Tax White Paper Task Force

The Treasury

Langton Crescent

PARKES ACT 2600

1 June 2015

To whom it may concern

**Submission to the Australian Government’s Tax Discussion Paper**

The Australian Government has commenced a process for considering future directions for Australia’s tax system. Interested parties have been invited to provide submissions to the Government by 1 June 2015.

Aurizon is a top 50 ASX-listed company and Australia’s largest rail freight operator. Aurizon provides a range of transport and logistics services in Australia. Aurizon also owns and operates the 2,670 km of rail track (the Central Queensland Coal Network (CQCN)) connecting the coal mines of Central Queensland to their export facilities on the coast.

As an Australian corporate taxpayer with a large Australian shareholder base, Aurizon has a strong interest in the Australian tax system and any tax reform process.

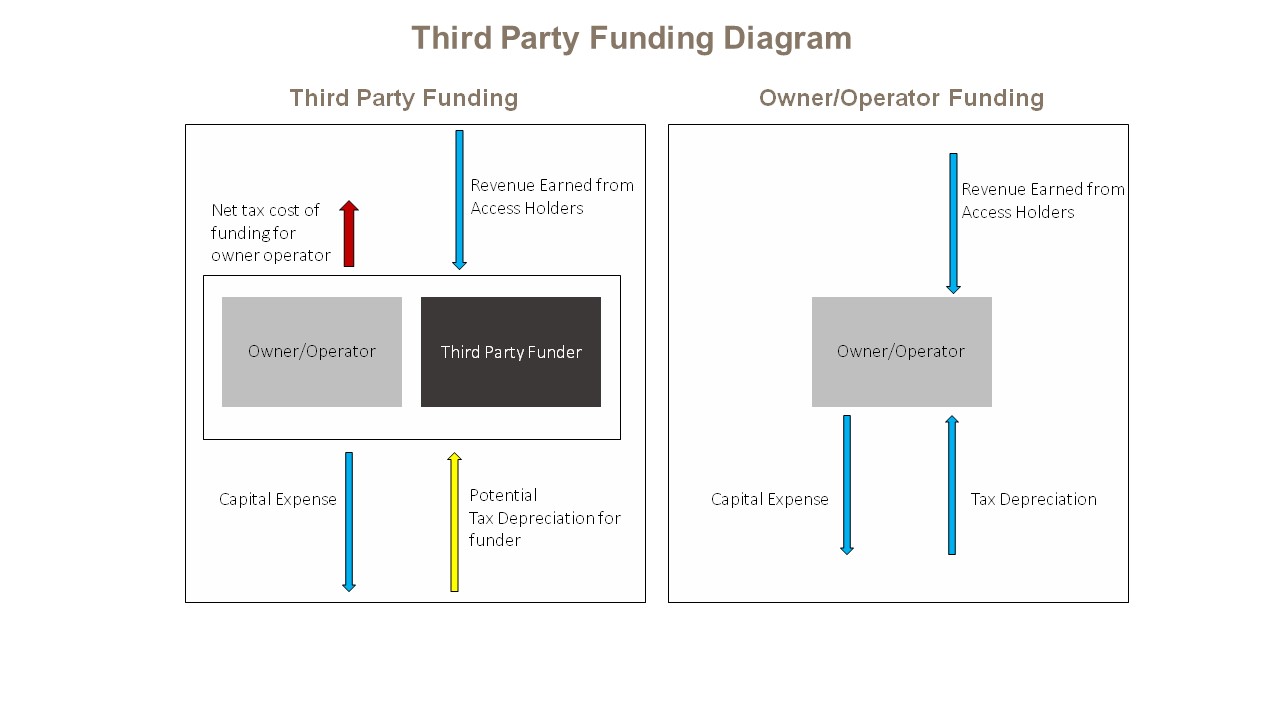
Aurizon is making this submission to seek improvements to the tax treatment of financing arrangements for infrastructure projects.

**Executive Summary**

There is increased need and/or desire for one party to fund (**Third Party Funding[[1]](#footnote-1)**) significant infrastructure assets (**Major Lineal Assets[[2]](#footnote-2)**) owned and operated by another party (**Owner/Operator[[3]](#footnote-3)**). This increased need has arisen, in part, due to the ongoing privatisation of Major Lineal Assets and the increasing need to apply new funding models to develop significant infrastructure. Where Governments retain ownership they would also benefit from effective options for Third Party Funding as an option to asset divestment or leasing when budgets are constrained.

Third Party Funding of Major Lineal Assets does not currently result in comparable tax treatment for the Third Party Funder compared to the Owner/Operator funding the same assets (**Tax Neutrality[[4]](#footnote-4)**). This is because when an asset is funded by a third party:

* the Owner/Operator is assessed upfront on the contribution received and is only able to claim tax depreciation on the constructed asset over the life of the asset resulting in a negative net present value impact for the transaction; and
* the Third Party Funder may not always obtain a tax depreciation benefit for its funding cost – potentially resulting in an additional cost to the transaction.



This lack of Tax Neutrality represents a significant impediment to such Third Party Funding and, thus, can act as a brake on investment in necessary infrastructure, with consequential negative impacts on economic growth.

Correcting this situation to provide for tax neutrality would remove this impediment and should enable greater investment in assets, expansion of businesses, growth in the Australian economy and increased taxable revenues for Australia.

A detailed explanation of the issue is provided in the attached Appendices.

**Further Information**

Should you have any questions in relation to our submission, please do not hesitate to contact the signatories below.

Kind regards

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**APPENEDIX A**

**Why is third party funding required?**

Major Lineal Assets are key infrastructure assets which are generally natural monopolies and are not able to be duplicated in an economic manner. Historically, these assets have been held by government entities, however in recent years many Major Lineal Assets have been privatised. These assets are often (but not always) regulated under Australia’s various competition regimes. Broadly, the competition regimes regulate the pricing, terms and conditions under which the existing infrastructure assets are owned and operated and require asset owners to expand the assets (**Expansions**) (except in limited circumstances)[[5]](#footnote-5) to facilitate growth and competition.

Due to the nature of Major Lineal Assets, Expansions are capital intensive and are generally integrated with existing assets, preventing separation of ownership or operation from the existing assets. For example, an Expansion to a railway network may include duplicating part of the track to enable trains to pass or strengthening existing bridges to carry longer and heavier trains. Further, significant Expansions are generally driven by demand from users of the assets (rather than the owner or operator) and are required to be completed in conjunction with other developments. For example, telecommunications systems and power distribution systems may need to be expanded at a certain time due to an expected increase in demand resulting from the construction or expansion of a mine or port.

The recent Infrastructure Australia audit also noted that Australia will have to increase the amount of funding available from both public and private sources, to maintain and grow our infrastructure networks[[6]](#footnote-6). This follows work by the Infrastructure Finance Working Group that concluded the primary issue preventing more projects proceeding was the lack of available funding and that Australia must embrace bold reforms to find new opportunities to fund projects[[7]](#footnote-7).

The owner and operator of a Major Lineal Asset (whether regulated or not) has the ability to determine whether they expand the asset (including whether or not to fund the Expansion).[[8]](#footnote-8) The owner and operator of a Major Lineal Asset may choose not to fund an Expansion due to:

* having insufficient funds available;[[9]](#footnote-9)
* having more attractive options for use of available funds (particularly where the return is regulated under a competition regime); or
* not finding the business case for investment attractive (particularly where the return is regulated under a competition regime).

Accordingly, it is necessary to have an effective mechanism for enabling third parties to fund an Expansion to Major Lineal Assets to facilitate economic growth in circumstances where an Owner/Operator does not fund.[[10]](#footnote-10)

This Third Party Funding must be competitively neutral to Owner/Operator funding in order to ensure Owner/Operators are not advantaged compared to third parties looking to fund Expansions or that the transaction costs do not provide material disincentives for the investment.

Third Party Funding under the current tax regime often does not result in Tax Neutrality (a component of the wider competitive neutrality) for the Owner/Operator or the Third Party Funder – that is, the Owner/Operator’s tax profile is affected by the capital contribution and the Third Party Funder is not placed economically in the same net position as the Owner/Operator when they fund. Overall, this results in a net higher transaction cost for Third Party Funding compared to where the Owner/Operator funds. That is, as the cost of the transaction is higher the Third Party Funder is competitively disadvantaged compared to the Owner/Operator.

There is an opportunity to provide for equitable, fair treatment of Third Party Funding. This submission is encouraging a change in tax law to enable Third Party Funding to be undertaken in a tax neutral manner. This change in law would not be expected to have a negative effect on tax revenues. This is because, to the extent tax neutrality is not able to be achieved under the existing tax rules, either the Owner/Operator is funding (i.e. Third Party Funding is not occurring) or the expansion projects themselves (and expansion of the Australian economy) are not occurring. Accordingly, the change in the law to enable tax neutral Third Party Funding should more readily enable an Expansion of Major Lineal Assets in conjunction with the expansion of other economic activity, thereby increasing taxable revenues compared to what would otherwise have been available.

**What is the tax issue with Third Party Funding?**

There are two key elements to achieving Tax Neutrality in the funding of Major Lineal Assets:

1. Treatment of funding contributions by Owner/Operators; and
2. Treatment of funding contributions by Third Party Funders .

*Treatment of capital contributions by Owner/Operators*

Currently, funding contributions by Third Party Funders are treated as assessable revenue in the income year the contribution is received by the Owner/Operator and subject to tax at the relevant rate. The Owner/Operator is able to claim a tax deduction for the cost of the construction of the Expansion over time.

Instead, these funding contributions should not be treated as income for the Owner/Operator and the Owner/Operator should not be entitled to a tax deduction for the cost of the construction of the Expansion. In this way, the contribution should be tax neutral for the Owner/Operator.

*Treatment of funding contributions by Third Party Funders*

Currently, funding contributions by Third Party Funders to an Owner/Operator are treated in varying manners under the tax law (depending on the circumstances) and may in some circumstances not give rise to any tax deduction entitlement for the Third Party Funder. The Third Party Funder should be entitled to a tax deduction for the cost of the construction of the Expansion, in the same way an Owner/Operator would be entitled to tax depreciation if it had funded the Expansion itself. In this way, the Third Party Funder would also be Tax Neutral.

Following this change of law, the funding transaction would effectively be ignored for tax purposes and the Third Party Funder would effectively be treated for tax purposes as if it owned the Expansion. Whilst this sounds simple, there will no doubt be a level of consideration required to select the optimum mechanisms to provide these outcomes without unintended consequences. Any new law would be subject to reasonable integrity provisions to prevent any potential abuse.

In summary, Aurizon believes there are significant benefits to providing for Tax Neutrality in Third Party Funding of Expansions to Major Lineal Assets*.* These benefits extend to parties who directly and indirectly utilise the services provided by such assets and to the broader Australian economy. Aurizon has consulted with various stakeholders (including mining companies, Owner/Operators and competition regulators) and has received broad support for the proposal included in this submission.

**APPENDIX B**

**Extensions Provision in Access Regulation**

A number of access regimes and economic regulatory models include the option or requirement for a customer of the service to make a capital contribution towards the extension of the facility. Under various access regimes the regulator is empowered to make an enforceable and binding determination requiring the service provider to extend the facility (both linearly and capacity) provided the service provider does not bear any costs of that extension. The rationale for these powers is summarised by the Productivity Commission in its Inquiry into the National Access Regime:

*The economic rationale for the ACCC’s powers to direct extensions is to prevent service providers undermining the objective of the regime by deliberately delaying infrastructure investment, or constructing facilities with suboptimal capacity, to limit competition and extract monopoly rents.*

The Productivity Commission also recognised that these powers are very strong and it is appropriate that safe guards are in place to protect the legitimate business interests of the service provider noting that:

*Regulatory risk associated with access regulation could impede efficient investment in infrastructure facilities. Infrastructure developments typically involve large, sunk and lumpy capital investments and a requirement to extend a facility could pose a significant risk for prospective infrastructure developers. Appropriate safeguards are therefore needed to protect the infrastructure service provider’s legitimate business interests, reduce risks and preserve investment incentives.*

This attachment summarises the relevant arrangements within a sample of regulatory framework were these provisions are enshrined.

## **National Access Regime**

The National Access Regime **(NAR)** is contained in Part IIIA of the *Competition and Consumer Act 2010* **(CCA)**. The regime applies to essential facilities which have been subject to declaration and an obligation to negotiate third party access to their facilities.

In the event of arbitration of a dispute between the service provider and an access seeker regarding the terms of access the Australian Competition and Consumer Commission **(ACCC)** may, under clause 44V(2), make a determination which:

* *requires the provider to extend the facility*

However, clause 44W(1) requires that the determination must not have the effect of:

* *resulting in the* [*third party*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s44b.html#third_party) *becoming the owner (or one of the owners) of any part of the* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility)*, or of extensions of the* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility)*, without the consent of the* [*provider*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s44b.html#provider)*; or*
* *requiring the* [*provider*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s44b.html#provider) *to bear some or all of the costs of extending the* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility) *or maintaining extensions of the* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility)*;*

## **Telecommunications Access Regime**

The Telecommunications Access Regime is contained in Part XI of the CCA. The regime applies to declared carrier services. In arbitrating a dispute between the carriage service provider and an access seeker the ACCC, may, under clause 152BC(3), make an access determination which:

* [*require*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s4.html#require)*s a* [*carrier*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#carrier) *or* [*carriage*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#carriage_service_provider)[*service provider*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#carriage_service_provider) *to extend or enhance the capability of a* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility) *by means of which the* [*declared service*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#declared_service) *is supplied*

However, clause 152BCB(1) requires that the determination must not have the effect of:

* *resulting in an* [*access seeker*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#access_seeker) *becoming the owner (or one of the owners) of any part of a* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility) *without the consent of the owner of the* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility)*;*
* *requiring a* [*person*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#person) *(other than an* [*access seeker*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#access_seeker)*) to bear an unreasonable amount of the costs of:* 
  + *extending or enhancing the capability of a* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility)*; or*
  + *maintaining extensions to or enhancements of the capability of a* [*facility*](http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s152ac.html#facility)*;*

## **National Electricity Rules**

The regulatory framework governing the achievement of the objectives of the National Electricity Market includes provision for a person wishing to connect to a declared network making a capital contribution to the augmentation of that network. This is evident in clause 50E(3) of the National Electricity (South Australia) Act 1996 which requires that if

* *a person to whom this section applies (the applicant) wants to connect to a declared shared network; but*
* *the fault levels at the proposed connection point would, if the connection were allowed, be likely to exceed the limits fixed under the Rules; then*
* *AEMO may, as a condition of entering into a connection agreement with the applicant, require the applicant to make a contribution to the cost of carrying out the augmentation to the declared shared network necessary to reduce fault levels to an acceptable level*

Similarly, clause 6.21.2 of the National Electricity Rules allows for:

* *the Distribution Network Service Provider may receive a capital contribution, prepayment and/or financial guarantee up to the provider's future revenue related to the provision of direct control services for any new assets installed as part of a new connection or modification to an existing connection, including any augmentation to the distribution network*

These provisions are usually given effect through a Capital Contributions Policy approved by the regulator. These policies may include a requirement that the customer provide additional compensation to the service provider for any additional tax liability as show in the following extract from the approved policy for Western Power.

* *The receipt by Western Power of a contribution may result in Western Power incurring a tax liability (whether under Commonwealth or State income tax and other legislation or under a tax equivalent regime applicable to Western Power as a government owned enterprise) and Western Power may recover from the applicant, as part of the contribution payable by the applicant, Western Power’s forecast of the net tax liability it will incur as a result of the receipt of such contribution*

Alternatively, the service provider incurs the upfront tax liability with recovery included in the tax asset base used to derive the annual allowable revenue.

## **AustralAsia Railway (Third Party Access) Code**

The AustralAsia Railway (Third Party Access) Code covers the facilities necessary for the operation of the railway from Tarcoola to Darwin. The access regime is certified as an effective regime for the purpose of the Competition Principles Agreement.

The access regime establishes the right to negotiate access to use the railway infrastructure between Tarcoola and Darwin. It sets out the rights and responsibilities of both access seekers and the infrastructure owner, covering matters such as terms and conditions of access, the negotiation process, and dispute resolution.

The dispute resolution procedures provide for a commercial arbitrator may, under clause 19(2) make an award which:

* *require the access provider to extend the railway infrastructure facilities*

However, clause 20(1) does not allow the arbitrator to make an award which would:

* *have the effect of requiring the access provider to bear any of the capital cost of any addition or extension to the railway infrastructure facilities, unless the access provider agrees*

## **Queensland Rail Access Regime**

The Queensland Rail access regime is contained in Part 5 of the *Queensland Competition Authority Act 1997*. The regime was certified as effective for the purpose of the Competition Principles Agreement in 2010. The regime includes a negotiate-arbitrate model where the Queensland Competition Authority (QCA) may make a determination in the arbitration of a dispute under clause 118(1) which may include:

* *require the access provider to extend, or permit the extension of, the facility*

However, clause 119(2) precludes the QCA from making an access determination which would have the effect of:

* *resulting in the access seeker, or someone else, becoming the owner, or 1 of the owners, of the facility, without the existing owner’s agreement; or*
* *requiring an access provider to pay some or all of the costs of extending the facility*

## **South Australian Rail Access Regime**

The South Australian Rail Access Regime is embodied in the Railways Operations and Access Act 1997. The regime is a negotiate arbitrate model with commercial arbitration. In making an award, clause 52(1) requires that arbitrator cannot:

* *make an award that would have the effect of requiring the operator to bear any of the capital cost of any addition or extension to railway infrastructure unless the operator agrees*

1. **Third Party Funding** is where one party funds assets which are to be owned and operated by a different party. In Aurizon’s case this occurs where a mine or other third party funds an expansion to the CQCN. [↑](#footnote-ref-1)
2. **Major Lineal Assets** are assets which are substantial, span long distances and do not have great width – for example roads, railways, pipelines, telecommunications cables and power distribution systems. In Aurizon’s case the CQCN is a Major Lineal Asset. [↑](#footnote-ref-2)
3. An **Owner/Operator** is a party who owns and operates an asset. This party may, but does not necessarily have to, fund the asset. In Aurizon’s case, it is the Owner/Operator of the CQCN. [↑](#footnote-ref-3)
4. **Tax Neutrality** is where two parties have comparatively the same tax outcomes when either funds a given asset. [↑](#footnote-ref-4)
5. See Appendix B for a summary of Extension provisions within Australian Access Regulation. [↑](#footnote-ref-5)
6. Infrastructure Australia (2015) Australian Infrastructure Audit: Our infrastructure challenges, Canberra p. 14 [↑](#footnote-ref-6)
7. Infrastructure Finance Working Group (2012) Infrastructure Finance and Funding Reform: Report to Infrastructure Australia, Canberra, p. 3. [↑](#footnote-ref-7)
8. Despite the requirement by competition regimes to expand Major Lineal Assets, the competition regimes recognise an Owner/Operator cannot be required to fund such an expansion. [↑](#footnote-ref-8)
9. This position has been acknowledged by the Infrastructure Finance Working Group of Infrastructure Australia in 2012, which recommended Australia “embrace bold reforms to find new opportunities to fund projects - and efficient finance - to support an enlarged program of infrastructure delivery.” [↑](#footnote-ref-9)
10. For regulated entities, there is generally a requirement that Owner/Operators enable third parties to fund an Expansion to their Major Lineal Asset. [↑](#footnote-ref-10)