

Queensland Resources Council:
Submission on tax aspects of
Queensland Competition
Authority Position Paper

7 July 2014

1 Executive summary

1.1 Background

As the QCA is aware, the tax aspects of the SUFA framework and SUFA documents have been the subject of prolonged negotiation between the QRC and Aurizon Network. In light of this prolonged negotiation and the still significant differences between the parties, the QRC welcomes the QCA's involvement in this process and in particular the extensive consideration of the tax aspects of SUFA and the workability, from a tax perspective, of the SUFA framework.

The QRC agrees with the QCA's view that the SUFA documents and Aurizon Network's Access Undertaking should provide the maximum level of certainty regarding the tax position and treatment of a SUFA transaction.¹ In addition, the QRC agrees with the QCA's view that as currently drafted, SUFA does *not* provide the necessary level of clarity to potential SUFA funders about the overarching tax treatment of a SUFA project, nor the tax indemnities and other tax risks associated with a SUFA transaction.² The QRC considers that the current level of uncertainty and tax risk is highly likely to prevent the SUFA framework from being workable, bankable and creditable.

1.2 QRC's view

From a tax perspective, the QRC considers that the QCA's views as expressed in the QCA Position Paper and the Term Sheets by and large represent a positive step towards developing a SUFA framework that does not expose participants to an unacceptable level of tax risk. The QRC considers that ensuring an appropriate level of tax risk is a key aspect in making SUFA workable, bankable and creditable.

The QRC welcomes the QCA's proposed measures as they relate to tax (including the QCA's proposed amendments to the transaction documents as set out in the Term Sheets) and considers that if implemented, these measures will go some way to creating a SUFA which is, from a tax perspective, workable, bankable and credible.

However, the QRC considers that several key matters require further consideration. These are:

- exactly how the Trust will establish that it is entitled to claim depreciation deductions in respect of the Extension Infrastructure, given the various technical tax requirements which must be established in order for this to occur;
- the scope of the tax indemnity provided to Aurizon Network and QTH and in particular, obtaining clarity from QTH in respect of the risks intended to be covered by this indemnity and whether this indemnity is appropriate;
- the circumstances in which a SUFA trust may generate tax losses (including in circumstances in which debt funding is provided to a SUFA trust) and the ability of the Trust to carry forward these tax losses to offset future income; and

¹ QCA Position Paper, 53.

² QCA Position Paper, 53.

- the processes and roles and responsibilities of the parties in obtaining administratively binding advices (**ABAs**) and private binding rulings (**PBRs**) from the Australian Taxation Office (**ATO**) in respect of the SUFA documents.

Each of these issues is discussed in further detail in 2 below. The QRC's submissions and comments in respect of other tax issues are discussed in section 3.

2 Key tax matters requiring further consideration

2.1 Ability of Trust to claim tax depreciation deductions

The ability of the Trust to claim tax depreciation deductions in respect of the Extension Infrastructure is fundamental to the economics of the SUFA structure as a whole, as it is depreciation deductions which allow distributions to Preference Unit Holders to be made in a tax effective manner. As acknowledged by the QCA, if the Trust is not able to claim depreciation deduction, the SUFA structure will fail its primary tax design requirement.³

The QRC agrees with the QCA's view that Aurizon Network should provide an upfront commitment to obtain ABAs on the standard form of SUFA documents and to pursue favourable PBRs in respect of a particular SUFA transaction.⁴ The QRC's view on how this process is best implemented are discussed in 2.3 below.

Confirmation of tax technical basis for depreciation

However, as a first step the QRC considers that further clarity is required as to the particular tax technical basis on which the Trust will establish that it is the "holder" of the Extension Infrastructure and therefore eligible to claim depreciation deductions. This is particularly in light of the QCA's concern that it may be Aurizon Network, and not the Trust, which will be the "holder" of the Extension Infrastructure.⁵

Although, as above, the QRC agrees that ABAs and PBRs must be sought, the QRC considers that further clarity on the technical positions is required as it will be difficult to pursue an ABA on the Trust's ability to claim depreciation without first confirming the agreed tax technical position and confirming that, to the maximum extent possible, the SUFA documents reflect and support this technical tax position.

From our previous discussions with Aurizon Network, we understand that Aurizon Network's intention is that the Trust establish it is the "holder" of the Extension Infrastructure under Item 2 of the table in section 40-40 of the *Income Tax Assessment Act 1997* (Cth). Broadly, this involves establishing that:

- the assets comprising the Extension Infrastructure are "fixed to land";
- the Trust has a "quasi-ownership right" in respect of that land; and

³ QCA Position Paper, 54.

⁴ QCA Position Paper, 54.

⁵ QCA Position Paper, 55.

- the Trust has a right to remove the Extension Infrastructure.

“Fixed to land” and “quasi-ownership right”

In respect of the first point it is intended that the assets comprising the Extension Infrastructure will, even if they are in fact affixed to land, not be *fixtures* for legal purpose.⁶ This is because, once constructed, it is intended that the assets will be statutorily severed from the land for legal purposes (see 2.2 below). Therefore, in order to establish that the Trust is the “holder” of the Extension Infrastructure under Item 2 of section 40-40, it will be necessary to distinguish between what is a *fixture* for legal purposes and what is “fixed to land” for the purposes of Item 2 of section 40-40. We understand that Aurizon Network has been successful in obtaining a PBR from the ATO on this point in another context.

Right to remove

In respect of the second point, the Trust currently has a licence to access the Extension Land under the Rail Corridor Agreement (**RCA**),⁷ which should constitute a “quasi-ownership right” for these purposes. In addition, the RCA also provides the Trust with a right to remove the Extension Infrastructure at any time.⁸

In light of the QCA’s proposal to significantly reduce the scope of the RCA, the QRC are keen to understand whether the Trust’s right to access the Extension Land and its right to remove the Extension Infrastructure will remain in the SUFA transaction documents. If this is not the case, it is likely that Item 2 of section 40-40 cannot be relied upon and the parties will need to work together to explore alternate basis (if any) on which the Trust can establish that it is entitled to claim depreciation. That the parties work together is particularly important in light of the QCA’s concern that Aurizon Network’s rights under the SUFA transaction documents may result in Aurizon Network, and not the Trust, being the “holder” of the Extension Infrastructure.

As the QCA would appreciate, given the significance of tax depreciation to the economics of the SUFA structure, it is the interests of all parties that the Trust’s entitlement to claim depreciation is clearly established.

2.2 Tax indemnity provided to Aurizon Network and QTH

Tax indemnity provided to Aurizon Network

The QRC welcomes the QCA’s proposed amendments to the tax indemnity provided by Preference Unit Holders to Aurizon Network.⁹ The QRC considers that these amendments will assist in making the indemnity more reasonable in its scope and approach.

In addition to the QCA’s proposed amendments and as proposed in the QRC’s submission on 30 August 2013, the QRC considers that the tax indemnity should not provide compensation for a loss of tax relief (for example, for tax losses utilised) as Aurizon Network will be compensated for actual tax costs in the period in which they arise. The QRC considers that providing an indemnity for tax relief foregone as well as actual tax paid will potentially allow Aurizon Network to claim twice for the same loss.

⁶ cl. 6 of the EIHL.

⁷ cl. 3.1 of the RCA.

⁸ cl. 13.1 of the RCA.

⁹ QCA Position Paper, 56. Term Sheet, section 2.4(e)(iii).

Statutory severance and duty liability

In respect of the 'back to back' tax indemnity provided by Preference Unit Holders to QTH, the QRC welcomes the QCA's proposal that appropriate legislative amendments be made as a matter of absolute priority to provide for the effective severance of the Extension Infrastructure so that the transfer and lease back of the Extension Infrastructure does not attract duty. The QRC agrees that appropriate statutory severance is likely to address, to a certain extent, the risk of the 'back to back' tax indemnity being called upon (particularly as it relates to duty).

Appropriateness of indemnity to QTH

However, the QRC considers that there is still significant uncertainty in respect of what tax risks the 'back to back' indemnity is intended to cover. The QRC agrees with the QCA's observation that the indemnity provided to QTH is likely to be unattractive and rejected as a matter of principle by third party investors.¹⁰ As stated in its 30 August 2013 submission, the QRC considers that:

- indemnification of QTH in respect of duty paid to the Queensland State Treasurer is **not** appropriate as it does not represent a 'real' loss to QTH, being a State-owned body; and
- indemnification of QTH in respect of National Tax Equivalents Regime (**NTER**) paid to the Queensland State Treasurer is **not** appropriate as it again does not represent a real 'loss' to QTH.

In respect of the first point, if despite the QRC's view the indemnity provided to QTH is to be maintained, in order to provide an additional level of protection and in addition to obtaining appropriate statutory severance, the QRC considers that further work should be undertaken to determine whether *ex gratia* or other relief may be available in respect of any duty payable on the transfer and lease back.

In respect of the second point, the QRC appreciates the QCA's efforts in liaising with QTH to confirm that QTH is not subject to the National Tax Equivalents Regime (**NTER**). However, the QRC notes that QTH's financial statements for the year ended 30 June 2013 indicate that from 1 July 2010, QTH has been registered under the NTER.¹¹ As such, if despite the QRC's view the indemnity provided to QTH is to be maintained, the QRC considers that further work is required in order to understand QTH's tax profile and the risks which the 'back to back' indemnity is intended to cover.

If, despite the QRC's views, the 'back to back' indemnity must be maintained, as set out in its 30 August 2013 submission the QRC considers that various amendments are required to the indemnity to ensure that it is truly 'back to back', properly reflects an appropriate and commercially acceptable scope and is sufficiently clear in its drafting.

2.3 Circumstances in which a SUFA trust may generate tax losses

The parties had previously proceeded on the basis that a SUFA trust would not generate tax losses. This is because it was understood that a SUFA trust would not raise debt (either directly or indirectly) and that depreciation deductions claimed by the Trust would be absorbed by rent received by the Trust from Aurizon Network such that no tax losses would arise at any stage.

Debt financing

¹⁰ QCA Position Paper, 55.

¹¹ Queensland Treasury Holdings Pty Ltd consolidated financial report 2012-13, 30 June 2013. note 2 to the financial statements.

We understand from our recent conversations with the QCA and from the QCA Position Paper that the option of the SUFA trust raising debt, either directly through a SUFA trust or indirectly through a financing trust sitting above the Trust, is now being considered.¹² Although we have not had the benefit of discussing this proposal in detail, it appears that both of these debt financing options could give rise to tax losses being generated by the Trust. We understand that Aurizon Network's position is that a SUFA trust should be run on a no-loss basis such that it does not generate tax losses.

Although the QRC has not had the benefit of discussing this issue with Aurizon Network, we understand that this is because Aurizon Network has some concerns about the Trust's ability to carry forward tax losses generated.¹³ Whilst the QRC would like to understand Aurizon Network's position and the debt raising proposal in further detail, we have set out our preliminary views on the ability of the Trust to carry forward tax losses below. However, as a general comment, we agree with the QCA's position that the tax risk arising as a result of a particular debt structure can be considered on a case-by-case basis by potential SUFA funders,¹⁴ and note that these types of issues are regularly encountered and addressed by parties to infrastructure projects and transactions.

Timing of depreciation deductions

We also understand from our recent conversations with the QCA that there may be potential for certain assets to become 'installed and ready for use' and therefore depreciable under the tax depreciation rules before the relevant assets enter the RAB and rent is received from Aurizon Network. Whilst the QRC would like to understand this issue in further detail, the QRC considers that this issue may not be of significant materiality and in any event, that consideration should be given to defining these assets as depreciable on a composite basis. If further certainty was desired, the parties could explore seeking an ABA or PBR on this point.

Trust loss rules

On the basis that the above issues could give rise to tax losses being generated in the Trust, we have briefly considered the application of the trust loss rules to a SUFA trust. Although the QRC have not had the benefit of discussing these issues with Aurizon Network, the QRC's initial view is that as currently drafted the Trust Deed (**TD**) and User Funding – Subscription and Unit Holders Deed (**SUHD**) require further amendment in order to maximise the prospects of any tax losses generated being able to be carried forward to offset future income. This is set out in more detail below.

There are various ways in which a trust can be classified which impacts the trust loss rules which apply. Based on the current SUFA structure, the QRC expect that the Trust will be classified as an unlisted widely held trust, subject to the comments below in respect of 'fixed trust' status.¹⁵

Fixed trust

In order to qualify as an unlisted widely held trust, the Trust will need to be a 'fixed trust'. Broadly, this requires limits on trustee discretion. In this regard, the QRC welcomes the QCA's recommendation that the Trustee's discretion to distribute cash flows to the Preference Unit Holders be removed.¹⁶ The QRC also welcomes the QCA's recommendation that the Trustee's ability to accumulate income be removed.¹⁷

¹² QCA Position Paper, 49.

¹³ QCA Position Paper, 49.

¹⁴ QCA Position Paper, 50.

¹⁵ This is on the basis that the a SUFA trust will be unlisted and it is likely that one or more of the Unit Holders will be a company with more than 50 members.

However, the QRC considers that further consideration and amendments to the TD and SUHD are required, in particular in respect of the following discretions of the Trustee:

- the discretion afforded to the Trustee regarding the determination of Distributable Income;¹⁸
- the ability of the Trustee to accumulate income;¹⁹
- the discretion afforded to the Trustee to determine whether any item is income or capital of the Trust;²⁰
- the ability to issue new units other than at net asset value (**NAV**) and the ability to redeem units if that redemption is at other than NAV;²¹ and
- the discretion to distribute capital or amounts in Reserve Accounts.²²

For completeness, with regard to there being two classes of units, as the documents provide that the Ordinary Unit Holder is not entitled to distributions whilst Preference Units are on issue,²³ the QRC's preliminary view is that this, and related clauses, removes the Trustee's discretion as to the Ordinary Unit Holder's entitlements to income or capital whilst Preference Units are on issue.

ATO confirmation

Even once the above issues are addressed, the QRC considers that an ABA or PBR should be obtained confirming that fixed trust status is available. This is likely to involve requesting that the Commissioner of Taxation exercise his discretion to treat the Trust as a 'fixed trust'. As recognised in the QCA Position Paper, the intention is that the Trustee act in a passive manner and focus on administrative tasks.²⁴ The QRC considers that this supports a positive exercise of the Commissioner's discretion to deem the Trust a fixed trust.

50% stake test

If the Trust is an unlisted widely held trust, the Trust must also satisfy the '50% stake test' in order to carry forward losses. Broadly, provided that the changes in the stakeholdings in income or capital of the Trust are less than 50%, this test should be satisfied. However, significant changes in the stakeholdings in income or capital of the Trust (for example, due to a Preference Unit Holder selling its units) could prevent this test being satisfied and prevent tax losses being used to offset future income.

¹⁶ QCA Position Paper, 34.

¹⁷ QCA Position Paper, 34.

¹⁸ cl. 12.2(b) of the TD.

¹⁹ cl. 12.5 of the TD and cl. 14.5 of the SUHD.

²⁰ cl. 12.1(b) of the TD.

²¹ cl. 6.7 and 10.2 of the TD.

²² cl. 12.4(a) of the TD and clause 14.1(b) of the SUHD.

²³ cl 14.1(b) of the SUHD states that 'the parties acknowledge that Ordinary Unit Holders are not presently entitled to any Distributable Income at any time that Preference Units are on issue'.

²⁴ QCA Position Paper, viii.

However, the structure and terms of any debt funding provided directly to the Trust could impact this test. In particular, depending on its terms, the possibility of third party financiers holding units in the Trust²⁵ could impact the ability to satisfy the 50% stake test and carry forward losses.²⁶

Where a listed public company has an interest in the Trust, there may also be some difficulties in tracing indirect interests for the purposes of the 50% stake test. In this regard, the QRC suggests that the Commissioner of Taxation's discretion be sought (for example, by way of ABA or PBR) to ensure that the 50% stake test is available.

2.4 Process for seeking ABAs and PBRs

The QRC welcomes the QCA's proposal that Aurizon Network should provide an upfront commitment to obtain ABAs on the standard form of SUFA documents and to pursue favourable PBRs in respect of a particular SUFA transaction. The QRC considers that the obtaining of ABAs and PBRs is essential to ensuring that the tax risk of SUFA is effectively managed such that the SUFA framework can become workable, bankable and creditable.

The QRC agrees with the QCA's view that the processes and roles and responsibilities of the parties in obtaining ABAs and PBRs must be clearly articulated and set out in the relevant documents. The QRC considers that the parties should work together to determine the most efficient and effective process for seeking ABAs and PRBs and is keen to hear the QCA's views on how this process may occur.

Roles and responsibilities for ABAs

In respect of the process and roles and responsibilities for ABAs, the QRC's view is that:

- to the extent an ABA relates to the tax treatment of the Trust, tax consequences for Preference Unit Holders or tax issues relevant to QTH, the QRC (acting as a representative of and in conjunction with Access Seekers) should be responsible for the preparation of the ABA application, negotiation with the ATO, as well as deciding whether that ABA is favourable, with Aurizon Network providing reasonable assistance and having reasonable review rights throughout this process; and
- to the extent the ABA relates to the tax treatment or consequences of SUFA for Aurizon Network (for example, the deductibility of the Rent), Aurizon Network should be responsible for the preparation of the ABA application, negotiation with the ATO, as well as deciding whether that ABA is favourable, with the QRC having reasonable review rights throughout this process.

For the QCA's information, the QRC attaches at Appendix 1 an indicative list of matters on which ABAs and PBRs would be sought.

The QRC considers that this allocation of responsibility is appropriate as it is the Preference Unit Holders who are ultimately exposed to the tax risk of SUFA, either directly or indirectly through the tax indemnity provided to Aurizon Network (and if the 'back to back' indemnity remains, to QTH). Although the tax risk of a SUFA transaction is primarily economic in nature, the QRC notes that parties also face reputational risks if the tax risk of SUFA is not appropriately managed. The QRC considers that the above processes are the best way of managing this reputational risk.

²⁵ QCA Position Paper, 49.

²⁶ The existence of any unit holders which are trusts may impact the classification of the Trust. The QRC considers that this would need to be considered on a case by case basis based on the identity of the Unit Holders.

In addition, the QRC considers that these processes are likely to provide the most efficient and effective way for the parties to obtain ABAs in respect of the standard form SUFA documents. The QRC recognises that Aurizon Network may have experience relevant to the ABA process and as such considers that Aurizon Network should providing reasonable assistance and have reasonable review rights throughout this process.

Roles and responsibilities for PBRs

The QRC welcomes the QCA's proposal that the obtaining of suitable PBRs be a condition precedent to the Expansion Project Agreement.²⁷ The QRC considers that the processes, roles and responsibilities for seeking PBRs in respect of a particular SUFA transaction should be similar to those outlined above, although the QRC acknowledges that flexibility should be retained so that parties to a particular SUFA transaction can agree whether a PBR on a particular tax issue is required and if so, which party will be responsible for seeking that PBR.

3 Additional tax matters

In respect of the more material drafting issues in the SUFA documents, the QRC welcomes the QCA's acceptance of its comments and proposed changes to the SUFA documents.²⁸

Given the QCA's preference that stakeholder submissions focus on issues rather than drafting,²⁹ we have not commented on drafting issues in the SUFA documents in this submission. Similarly, the QRC's 30 August 2013 submission did not address lower level tax drafting issues.

However, the QRC notes that from a tax perspective various aspects of the SUFA documents are still unnecessarily complex, confusing, and at times inconsistent. As such, we expect that in addition to drafting changes to address the issues discussed in 2 above, various additional drafting changes will be required to ensure that from a tax perspective SUFA is workable, bankable and credible.

By way of example, the clauses in the TD and SUHD, particularly as they relate to distributions, are still unnecessarily complex and confusing. Whilst the QCA's recommendation that the Trustee's discretion to distribute cash flows and ability to accumulate income be removed will go some way to addressing the complexity of these documents,³⁰ the QRC considers that if the SUFA documents are to be redrafted, it would be beneficial for all parties for these clauses to be simplified considerably. This is because the complexity in the SUFA documents gives rise to uncertainty and is likely to be particularly unattractive to third party investors who may not be familiar with the SUFA structure, or the operation of trusts structures more generally.

There are other aspects of the SUFA documents which could be more precise in their drafting. For example, clause 7.1(a)(iii) of the TD provides that unless otherwise expressly provided, the Preference Units have no right to receive a "return of capital" from the Trust. The QRC consider that this clause causes some confusion as to the entitlements of Preference Unit Holders and should be amended to make it clear that Preference Units can receive capital distributions, but are not entitled to returns of their "paid-up capital".

²⁷ Term Sheets, 2.4(b)(ii).

²⁸ Term Sheets, s 4.4.(c)(vi) and s 3.3(a)(ii).

²⁹ QCA Position Paper 2014, viii.

³⁰ QCA Position Paper, 34.

Appendix 1

1 Tax Rulings relevant to the Trust and Preference Unit Holders

- (a) that the Trust will not join the Aurizon Consolidated Group;
- (b) that the costs incurred by the Trustee in respect of issuing the Ordinary Units and Preference Units will be deductible over 5 years pursuant to section 40-880 of the Tax Act;
- (c) that the Preference Units will not satisfy the 'debt test' in the debt/equity rules in Division 974 of the Tax Act;
- (d) that the Fee paid by the Trustee under the Rail Corridor Agreement will be deductible to the Trustee under section 8-1 of Tax Act;
- (e) that the Rent receivable under the Extension Infrastructure Sub Lease will be assessable to the Trustee on a due and receivable basis under section 6-5 of the Tax Act;
- (f) that the sub-lease under the Extension Infrastructure Sub Lease will not give rise to a capital gain to the Trust as a result of capital gains tax event F1 in section 104-110 of the Tax Act;
- (g) that the transfer and lease-back of the Commissioned Railway Transport Infrastructure under clause 3.1 of the Extension Infrastructure Head Lease will not give rise to an assessable or deductible balancing adjustment event under Division 40 of the Tax Act;
- (h) that the transfer and lease-back of the Commissioned Railway Transport Infrastructure under clause 3.1 of the Extension Infrastructure Head Lease will not give rise to capital gain or capital loss under Part 3-1 of the Tax Act;
- (i) that the Trust will not be a 'prescribed trust' for the purposes of Division 6B of the Tax Act;
- (j) that the Trust will not be a 'public trading trust' for the purposes of Division 6C of the Tax Act;
- (k) that the Trust will not be a 'closely held trust' for the purposes of Division 6D of the Tax Act;
- (l) that the Trust is the 'holder' of the assets comprising the Extension Infrastructure under section 40-40 of the Tax Act and is eligible to claim depreciation on all assets comprising the Extension Infrastructure, including the Trust's cost in respect of the assets and whether the assets comprise a composite or single asset;
- (m) that the Trust is entitled to a deduction for any capital works relating to the Extension under Division 43 of the Tax Act;
- (n) that a distribution of the Trust's income in excess of Trust's taxable income will not be assessable income of a Preference Unit Holder and that any such amounts will be characterised as tax deferred distributions that reduce the Preference Unit Holder's cost base in their Preference Units under capital gains tax event E4 in section 104-70 of the Tax Act;
- (o) that the Trust is a 'fixed trust' including any relevant exercise of the Commissioner of Taxation's discretion with regard to tracing through listed public companies;

- (p) that the Taxation of Financial Arrangements rules in Division 230 of the Tax Act will not apply to alter the time when receipts or payments due under the Transaction Documents are assessable or deductible for tax purposes; and
- (q) that the general anti-avoidance provisions in Part IVA of the Tax Act will not apply to the arrangements contemplated by the Transaction Documents.

2 Tax Rulings relevant to QTH

- (a) that the lease under the Extension Infrastructure Head Lease will not give rise to a capital gain to the Trust as a result of capital gains tax event F1 in section 104-110 of the Tax Act;
- (b) that the transfer and lease-back of the Commissioned Railway Transport Infrastructure under clause 3.1 of the Extension Infrastructure Head Lease will not give rise to an assessable or deductible balancing adjustment event under Division 40 of the Tax Act; and
- (c) that the transfer and lease-back of the Commissioned Railway Transport Infrastructure under clause 3.1 of the Extension Infrastructure Head Lease will not give rise to capital gain or capital loss under Part 3-1 of the Tax Act.

3 Tax Rulings relevant to Aurizon Network

- (a) that the Rent payable under the Extension Infrastructure Sub-Lease will be deductible to Aurizon Network under section 8-1 of the Tax Act;
- (b) that section 21A of the Tax Act will not apply to include an amount in Aurizon Network's assessable income in relation to the construction of the Extension; and
- (c) that there will be no capital gain to Aurizon Network arising from the grant of a licence under the Rail Corridor Agreement as a result of capital gains tax event D1 in section 104-35 of the Tax Act.