CORRS
IN BRIEF

MAY 2011

INFRASTRUCTURE:
PRESERVING THE VALUE OF EARLY STAGE TAX LOSSES

On Tuesday 10 May 2011, the Treasurer delivered the 2011 Federal Budget which contained only modest announcements in terms of new infrastructure investment, presumably in light of the budget deficit.

Nevertheless, after much encouragement from industry and the accompanying media speculation, the Federal Government has announced a proposal to introduce new incentives to encourage investment in "designated infrastructure projects".

The incentives are aimed at facilitating access to, and preserving the value of, early stage tax losses.

The Federal Government intends to undertake detailed consultation with industry over the next few months. If enacted, the measures will apply from the date of assent of the enabling legislation.

However, the preservation of access to and the value of early stage tax losses is only one of the challenges in promoting equity investment in brownfield projects. In particular, stamp duty remains a significant impediment to changes in ownership of infrastructure projects and it is hoped that State and Territory Governments will respond to our call for reform in this regard.

EVOLUTION OF PROJECTS

The evolution of a large scale infrastructure project presents a number of challenges in respect of early stage tax losses.

A consortium will usually establish special purpose vehicles to undertake a greenfield infrastructure project. The considerable early stage tax losses incurred in delivering the project will usually be quarantined within those vehicles. The equity investors at this stage of the project will typically include the constructors and the operators.

A mature infrastructure project which has achieved completion with established and proven revenue streams (ie. brownfield projects) will be attractive to a different profile of investor, including superannuation funds and other long term investors.

One of the impediments to investment in a brownfield project is the potential impact of a change in ownership on the ability to continue to access early stage tax losses incurred by the special purpose vehicles. Further, even if those early stage tax losses remain available, their "value" diminishes in real dollars each year.

The Government has proposed a two pronged response in respect of "designated infrastructure projects".

DESIGNATED INFRASTRUCTURE PROJECTS

The proposed incentives will apply to designated infrastructure projects. That status will be conferred on privately financed public infrastructure projects assessed to be of national significance. The decision maker and the criteria by which that assessment will be made have not been announced. However, it has been suggested that Infrastructure Australia will play a considerable role in this regard.

The incentives will also include a global capital expenditure cap for all designated infrastructure projects of $25 billion over the period of the commencement of the measures to 30 June 2017. We expect that once further details of the incentive become available, there will be considerable competition to come within the cap.

ACCESSING EARLY STAGE LOSSES

The first element of the proposed incentives is intended to give greater certainty to equity investors in brownfield projects in respect of the continued availability of early stage tax losses.

The measure will exempt losses associated with designated infrastructure projects from the current tests for determining the ability to utilise early stage tax losses, namely the continuity of ownership test and the alternative same business test (**SBT**).

While this concession may not be significant to a special purpose company or a listed widely held trust that is only concerned with a single project – and is therefore likely to satisfy the SBT following a change in ownership – it should remove one of the impediments to the consolidation being seen in the infrastructure space. However, the detail of how the measure would apply to unlisted trusts and other more innovative structures will need to be monitored.

Clarity on the ability to access early stage tax losses following a change in ownership should enable initial equity investors to better assess their exit options, and potentially reduce the cost of equity.

PRESERVING VALUE

The second element to the incentives recognises the long lead time between the incurring of deductible expenditure giving rise to early stage tax losses and the establishment of the income stream from the project. This gap represents an erosion of the real value of the early stage tax losses.

The Government's response is to "uplift" project losses associated with designated infrastructure projects by applying the government bond rate. This is not dissimilar to the design of the (now abandoned) Resources Super Profits Tax and there will no doubt be some debate as to whether the government bond rate is adequate.

RESOLVING OTHER IMPEDIMENTS

It is refreshing that the Federal Government has acknowledged that there are certain impediments to preserving value in the delivery of large scale infrastructure projects based on the differing profiles of investors during a project's evolution.

However, it now casts the spotlight on stamp duty as another significant impediment to investment in brownfield projects. Corrs has been actively involved in the development of submissions to State and Territory Governments for relief in this area, which ought to be favourably received given that it is those governments that sponsor the projects and stand to benefit most directly from the infrastructure provided.

COMMENCEMENT AND FURTHER CONSULTATION

The measures are expected to commence with effect from 1 July 2013.

The Federal Government proposes to undertake detailed consultation with industry to develop the criteria by which to confer designated infrastructure project status. We expect that industry will be particularly interested in the scope of the incentive in the context of typical structures employed to deliver large scale infrastructure projects, including trusts.

Given the long lead time to develop and deliver large scale infrastructure projects, it will be necessary for participants in those projects to monitor or otherwise be involved in the consultation process.

For further information, please contact:

Melbourne

Reynah Tang
Partner
Tel +61 3 9672 3535
reynah.tang@corrs.com.au

Rhys Jewell
Special Counsel
Tel +61 3 9672 3455
rhys.jewell@corrs.com.au

Sydney

Jonathon Leek
Partner
Tel +61 2 9210 6530
jonathon.leek@corrs.com.au

SYDNEY
Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000
Tel +61 2 9210 6500
Fax +61 2 9210 6611

MELBOURNE
Bourke Place
600 Bourke Street
Melbourne VIC 3000
Tel +61 3 9672 3000
Fax +61 3 9672 3010

BRISBANE
Waterfront Place
1 Eagle Street
Brisbane QLD 4000
Tel +61 7 3228 9333
Fax +61 7 3228 9444

PERTH
Woodside Plaza
240 St George's Terrace
Perth WA 6000
Tel +61 8 9460 1666
Fax +61 8 9460 1667

CORRS CHAMBERS WESTGARTH lawyers