constitutes an infrastructure borrowing will not be tax deductible;

expenditure incurred in borrowing to invest in infrastructure borrowings will be tax deductible.

Background to the Legislation

1.8. Certain infrastructure projects with lengthy construction periods may not produce assessable income for some years. Where taxpayers borrow funds to finance the construction of those projects which accumulate tax losses in the early stages of development, they are often unable to access the interest deductions available to them.

1.9. In order to encourage private investment in the construction of certain publicly accessible infrastructure projects, the Government decided to allow companies borrowing to finance the construction of such infrastructure projects to effectively transfer the interest deductions incurred on those borrowings to the providers of the finance. The introduction of this category of borrowings, known as "infrastructure borrowings", was announced in the "One Nation" Statement on 26 February 1992. The provisions in the Tax Act relating to infrastructure borrowings have been administered by the Commissioner of Taxation.

1.10. Due to limited interest in infrastructure borrowings since their introduction, the Government has decided to extend the range of eligible sectors and modify the administrative and tax treatment of

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infrastructure borrowings to make them more attractive to investors and to facilitate more private sector provision of publicly accessible infrastructure. From the date the Bill receives Royal Assent, the DAA will be responsible for the approvals, management and monitoring functions relating to infrastructure borrowings.

CHAPTER 2

Explanation of Proposed Amendments to the Development Allowance Authority Act 1992

Part 1 - Infrastructure Borrowings Criteria

2.1. The proposed amendments to the DAA Act relating to infrastructure borrowings will:

set out the conditions a borrowing must satisfy to qualify as a tax exempt or rebatable infrastructure borrowing; [*Clause 7*] and

provide for the arrangements relating to the DAA administration of infrastructure borrowings. [*Clauses 7 to 17*]

Infrastructure Borrowings

2.2. An infrastructure borrowing will be a borrowing by a borrower (see later notes) to finance:

the construction of one or more specified publicly accessible infrastructure facilities in Australia which the company intends will be owned, operated and controlled by the borrower or another qualifying private sector operator for the purpose of deriving assessable income for a period of at least 25 years; or

the construction or acquisition of one or more related facilities (see later notes).

2.3 The term "borrowing" is defined broadly and includes bonds, debentures, discounted securities and any other form of indebtedness. A borrowing may be secured or unsecured. [*New section 93D*]

2.4 There will be three kinds of infrastructure borrowing: [*New section 93E*]

direct infrastructure borrowing - a borrowing raised by a company, limited partnership or unit trust that is taxed as a company to spend on constructing infrastructure facilities or on constructing or acquiring related facilities;

indirect infrastructure borrowing - a borrowing raised by a company to lend under a direct infrastructure borrowing;

refinancing infrastructure borrowing - a borrowing to refinance a direct or indirect infrastructure borrowing or a previous refinancing infrastructure borrowing.

Borrowers

2.5 A company, limited partnership that is taxed as a company or a corporate unit trust or a public unit trust that is taxed as a company (under Division 6B or 6C of the Tax Act, respectively) will be able to be a borrower under a direct infrastructure borrowing or a refinancing infrastructure borrowing that is related to a direct infrastructure borrowing. *[New subparagraph 93I(2)(a)(i)]*

2.6. However, only a company will be able to be a borrower of an indirect infrastructure borrowing or a refinancing infrastructure borrowing that is related to an indirect infrastructure borrowing. *[New subparagraph 93I(2)(a)(ii)]*

2.7. A borrower must intend to retain the same structure (that is, company, limited partnership or unit trust, as the case may be) for the period from the borrowing until 25 years after the infrastructure facility commences to produce assessable income where the borrower intends to own, operate and effectively control the facility for 25 years as in subsection 93K(2).

Where the borrower intends to sell the facilities upon completion of construction or sell some time before the end of the 25 year assessable income period, that borrower must intend to retain the same structure for the period from the borrowing until the time the borrower sells the facility to a qualifying purchaser. *[New paragraphs 93I(2)(b) and (c)]*

2.8 A borrower must also intend that there be no change in the majority ownership of the company, limited partnership or unit trust from the time of the borrowing until:

25 years after the infrastructure facility commences to produce assessable income; or

the time, that may be less than 25 years, when the borrower sells the facility.

Majority Ownership

2.9 If the borrower is a company listed on a stock exchange and one person controls more than 50 per cent of the voting power in the company, that person must intend not to dispose of his, her or its majority interest in the company until: *[New subsection 93I(5)]*

the 25 year assessable period has expired; or

the time, that may be less than 25 years, when the borrower sells the facility.

2.10. If the borrower is an unlisted company, the person, or a group of persons, holding more than 50 per cent of the voting power in the company must intend not to dispose of the majority ownership until: *[New subsection 93I(6)]*

the 25 year assessable period has expired; or

the time, that may be less than 25 years, when the borrower sells the facility.

Partnerships

2.11. Companies borrowing in partnership with another person will not be able to use infrastructure borrowings. This provision does not preclude a limited partnership that is taxed as a company or a joint venture that is not a partnership from raising funds under an infrastructure borrowing. (Partnership has its general law meaning.) *[New paragraph 93I(2)(d)]*

Government Owned Bodies

2.12. Bodies that are government owned will be excluded from raising funds under infrastructure borrowings unless they are deemed to be, in accordance with criteria published in the Gazette by the Minister, operating on a commercial basis. That is, the body is

effectively operating as if it were a private sector body. *[New paragraph 93I(2)(e) and new subsection 93I(4)]*

2.13. A company will be government owned if a government body, defined as the Commonwealth, a State, a Territory or a public authority that is exempt from tax under paragraph 23(d) of the Tax Act, is beneficially entitled to more than 50 per cent of the dividend, voting or return of capital rights. Similarly, a trust is government owned if a government has more than a 50 per cent interest in the income or corpus of the trust. *[New subsection 93I(3)]*

Direct Infrastructure Borrowing

2.14. To qualify as a direct infrastructure borrowing, the borrowed funds must, at the time of borrowing, be intended to be spent on:

the construction of facilities for land transport, air transport, seaport, electricity generation, transmission or distribution, gas pipelines, water supply or sewage and wastewater facilities (principal facilities);

the construction or acquisition of facilities without which the principal facility could not operate effectively (related facilities); or

paying interest on an earlier direct infrastructure borrowing.

If the funds raised by infrastructure borrowings are unable to be spent immediately, those funds may be invested in a "prescribed investment" (see later notes) until they are able to be spent. *[New section 93J]*

Facility Use or Sale Requirement

2.15. The borrower must also intend that the facility will be owned, operated and effectively controlled by the private sector from the time of the borrowing to at least 25 years from the time the facility starts producing assessable income. In intending this, the borrower must do one of the following: *[New section 93K]*

Own, operate and effectively control the use of the facility financed by these borrowings for at least 25 years from the time the facility starts to produce assessable income. *[New subsection 93K(2)]*

Sell all rights, interests and obligations in respect of the facility financed by these borrowings upon completion of construction of the facility or upon the acquisition or construction of related facilities. In this case the purchaser of the facility must operate in a commercial manner and satisfy all criteria relating to the borrower and the operation of the facility. *[New subsection 93K(3)]*

Sell all rights, interests and obligations in respect of the facility financed by these borrowings after that facility has been owned, operated and effectively controlled for some period less than 25 years from the time the facility starts to produce assessable income. In this case the purchaser of the facility must operate in a commercial manner and satisfy all criteria relating to the borrower and the operation of the facility *[New subsection 93K(4)]*

In any of these cases, if section 51AD or Division 16D of the Tax Act will apply to any property in either the main or related facility, infrastructure borrowings will not be able to be used. Persons who must have an intention not to do anything that will cause section 51AD or Division 16D of the Tax Act to apply to any of the facilities are:

the person who intends to own, use and effectively control the use of the facility for a period of 25 years from the time the facility becomes income producing [subsection 93K(2) and paragraph 93R(b)];

the person who intends to own, use and effectively control the use of the facility for a period of less than 25 years from the time the facility becomes income producing [subsection 94K(4) and paragraph 93R(b)];

the person to whom a certificate is transferred before the facility was used by the person who constructed it, that is, the facility was constructed with the intention of selling to someone else before using it [subsection 93K(3), section 93V and paragraph 93R(c)];
and

the person to whom a certificate is transferred after the facility was used by the person who constructed it before the period of 25 years from the time the facility became income producing has expired [subsection 93K(4), section 93V and paragraph 93R(c)].

Section 51AD and Division 16D of the Tax Act

2.16. Section 51AD and Division 16D of the Tax Act prevent taxable financiers from obtaining tax benefits related to costs associated with property that is controlled, or the use of which is controlled, by tax exempt bodies. In the absence of section 51AD and Division 16D, financing arrangements could be structured so as to allow the tax exempt controller of the property to transfer these benefits to taxable financiers in return for cheaper finance.

2.17. The infrastructure borrowings measure is intended to encourage genuine private investment in publicly accessible infrastructure, not to facilitate public sector involvement in the construction and financing of infrastructure projects. Section 51AD and Division 16D of the Tax Act ensure that the tax benefits provided through infrastructure borrowings will only be available where property is controlled by, and the benefits and burdens of control belong to, private investors.

Owning the Facility

2.18. To be eligible, a company must own the principal facility (and any related facility) that is to be constructed using infrastructure borrowings. If the land on which a company is constructing a facility is the subject of a Crown lease (see later notes), the company will be treated as owning the facility provided that:

the lease will not expire for at least 25 years from the day the facility is expected to become income producing; or

if the lease is due to expire before that time, the company expects, because of law, custom or otherwise, that the lease will be renewed or extended, and that the renewed or extended lease will not expire until a time at least 25 years from the day the facility is expected to become income producing.

[New subsection 93D(3)]

2.19. Where an infrastructure facility will be sold upon completion of construction or it will be owned, operated and controlled for some period less than 25 years from the time the facility becomes income producing and then sold, the qualifying purchaser must:

where the lease will not expire for at least 25 years from the day the facility first becomes income producing, continue to hold the lease for the whole period on the same terms and conditions as the borrower; or

where the term of the lease is less than 25 years from the day the facility first becomes income producing, renew or extend the lease and continue to hold the lease throughout the whole of the 25 year period on the same terms and conditions as the borrower.

[New subsection 93D(3)]

Crown Lease

2.20. A "Crown lease" is defined to mean 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 [New section 93D]*.

2.21. "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).

2.22. This 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.

2.23. 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.

2.24. 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.

Using and Controlling the Facility

2.25. In addition to the intention that the borrower or another qualifying private sector operator will own, operate and derive assessable income from public use of the facility for at least 25 years in total, the company must also intend, in the course of deriving the assessable income, to effectively control the use of the facility. A company that intends to derive assessable income by leasing the facility cannot use infrastructure borrowings to finance the facility.

Owner to have Effective Control

2.26. It is not enough that the company constructing the facility intends to own and use the facility. It must also effectively control use of the facility. A company will be considered to effectively control a facility if it either operates the facility on a day-to-day basis through its employees or agents, or has such an immediate supervisory role that enables it to direct others in that day-to-day operation.

Spending on Related Facilities

2.27. Borrowings will be able to be spent on a related facility if the borrower:

will be spending some of the money on an infrastructure facility;

intends to either:

- own, operate, effectively control and derive assessable income from the principal facility for 25 years,
- sell the principal facility to a qualifying purchaser upon completion of construction of that facility, or

- own, operate, effectively control and derive assessable income from the principal facility for a period less than 25 years and then sell to a qualifying borrower; and
- intends to begin constructing or acquiring the related facility no later than 15 years after:
 - construction commenced on the principal facility; or
 - the principal facility was acquired.

[New subsection 93J(2)]

Interest During Construction

2.28. Interest incurred on funds raised by infrastructure borrowings to finance construction is considered to be money spent on the construction of the facility. Money raised under direct infrastructure borrowings will be able to be spent on paying interest on an earlier direct infrastructure borrowing where the interest:

- accrues during the construction period; and
- is paid during the construction period.

[New subsection 93J(3)]

Prescribed Investments

2.29. Infrastructure borrowings not immediately spent must be invested in a "prescribed investment". A "prescribed investment" means an investment of a kind prescribed by regulations as determined by the Minister. Prescribed investments will only cover the short-term 'parking' of money and, therefore, more liquid investments rather than longer term investments. *[New section 93D and paragraph 93J(1)(b)]*

Exclusions

2.30. An infrastructure borrowing will not be able to be spent on:

- leasing;
- acquiring a partly constructed facility; or

refinancing a loan that is not an infrastructure borrowing.

[New subsection 93J(4)]

2.31. However, the funds raised through infrastructure borrowings will be able to be spent on acquiring the land on which the facility is to be constructed, except where there is an existing building or structure that will form part of the infrastructure facility or the related facility concerned.

Indirect Infrastructure Borrowing

2.32. A company that is established for the special purpose of acquiring infrastructure borrowing securities will be able to undertake infrastructure borrowings to finance the acquisition of such securities. These special purpose companies will be able to pool funds for investing in infrastructure borrowings in eligible facilities being constructed by different bodies. *[New section 93G]*

2.33. The whole of the monies raised by a borrower in an indirect infrastructure borrowing must be invested in direct or refinancing infrastructure borrowings.

Refinancing Infrastructure Borrowing

2.34. Infrastructure borrowings will not be able to be used to repay existing debt other than as specifically permitted. The funds are to be used to finance new work on constructing the facility. However, a borrowing to repay the debt due under an existing infrastructure borrowing, that is, a direct, indirect or refinancing borrowing, within 15 years of the initial borrowings will qualify as an infrastructure borrowing. *[New section 93H]*

Infrastructure Facilities

2.35. An infrastructure facility is a land transport, air transport, seaport, electricity generation, transmission or distribution, gas pipeline, water supply, sewage or waste water facility in Australia that the public will be charged a fee to use. Facilities that are functionally related to these facilities will be treated as being part of the facility. *[New subsection 93L]*

2.36. There are seven basic kinds of infrastructure facilities. These are:

land transport;
air transport;
seaport;
electricity generation, transmission or distribution;
gas pipeline;
water supply; and
sewage or wastewater.

2.37. A further kind of facility is a related facility. This is a facility in Australia which is reasonably necessary for the infrastructure facility to be able to operate in the intended manner. (See earlier notes on "related facilities".) [*New section 93M*]

Land Transport Facilities

2.38. Land transport facilities will be roads, railways, tunnels and bridges in Australia that are used by the public for a fee for the transport of persons or goods. [*New subsection 93L(2)*]

2.39. Facilities related to a land transport facility will include plant, buildings and other equipment needed to operate and maintain the road or railway, such as rolling stock, buildings from which staff carry out their duties, storage facilities and railway stations.

2.40. A land transport facility that services a specific project, such as a mine, is not used for the public carriage of goods and passengers and will not be able to be financed by infrastructure borrowings. This will be the case whether the taxpayer operates the specific project or provides the land transport facility to another person for a fee.

2.41. Expenditure on upgrading an eligible facility, including a facility that is not new, so as to increase its capacity, will be eligible. Maintenance and repair costs will not be eligible.

Air Transport Facilities

2.42. An air transport facility will be a runway and any associated taxiway or runway apron area in Australia used by the public to facilitate the carriage or transfer of air cargo or passengers for a fee.

Recreational and specific use air transport facilities (for example, flight training schools, heliports or helipads used for joy flights) will not be eligible facilities. [*New subsection 93L(3)*]

2.43. Related facilities would be buildings and plant necessary for the operation of an airport; including terminal buildings, buildings from which staff carry out their duties, storage facilities and other supporting infrastructure (such as aviation fuel pipelines and water and sprinkler facilities relating to normal airport safety requirements). Specific purpose equipment used for unloading cargo or passengers at the airport (such as mobile airstairs) will also be related facilities. However, general purpose motor vehicles for unloading cargo or passengers will not be related facilities.

2.44. An aviation facility that services a specific project (that is, not for public carriage) will not be able to be financed through infrastructure borrowings. This will be the case whether the borrower operates the specific project or provides the aviation facilities to another person for a fee.

2.45. Expenditure on upgrading an eligible facility, including a facility that is not new, so as to increase its capacity, will be eligible. Maintenance and repair costs will not be eligible.

2.46. Aeroplanes, gliders and similar aircraft or facilities designed for the storage, repair or maintenance of aircraft (such as hangars) will not be related facilities. [*New subsection 93M(6)*]

Seaport Facilities

2.47. A seaport facility will be a wharf or dock in Australia used by the public to facilitate the carriage or transfer of sea cargo or passengers for a fee. Recreational and specific use seaport facilities (such as boat ramps and marinas) will not be eligible facilities. Related facilities will include cranes and passenger terminals. [*New subsection 93L(4)*]

2.48. A seaport that services a specific project, such as a mine, is not used for the public carriage of sea cargo and passengers and will not be able to be financed by infrastructure borrowings. This will be the

case whether the borrower operates the specific project or provides the seaport facilities to another person for a fee.

2.49. Expenditure on the upgrading of a facility, including a facility that is not new, such as to increase its capacity, and on the upgrading of any of the above items will be eligible. Maintenance and repair costs will not be eligible.

2.50. Ships, barges, tugs and similar vessels or facilities designed for their construction or repair and maintenance (such as dry docks) will not be related facilities. *[New subsection 93M(4)]*

Electricity Generation, Transmission or Distribution Facilities

2.51. An electricity generation, transmission or distribution facility will be a facility that generates, transmits or distributes electricity principally for sale to the public. An eligible electricity facility will be any one, or combination of two or more, of these types of facilities. The electricity supplied must be sold to the public either directly by the operator of the facility or indirectly through other persons or operators. *[New subsection 93L(5)]*

2.52. The construction costs of the power station, transmission lines, transformers, substations and those buildings directly related and essential to the operation of a generation, transmission or distribution facility will be eligible.

2.53. To be eligible an electricity generation, transmission or distribution facility must not operate in an environment where competition from third parties is restricted or prevented (see later notes). *[New subsection 93O(2)]*

2.54. A facility is not eligible where it generates or supplies electricity primarily for a specific project and merely sells excess production (that is, less than 50 per cent) to the public. In this case, the majority of the electricity is not supplied to the public. Electricity generation, transmission or distribution facilities which sell, over the life of the facility, at least 50 per cent of the electricity generated or supplied to the public will be eligible electricity facilities (refer paragraph 2.77).

2.55. Expenditure on the upgrading of an eligible facility, including a facility that is not new, so as to increase its capacity, will be eligible. Maintenance and repair costs will not be eligible.

2.56. The energy source of the power station, such as a dam or coal mine, and the cost of transporting the fuel or water for generating the electricity will not be a related facility. *[New subsection 93M(5)]*

Gas Pipeline Facilities

2.57. A gas pipeline facility will be a pipeline that is used to transport gas from a processing plant on land in Australia principally for sale to the public in Australia. Only gas pipeline facilities that transport gases which liquefy under pressure (including natural gas, ethane and LPG) will be eligible. The supply of gas to the public for a fee can be either directly by the operator of the gas pipeline facility or indirectly through other persons. *[New subsection 93L(6)]*

2.58. The cost of constructing the pipeline and assets directly related and essential to the provision of transmission services (such as compressor station assets) will be eligible.

2.59. To be eligible a gas pipeline facility must not operate in an environment where competition from third parties is restricted or prevented (see later notes). *[New subsection 93O(2)]*

2.60. A facility is not eligible where it transports gas primarily for a specific project and merely sells excess production (that is, less than 50 per cent) to the public. In this case, the majority of the gas is not supplied to the public. A gas pipeline facility which sells, over the life of the facility, at least 50 per cent of the gas supplied to the public will be an eligible gas pipeline facility (refer paragraph 2.77).

2.61. Expenditure on the upgrading of an eligible facility, including a facility that is not new, so as to increase its capacity, will be eligible. Maintenance and repair costs will not be eligible.

2.62. A gas processing plant and any drilling, extraction, processing or other plant and equipment used in obtaining gas, processing it or transporting it to the processing plant will not be a related facility. *[New subsection 93M(7)]*

Water Supply Facilities

2.63. A water supply facility will be any one, or combination of two or more, of the following: [*New subsection 93L(7)*]

dams, weirs, reservoirs, tanks and related headworks which serve the purpose of storing water and regulating water flows for public use (that is, which supply a public water distribution or irrigation system);

water distribution and drainage systems, either open channels or closed pipelines, which:

- convey water to the point of use by the public (this includes general water supply, irrigation and reticulation), or
- transport water from one storage to another storage facility from which it will be supplied to the public;

pumps and pumping stations which assist in the movement of water between storages and through channels and pipelines;

water treatment facilities (equipment and structures) used for processing water and upgrading its quality such that it is fit for human consumption (that is, potable) as defined by the relevant authorities (such as the National Health and Medical Research Council of Australia); and

bores drilled for the purpose of providing water for public consumption, or other use by the public, at a charge to them, including the pumping equipment and associated structures used to extract bore water and for pumping the water along channels or pipelines.

All eligible water supply facilities must be used directly or indirectly by the public for a fee.

2.64. Related facilities will include plant, buildings and other equipment needed to operate and maintain the water facilities, buildings from which staff carry out their duties and storage facilities.

2.65. Those water supply facilities used for a specific project will not be eligible. This will be the case whether the borrower operates the

specific project or provides the service to the operator of the specific project for a fee.

2.66. Expenditure on the upgrading of an eligible facility, including a facility that is not new, so as to increase its capacity, will be eligible. Maintenance and repair costs will not be eligible.

2.67. Pools, ponds, fountains and bottled drink manufacturing and supply will not be water supply facilities or related facilities.

Sewage and Wastewater Facilities

2.68. A sewage or waste water facility will be a facility that has the purpose of treating used water (including sewage water) to improve its quality to allow its safe disposal to the natural environment or recycling for use for some other purpose. *[New subsection 93L(8)]*

2.69. The construction costs of the equipment, excavations and structures used for treating sewage and waste water in this way are eligible. Water drainage systems, either drains, channels or pipelines, which carry bulk waste water (that is, sewage water) produced by the public to or from these equipment or structures for disposal and appropriate treatment are also eligible.

2.70. Related facilities will include plant, buildings and other equipment needed to operate and maintain the water or sewerage treatment facilities, buildings from which staff carry out their duties and storage facilities.

2.71. A water, sewage or waste water facility that services a specific project (that is, is not for public use) will not be able to be financed through infrastructure borrowings. This will be the case whether the taxpayer operates the specific project or provides the treatment facilities to another person for a fee.

2.72. Expenditure on upgrading an eligible facility, including a facility that is not new, so as to increase its capacity, will be eligible. Maintenance and repair costs will not be eligible.

2.73. Private use septic tanks will not be sewage and waste water facilities or related facilities.

Related Facilities

2.74. If other facilities are necessary for an infrastructure facility to function properly (for example, a railway station or a crane to unload cargo at a seaport) the borrowings will also be able to be used to finance the construction or acquisition of these related facilities. The test is whether the facility is related to the principal facility. Facilities that are related to the "related facility" will not be able to be financed by the infrastructure borrowing. *[New subsections 93M(1) and (2)]*

2.75. In the case of "stations or passenger or freight terminals" in paragraph 93M(2)(d), those terminals or stations servicing one or more eligible facilities (that is, mixed modal terminals) will be related facilities.

2.76. An access road will not be a land transport or related facility. However, a road that is part of a facility will not be an access road. For example, if a road is part of a port facility it will not be an access road. *[New subsection 93M(3)]*

Public to Pay to use the Facility

2.77. The owner is to derive income from the public being charged a fee to use the facility. In the case of a water supply, or sewage or waste water facility, the public may be charged indirectly through a third party provided that the charge is directly related to usage.

2.78. If an arrangement is entered into between the owner of a facility and a person who is to be the sole or major user, or purchaser of the output, of a facility, under which the user (or purchaser) pays a fixed amount that is not based on actual usage or output of the facility, the facility will not be a public infrastructure facility.

2.79. If it is likely that the public will be a minor user of the facility (that is, less than 50 per cent), it will not be an infrastructure facility.

Laws Restricting Competition

2.80. If at the time the DAA considers issuing a certificate, there is a law in force which will prohibit or restrict the sale or use of a product or service in competition with the product or service provided by the infrastructure facility, that infrastructure facility will not be allowed to

be financed through infrastructure borrowings (see later notes). *[New subsection 930(2)]*

Principal Use of a Facility

2.81. The electricity or gas generated and/or transported by an electricity generation, transmission or distribution facility, or a gas pipeline facility must be principally for the sale to the public in Australia. To be "principally" sold to the public, an infrastructure facility must sell 50 per cent or more of its product or service to the public over the life of that infrastructure facility. The onus will be on the borrower to demonstrate clearly that the facility or its product is principally for public use.

- Where a facility is "principally" used by the public from the outset it will be eligible.
- However, if the facility is not used "principally" by the public from its first use, the borrower will need to demonstrate a compelling case that, over the life of the facility, at least 50 per cent of the product or service will be sold to the public.

Tax Effects of Infrastructure Borrowings

2.82. A borrowing will only qualify as an infrastructure borrowing for a period of 15 years from the day the first tranche of the borrowing is drawn down or debt instruments, such as bonds, are issued. This 15 year period is referred to as the "exemption period". *[New section 159GZZZZD of the Tax Act]*

2.83. If the loan is for a period in excess of 15 years, it will only be an infrastructure borrowing (and qualify for the concessional treatment) until the fifteenth anniversary of the borrowing. After that it will be taxed on the same basis as an ordinary fund raising.

Interest

2.84. Interest and amounts in the nature of interest received by investors derived from infrastructure borrowings will be either:

exempt from income tax; or

rebtable at a rate of 33 per cent of the amount received by the investor. (see later notes)

Part 2 - DAA Administrative Arrangements

Issue, Variation and Transfer of Certificates

2.85. The requirements for applications to issue infrastructure borrowings are as follows: *[New section 93N]*

A person who proposes to borrow money, where the person considers the borrowing to be an infrastructure borrowing, must apply to the DAA for a certificate in relation to the borrowing.

An application must contain sufficient details to enable the DAA to decide whether the borrowing is an infrastructure borrowing.

The application must specify dates by which a person intends to borrow the money.

- In the case of a direct infrastructure borrowing, the application must specify the date by which the person intends to spend the money in constructing or acquiring the facility concerned, and dates by which specified stages in the construction of the proposed facility will be completed. *[New paragraph 93N(3)(b)]*
- In the case of an indirect infrastructure borrowing, the application must specify the date by which the person intends to lend the borrowed money. *[New paragraph 93N(3)(c)]*
- In the case of a refinancing infrastructure borrowing, the application must specify the date by which the person intends to use the borrowed money to repay the other infrastructure borrowing. *[New paragraph 93N(3)(d)]*

There is an additional requirement in relation to indirect infrastructure borrowings. The application for an indirect infrastructure borrowing must be accompanied by a copy of the certificate in relation to the other borrowing, or an application for

such a certificate in relation to the other borrowing. [*New subsection 93N(4)*]

- There is also an additional requirement for refinancing infrastructure borrowings, that the application must be accompanied by a copy of the certificate in relation to the other borrowing. [*New subsection 93N(5)*]

Criteria for Issuing a Certificate

2.86. Before issuing a certificate, the DAA must be satisfied that:

- the proposed borrowing is an infrastructure borrowing; and
- the dates specified in the application are reasonable.

In the case of an indirect infrastructure borrowing where a certificate is not in force in relation to the other borrowing, the DAA must issue a certificate for that borrowing at the same time as it issues the certificate in relation to the indirect infrastructure borrowing. [*New section 93O*]

Laws Restricting Competition

2.87. In the case of a direct infrastructure borrowing, the DAA must not issue a certificate if at that time there is a law in force which the DAA considers will prohibit or restrict the sale or use of the product or service in competition with the product or service provided by the infrastructure facility. [*New subsection 93O(2)*]

Undertaking by the Applicant

2.88. When the DAA is satisfied that the applicant has met all the criteria for the issue of a certificate, the DAA must request the applicant to give an undertaking that, if the certificate is issued, the applicant will comply with all conditions applying to the certificate. [*New section 93P*]

- The undertaking must be on an approved form and be signed by the applicant where the applicant is a natural person. In any other case, the undertaking must be signed by the Chairperson of the

Board of a company, or for non-companies, another suitable natural person. *[New subsection 93P(2)]*

The DAA will not issue a certificate until the undertaking is received. *[New subsection 93P(3)]*

Form of Certificate

2.89. If the DAA grants an application for a certificate, the certificate must be in the approved form and must be in the name of the applicant. The certificate must also contain details of the borrowing of money to which it relates and state the type of infrastructure borrowing (that is, direct infrastructure borrowing, indirect infrastructure borrowing or refinancing infrastructure borrowing). *[New section 93Q(1)]*

Cancellation of Certificate

2.90. The certificate may not be varied or revoked, but may be cancelled in accordance with Part 3 of Chapter 3 of the DAA Act (see later notes). The certificate will remain in force at all times until it is cancelled. *[New subsection 93Q(2)]*

Conditions Applying to the Certificate

2.91. Certain conditions apply to a certificate once it has been issued. The applicant must agree to those conditions before a certificate will be issued. The conditions are that: *[New section 93R]*

the holder of the certificate will continue to be an incorporated body or trust throughout the 25 year assessable use, or lesser, period as mentioned in paragraphs 93I(2)(b) or (c).

the holder will do, by the dates specified (if any) in the application, all the things that were specified in the application as things the applicant intended to do in relation to:

- the borrowing;
- the spending or lending of the borrowed money;
- the construction or acquisition of any facility;
- the use of any facility;

- any transfer of the certificate holder's rights, interests and obligations in respect of any facility; and
- any other matter.
- the certificate holder will only invest the borrowed money, until it is spent or used as specified in the application, in a manner prescribed by the regulations;
- the certificate holder will not do anything that would cause section 51AD or Division 16D of the Tax Act to apply to any facility;
- the certificate holder will keep proper records detailing all its dealings with the borrowed moneys and the doing of all other things specified in the application, such as the things done in constructing the facility.

Application and Criteria for Variation of Conditions Applying to a Certificate

2.92. A certificate holder may apply to the DAA for variation of the conditions applying to the certificate. *[New section 93S]*

2.93. Following receipt of an application to vary the conditions applying to a certificate, the DAA must, in writing, vary the conditions if, and only if, the DAA is satisfied that: *[New section 93T]*

- it would still have issued a certificate if the things specified in the application for issue of the certificate had originally been as proposed to be varied; and
- it is reasonable to vary the conditions.

Transfer of a Certificate

2.94. If the holder of a certificate proposes to transfer the certificate to another person, the holder and the other person may apply to the DAA for the transfer of the certificate on a specified date. *[New section 93U]*

2.95. Provided that certain criteria are met, the DAA may transfer a certificate: [*New section 93V*]

if there is a requirement in a condition applying to a certificate, for the holder to transfer to another person all of the holder's rights, interests and obligations in relation to facilities, as a result of subsections 93K(3) and (4), those facilities will be transferred to the transferee by the specified date; or

if there is no such requirement, the rights, interests and obligations of the certificate holder in relation to the spending or other allowable use of the borrowed money, and in relation to the acquisition, construction and use of the facilities covered by the conditions applying to the certificate will be transferred to the transferee by the specified date.

The other criteria which must be met before the DAA may transfer the certificate are as follows:

the rights, interests and obligations will not be transferred to the transferee in partnership with anyone else; and

the borrower requirements (section 93I) would be satisfied by the transferee if the transferee had been the person who proposed to borrow the money, and the transferee will satisfy so much of the 25 year assessable use period that occurs after the specified date; and

the transferee intends to comply with the conditions applying to the certificate, if the transfer is approved.

Provisions Relating to Applications for the Issue, Variation or Transfer of a Certificate

2.96. An application for issue, variation or transfer of a certificate must be made in writing to the DAA in the approved form and include such information as required by the DAA. The application must also be accompanied by any report or other document required by the form. An application, accompanying report or related document is to be signed by the Chairperson of the Board of a company, or for non-companies, as specified in the form. [*New section 93X*]

Ability to Refuse to Consider an Application

2.97. The DAA may refuse to consider an application unless an applicant complies with a request for information. *[New subsection 93X(5)]*

The DAA's Decision on an Application

2.98. The DAA, after considering the application, must either grant or refuse the application. The DAA is required to advise the applicant in writing of the outcome. If an application is refused, the DAA must set out the reasons for refusal in the written notice. *[New subsections 93X(7), (8) and (9)]*

Limits on the Costs of Borrowings to the Government

2.99. Details of the cap on the cost to Commonwealth revenue of infrastructure borrowings will be set out in regulations. A regulation will specify an amount as the intended maximum cost to the Commonwealth for the financial year of the taxation consequences of the issue of certificates. A regulation may be made either before or during a financial year to which it will apply. To ensure this amount is not exceeded, the Minister may direct the DAA in writing not to accept applications during a specified period. The DAA must not accept an application if to do so would contravene such a direction. *[New section 93Y]*

Cancellation of Certificates

Cancellation or Termination: Failure to Comply with a Request to Give Information or Provide a Report

2.100. The DAA may cancel or terminate a certificate if a certificate holder fails to comply with a request for information made under Part 4 of Chapter 3 of the DAA Act. *[New section 93Z]*

Cancellation: False or Misleading Statements

2.101. The DAA may cancel in writing a certificate if a certificate holder provides the DAA or a Department officer with false or

misleading information or knowingly provides a false or misleading document. *[New subsections 93ZA(1) to (4)]*

2.102. In providing the DAA with a document:

an incorporated body is taken to know anything known by any of its directors or employees;

a corporate limited partnership is taken to know anything known by a partner (if the partner is a natural person) or by any of the directors or employees of the partner, if the partner is an incorporated body; and

a natural person is taken to know anything known by an employee of the natural person.

[New subsection 93ZA(5)]

Cancellation: Contravention of Conditions Applying to Certificate

2.103. If the DAA is satisfied that the certificate holder has not complied with conditions applying to a certificate, it must cancel the certificate in writing. If the DAA cancels a certificate for a direct infrastructure borrowing, it must also cancel (at the same time) any certificate issued for an indirect or refinancing infrastructure borrowing that relates to that direct infrastructure borrowing. *[New section 93ZB]*

Provision of Information to the DAA

Request to Provide Information or Produce Documents

2.104. A person who is an applicant for a certificate or a certificate holder must provide the DAA with information and/or documentation at the DAA's written request. The information and/or documents must be supplied within the time and in the manner specified in the request. *[New section 93ZC]*

Dealing with Documents and Information Produced

2.105. In handling documents provided at its written request, the DAA, or an authorised officer of the Department, may inspect, take

extracts from or retain copies of those documents. *[New section 93ZD]*

Certificate Holder to Provide Annual Progress Reports

2.106. A certificate holder must provide the DAA with written annual progress reports. The first report is required within one month after the end of the first 12 month period after the issue of the certificate. Subsequent reports are required annually, within one month after the end of each 12 month period after the first reporting year. The reports must provide information on the progress during the reporting year concerned in doing the things specified in the conditions applying to the certificate (such as spending the borrowed money and constructing the facility). *[New section 93ZE]*

- The reports by the certificate holder may simply specify that the conditions applying to the certificate have been satisfied and/or there has been no variation from the details specified in the certificate holder's application.

2.107. The DAA's commercial-in-confidence arrangements will be extended to cover information relating to infrastructure borrowings supplied to the DAA. Prospective infrastructure borrowers will be able to apply for protection of commercial-in-confidence information.

Provision of Information by the DAA to the Commissioner of Taxation

2.108. The DAA must advise the Commissioner of Taxation in writing of any action taken under this Act which impacts on the operation of Division 16L of Part III of the Tax Act which sets out the relevant tax provisions for the operation of infrastructure borrowings. For example, the DAA must advise the Commissioner of Taxation of the issuing of certificates. *[New section 93ZF]*

The DAA's Power to Facilitate Issue of a Certificate

2.109. The DAA, with an applicant's consent, may notify a third party that its action or inaction is preventing the DAA from issuing a certificate to the applicant. This provision allows the Authority to undertake a project facilitation role. *[New section 93ZG]*

Reporting Requirements of the DAA

Quarterly Reports by DAA

2.110. Section 115 of the DAA Act has provided for the DAA to provide the Minister with Quarterly Reports. This section will be amended to broaden its scope to include the requirement that the DAA report on the number and type of certificates granted for infrastructure borrowings in each quarter.

Under Chapter 2 of the DAA Act, which relates to the development allowance, the DAA will be required to report on the number and type of registrations for the development allowance granted in a quarter.

The DAA will be required to report on the number and type of certificates granted for infrastructure borrowings in a quarter under Chapter 3 of the DAA Act.

CHAPTER 3

Explanation of Proposed Amendments to the Income Tax Assessment Act 1936

Tax Effects of Infrastructure Borrowings

3.1. The Bill also proposes amendments to the Tax Act to:

repeal the interpretations in the income tax law that define infrastructure borrowings and related concepts, that will be replaced in the development allowance authority law; and

allow investors, at their election, to include interest income derived from infrastructure borrowings in assessable income and receive a rebate of 33 per cent of that amount.

Infrastructure Borrowings

3.2. Subdivision A of Division 16L of the Tax Act specifies the conditions under which certain loans may be characterised as infrastructure borrowings. The Bill proposes amendments that will transfer the administration of revised conditions and some other administrative responsibilities relating to infrastructure borrowings to the DAA. Accordingly, the Bill will repeal Subdivision A of Division 16L for infrastructure borrowings raised on or after the date the Bill receives Royal Assent. *[Clause 21]* A heading is omitted in consequence. *[Clause 22]*

3.3. Under the existing law if a borrowing is an infrastructure borrowing then interest and payments in the nature of interest are exempt from income tax for the exemption period.
[Subsection 159GZZZZE(1)]

3.4. Similarly, if a borrowing is a "security" within the definition of the term in section 159GP, the interest accrued on the borrowing during the exemption period is exempt from tax and not tax deductible to borrowers. Once the fifteenth anniversary of the issue of the security has passed, Division 16E will apply to determine the assessable return on the security. [Subsection 159GZZZZE(2)]

3.5. Section 159GZZZZE will be amended so that it will not apply to interest, payments in the nature of interest and accrued interest in a year of income if the taxpayer has elected to treat infrastructure borrowing (IB) amounts (see later notes) as assessable income and claim the rebate. *[New subsection 159GZZZZE(1A)]*

Exemption Period

3.6. The Bill will extend the "exemption period" from 10 years to 15 years for borrowings raised on or after the date the Bill receives Royal Assent, other than refinancing infrastructure borrowings, which will have only the balance of the exemption period of the borrowing they replace. *[New section 159GZZZZD]*

3.7. The exemption period will commence at the time of the borrowing, which is when the lender/borrower relationship is created. Investors will therefore be exempt from income tax on interest, payments in the nature of interest, and accrued interest on securities on infrastructure borrowings (for which the DAA has issued a certificate) for 15 years from the day the borrowing was raised.

Rebate Election

3.8. The amendments will provide investors in infrastructure borrowings with a choice as to the way interest, a payment in the nature of interest, or income accrued on a "security" within the definition of the term in section 159GP of the Tax Act, is to be treated for tax purposes.

3.9. The options available to an investor are to:

- treat the income as exempt; or
- include interest, payments in the nature of interest and accrued income on securities (assessable under Division 16E) in assessable income and receive a tax rebate of 33 per cent of the amount.

3.10. The rebate will be allowable on an "**IB amount**", which in the case of a share of the net income from a trust or partnership, will include an "**IB attributable amount**".

IB Amount

3.11. An IB amount will be interest, payments in the nature of interest or amounts that would be included in the assessable income of the investor under section 159GQ (which provides for the inclusion of income from certain securities on an accruals basis under Division 16E). Gains arising on the disposal of securities that are infrastructure borrowings will not be IB amounts and will not qualify for the rebate, whether those gains are of a capital or revenue nature and whether the securities are trading stock. *[New section 159GZZZZD]*

IB Attributable Amount

3.12. The IB attributable amount is the share of the net income of a beneficiary in a trust or a partner in a partnership that is attributable to IB amounts derived by the trust or partnership. It will include such amounts derived by the trust or partnership directly, or indirectly through other trusts or partnerships.

Infrastructure Period

3.13. 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

Tax Benefit Amount

3.14 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).

3.15 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 that year but for the relevant certificate. The amount will be calculated in relation to each certificate cancelled.

How to Make the Election

3.16. A taxpayer who derives income from infrastructure borrowings, either from a direct investment or indirectly through a partnership or trust, will be able to elect to claim the rebate simply by including all the IB amounts derived in a year of income in the assessable income of that year of income. *[New paragraph 159GZZZZG(1)(b)]*

3.17. In the case of an investor who claims the rebate on interest accrued on a security, the IB amount to be included in assessable income will be calculated under section 159GQ.

3.18. A taxpayer who has elected to claim the rebate on an IB amount in a particular year of income must include all IB amounts and IB attributable amounts in assessable income. A taxpayer who includes only some amounts or part of any amount in assessable income will have elected to be taxed on all the IB amounts. Any IB amount or IB attributable amount not included in assessable income by a taxpayer who has included other such amounts in assessable income of that year of income, will constitute an omission of assessable income and may be penalised in the same way as any other omission of assessable income.

3.19. An election may be made by a taxpayer who in the year of income in which the income is derived is:

a natural person;

a company;

a corporate unit trust - that is a unit trust that is taxed as a company under Division 6B of the Tax Act;

a public unit trust - that is a unit trust that is taxed as a company under Division 6B of the Tax Act;

an eligible entity for the purposes of Part IX of the Tax Act. The following taxpayers are eligible entities:

- a complying or non-complying approved deposit fund (ADF);
- a complying or non-complying superannuation fund; and
- a pooled superannuation trust.

[New subsection 159GZZZZG(1)]

3.20. A corporate limited partnership within the meaning of section 94D of the Tax Act is treated as a company for tax purposes because of the application of section 94J of that Act. A corporate limited partnership will therefore be entitled to elect to claim the rebate.

Trusts and Beneficiaries

Beneficiary Assessable Under Section 97

3.21. A beneficiary is assessable under section 97 if he or she is beneficially entitled to a share of the net income of the trust and is not under a legal disability. If the beneficiary elects to claim the rebate, the beneficiary's share of the net income of the trust will be calculated as if the IB amount derived by the trust was assessable income of the trust. A beneficiary who elects to claim an IB attributable amount received through a trust must include all other IB amounts derived from all sources in assessable income. [*New subsection 159GZZZZG(2)*]

3.22. A beneficiary in a trust whose share of net income from the trust includes an amount that is an **attributable IB amount** (see above) will be able to elect to claim the rebate on an IB attributable amount received through the trust. Any beneficiary who elects to receive the rebate on an IB amount received from a trust must include all IB amounts and IB attributable amounts in assessable income.

3.23. A beneficiary must have a share of net income from the trust to be able to treat an IB attributable amount as assessable. If the trust incurs a net loss in a year of income, a beneficiary does not have a share of the net income. IB amounts derived by a trust will not have the effect of converting a net loss incurred by a trust into net income.

Trustees

3.24. The trustee of a trust estate may be assessed on the net income of a trust estate if:

- a beneficiary is presently entitled to a share of the income of the trust but is under a legal disability (for example, a minor) (section 98); or

no person is presently entitled to the whole or a part of the net income of the trust (section 99 or 99(A)) (for example, the administration of a deceased estate has not been completed or trust income has been accumulated).

Beneficiary Assessable Under Section 98

3.25. Where a trustee is assessed as an individual under section 98 on the income of a beneficiary who is under a legal disability, the trustee is liable for any tax assessed. The beneficiary must also include the trust income in his or her assessable income and receives a rebate of tax for the amount of tax paid by the trustee (section 100).

3.26. A trustee who is assessed on the trust income of a trust under section 98 will be able to elect to claim the rebate by including any of the IB attributable amount in the net income on a share of which the trustee is being assessed. The whole IB attributable amount must then be included in that net income for the purpose of calculating that share of income.

3.27. The beneficiary will not be able to make the decision as to whether the IB amount is rebatable or exempt. The amount on which the beneficiary is assessable (under section 100) will be assessed on the same basis as the section 98 assessment to the trustee. That is, if the trustee exercises the rebate election, the income will be included in the beneficiary's share of the net income and the rebate will be included in the credit allowed (under subsection 100(2)) to the beneficiary. Where a trustee does not elect to claim the rebate, the IB amount will constitute exempt income on which the trustee is exempt from tax.

3.28. If the beneficiary on whose behalf the trustee is assessed also derives another IB amount in the same year of income from a direct investment in infrastructure borrowings, the beneficiary is free to elect to claim the rebate in that respect or to treat that income as exempt.

[New subsection 159GZZZZG(3)]

Beneficiary Assessable Under Section 99 or 99A

3.29. A trustee who is assessed on the trust income of a trust under section 99 or 99A will be able to elect to claim the rebate or to treat

the IB amount derived by the trust as exempt. *[New subsection 159GZZZZG(3)]*

Partnerships

3.30. A partner in a partnership whose share of net income from the partnership includes an amount that is an **attributable IB amount** (see above) will be able to elect to claim the rebate on the IB amount received through the partnership. Any partner who elects to receive the rebate on any IB amount received through the partnership must include all IB amounts and IB attributable amounts in assessable income. *[New subsection 159GZZZZG(4)]*

3.31. The share of the net income of a partner who has elected to claim a rebate on IB amounts will be calculated as if the IB amount derived by the partnership was assessable income of the partnership.

3.32. A partner must have a share of net income from the partnership to be able to treat an IB attributable amount as assessable. If the partnership incurs a net loss in a year of income, a partner does not have a share of the net income. IB amounts derived by a partnership will not have the effect of converting a net loss incurred by the partnership into net income.

Non-deductibility of Payments Where Rebate Election is Made

3.33. 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).

Assessment of Tax on Cancelled Certificate

3.34. 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 above), the holder of the certificate is liable to pay tax imposed by the *Infrastructure Certificate Cancellation Tax Bill 1994* 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]*

3.35. The provisions of the income tax law dealing with the issue of notices of assessment, amendments of assessments, refunds of amounts overpaid, various provisions relating to the collection and recovery of income tax, and miscellaneous provisions relating to agents, trustees, persons 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

3.36. 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)]*

3.37. 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 per cent of tax benefits obtained up 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:

$$15\% \times \text{Tax Benefit Amount} \times$$

$$\frac{\text{Part of the Infrastructure Period Occurring After the Act or Omission}}{\text{Infrastructure Period}}$$

3.38. 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.

3.39. 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").

3.40. 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 per cent 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 per cent tax.

Example

3.41. 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:

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

Kinds of Infrastructure Borrowing

3.42. Definitions of the following terms which are presently expressed in section 159GZZZU will now be included in proposed section 93D of the DAA Act:

- direct infrastructure borrowing;
- indirect infrastructure borrowing; and
- refinancing infrastructure borrowing.

3.43. The Bill amends these definitions to give each term the same meaning as in the DAA Act. The term "certificate" will also have the same meaning as in the DAA Act. *[New section 159GZZZZD]*

Secrecy

3.44. The amendment proposed to section 16 of the Tax Act (the secrecy provision) is necessary because of the restructuring of the DAA Act to provide for the administration of infrastructure

borrowings. Paragraph 16(4)(hba) of the Tax Act allows the Commissioner of Taxation to disclose information to enable the DAA to discharge its administrative responsibilities and to take prosecution action. *[Clause 20]*

Effect on Borrowings Before the Date the Bill Receives Royal Assent

3.45. Under the proposed amendments Subdivision A of the Tax Act will not apply to:

- direct and indirect infrastructure borrowings raised on or after the date the Bill receives Royal Assent; or
- refinancing infrastructure borrowings that relate to such direct or indirect borrowings

3.46. The Subdivision will continue to apply to a refinancing infrastructure borrowing raised on or after the date the Bill receives Royal Assent to repay a direct or indirect infrastructure borrowing raised before that date. The exemption period for these borrowings will continue to be 10 years, and investors in these borrowings will not be able to exercise the rebate option. *[Clause 26]*

Transitional Arrangements

3.47. 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.

CHAPTER 4

Commencement date

4.1. The amendments will apply to borrowings undertaken on or after the date the Bill receives Royal Assent. *[Clause 2]*

CHAPTER 5

Unchanged Provisions in the Income Tax Assessment Act 1936

Tax effects of Infrastructure Borrowings

Capital Gains and Losses

5.1. Where the infrastructure borrowing is in the form of a security, any gains or losses arising on the disposal of the security, whether the gain or loss is of a capital, trading or revenue nature, are exempt from tax (gains) and not tax deductible (losses). Similarly, any profit (or loss) on the redemption of a security (by the issuer) while it is an infrastructure borrowing is exempt from tax (and not deductible).

5.2. If the infrastructure borrowing is a security that has not been redeemed during the exemption period, it is deemed to be disposed of for its market value immediately before the exemption period expires, and to be acquired for the same price immediately after the exemption period expires. (The exemption period will be extended from 10 years to 15 years under the proposed amendment to the definition of that term in new subsection 159GZZZZD of the Tax Act.)

[Subsection 159GZZZZE(3) of the Tax Act]

"Bearer Debentures"

5.3. Generally, companies paying interest on bearer debentures are required to deduct tax before making the interest payment (Division 11 of Part III). However, companies paying interest on infrastructure borrowings that are in the form of bearer bonds are exempt from tax on that interest (section 125).

"Non-Residents"

5.4. Non-residents deriving interest from Australian investments may be liable for withholding tax on that interest (section 128B). However, interest paid to non-residents on infrastructure borrowings is exempt from withholding tax (paragraph 128B(3)(bb)).

Unit Trusts

5.5. Where exempt income is generated by a unit trust and is distributed to investors, the cost base of the units is normally reduced for capital gains tax purposes. However, the exempt income in respect of infrastructure borrowings does not reduce the cost base of the units in the unit trust. *[Paragraph 160ZM(3A)(d) of the Tax Act]*

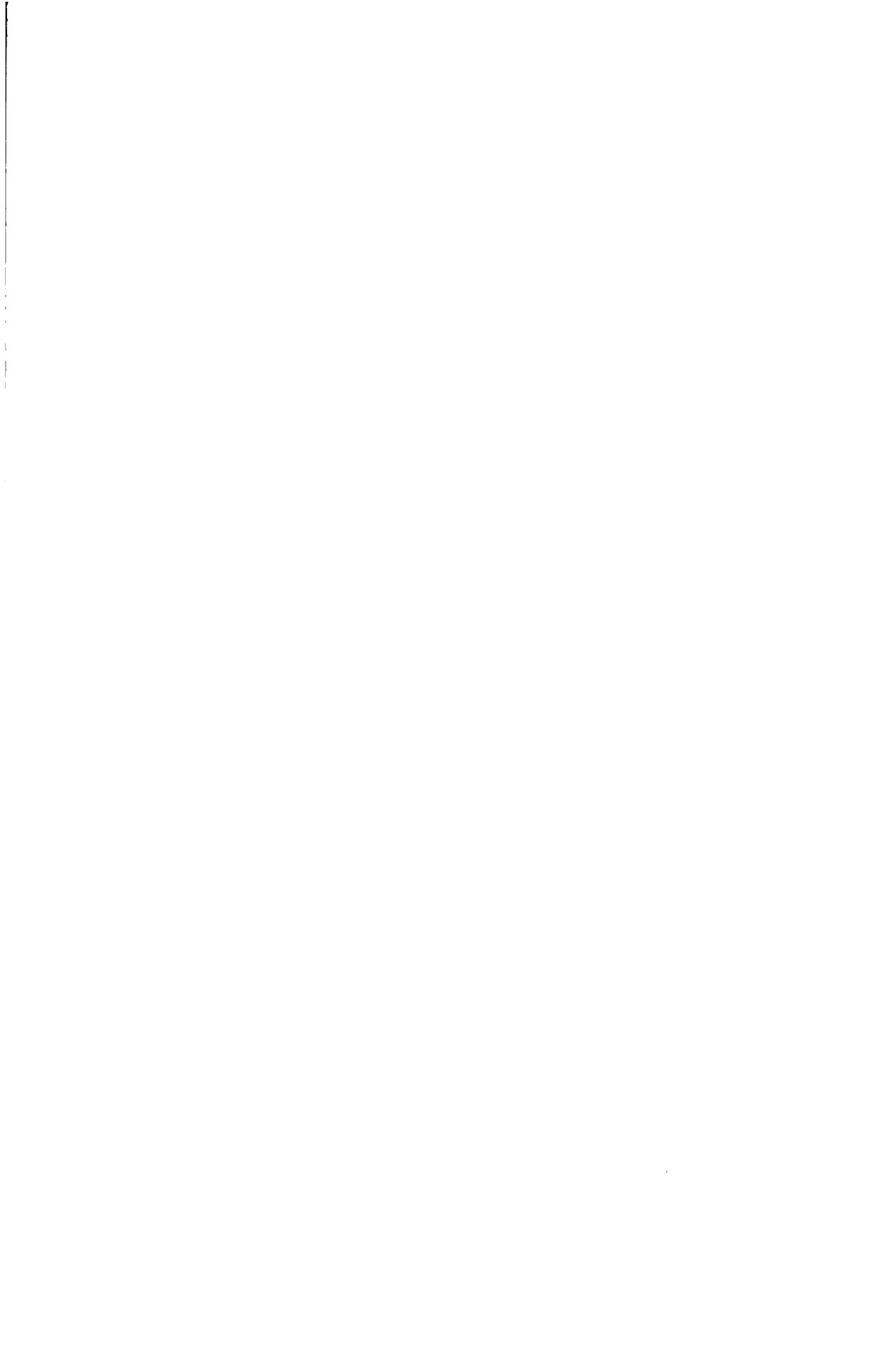
Costs Incurred by Investors

5.6. Under the existing law expenditure incurred in deriving exempt income is not tax deductible (section 51(1)). However, expenditure incurred by investors in investing in infrastructure borrowings is allowable as a deduction as if the investment was income producing. *[Section 159GZZZZF of the Tax Act]*

5.7. This concession is limited to deductions allowable under subsection 51(1) (for example, borrowing costs). Thus, deductions are not allowable for the cost of infrastructure borrowings acquired as trading stock or on revenue account or for interest or borrowings written-off as bad debts. *[Paragraph 159GZZZZE(1)(d) of the Tax Act]*









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