Taxation of PPPs for social infrastructure projects

Guidance on the ATO's position on the taxation of social infrastructure Public Private Partnerships (PPPs).

Last updated 10 April 2024

The transactions between government, Project Trust and Finance

Income tax implications of a standard form social infrastructure PPP

Finance Co and Project Trust income tax implications plus other tax considerations to be aware of.

Variations to the standard form model

Variations to the standard form social infrastructure PPP model may have different income tax implications.

GST implications of a standard form social infrastructure PPP

These include valuation, attribution rules and administrative matters.

Tax treatment for investors in PPPs

Explains the tax treatment and implications for PPP consortium members.

QC 47235

About this guidance

This guidance updates our previous guidance called Infrastructure – Australian federal tax framework.

Last updated 10 April 2024

The purpose of this guidance is to outline our position on how the income tax and goods and services tax (GST) laws apply to social infrastructure Public Private Partnerships (PPPs) in respect of a 'standard form' securitised licence structure and a few variations on the 'standard form' structure.

It is not meant to provide the answers to all your questions or explain the tax treatment of every type of transaction you might enter. Our aim is to outline the key tax outcomes for the standard form PPP model and share our areas of concern, to help you make informed decisions about your tax affairs.

This guidance does not bind us to a particular view of the law. Only taxation rulings, taxation determinations or private rulings can do that. However, if you have transactions that are materially the same as the transactions outlined in this guidance, our officers would be expected to follow the views set out in this guidance.

The guidance may be updated as new transactions emerge, or changes are made to tax laws that may impact the analysis.

This guidance does not apply where the purported ‘standard form’ structure includes:

- the securitised licence fees relate to a pre-existing asset and/or to pre-existing cash flows
- the project entity (depicted as Project Trust in the standard form PPP) is a partnership, or
- where one or more members of the consortium effectively finance, other than insubstantial or nominal amounts, the 'design and construction' (D&C) or 'operations and maintenance' (O&M) phases of the project (such finance we refer to as 'investor debt').

Investor debt should be contrasted with third-party debt. We refer to the terms 'members of the consortium' and 'investors' interchangeably and these words should be contrasted with 'third-party investors'.

For guidance on non ‘standard form’ PPP structures, contact us or apply for a private ruling:

- Guidance and general enquiries – PGPrivateEquity@ato.gov.au
- Private rulings – PGIAdvice@ato.gov.au

What is a social infrastructure PPP?

How a social infrastructure PPP differs from an 'economic' PPP.

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A social infrastructure PPP involves a consortium of investors and a government agreeing that:

- the consortium will design, construct, operate and maintain some public infrastructure
- the consortium will obtain the financing for that infrastructure
- the government will pay the consortium for the infrastructure, plus a return, over a certain period.

Examples of the type of infrastructure that may be subject to this arrangement include schools, hospitals, prisons, roads and public utilities.

Social infrastructure PPPs are different to ‘economic’ PPPs, which involve user fees (for example, tolls or fares) being used to repay a consortium’s cost of construction and financing (rather than payments from a government).

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Structure of a standard form social infrastructure PPP

Key entities and agreements of a standard form securitised licence PPP structure.

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The substance of commercial relations

The substance of the commercial relations between the parties involved in a social infrastructure PPP is generally as follows:

- An infrastructure asset is built for the government by a private sector consortium. The period of this construction is called the D&C (design and construction) phase. The private sector consortium also obtains third-party financing for the cost of construction during this phase.
- Once the D&C phase is complete, the government
  - continues to own the asset(s) constructed/supplied, and
  - starts paying for the cost of construction, progressively paying down principal and interest over a defined term (like an amortising loan).
- The private sector consortium also operates and maintains the infrastructure. This phase is called the O&M (operation and maintenance) phase. The consortium is compensated by the government for providing this service through 'availability payments'.
- The consortium may make profits in 2 ways
  - the amount it receives from the government for the cost of construction is more than its actual cost of construction and the interest incurred on the D&C Loan during construction, and/or
  - the amount it receives from the government through availability payments is more than its actual costs for O&M services.

Standard form model

The standard form model typically contains the following entities and agreements.

Special purpose entities

There are generally 2 special purpose project entities established as follows:

1. A project trust (Project Trust), whose role it is to carry out the design, construction, operation and maintenance of the infrastructure asset. Project Trust is usually owned by the private sector consortium's members, and it is Project Trust that makes most of the profits from the project.

2. A finance company (Finance Co), whose role it is to obtain senior debt for the project. Finance Co may be held by the consortium's members or by a charitable trust (that is, a trust that distributes its entire income to one or more charities). Finance Co generally does not make profits from the project.

Agreements

The following agreements are generally entered:

1. Project Trust enters a project deed with the government, which sets out Project Trust's obligations to procure the D&C of the asset and then operate and maintain the asset. The deed also specifies the consideration payable by government to Project Trust, specifically
– the construction payment at the end of the D&C phase, and
– availability payments during the term of the O&M phase.

2. Project Trust also enters into a licence agreement covering the O&M phase with the government that allows Project Trust to access the Crown land the project is to be undertaken on. The licence payments are ostensibly the consideration for the licence agreement, but in reality, are calculated to be sufficient to repay debt (plus interest) Finance Co will owe to third-party financiers.

3. Finance Co raises external debt in the form of loans or facility agreements for the D&C phase of the project. Finance Co on-lends these funds to Project Trust (the 'D&C Loan'), which in turn, procures the design and construction of the asset. This external debt is repaid at the end of the D&C phase.

4. At the end of the D&C phase, Finance Co raises long-term external debt for the O&M phase (the 'O&M Loan'). In some circumstances, the D&C Loan and the O&M Loan may not be separate, and in other circumstances it may be a different loan with different financiers.

5. Finance Co enters into a securitisation agreement with the government under which it

– is assigned the licence payments Project Trust pays to the government, and
– pays the government a lump sum (called the receivables purchase payment) for the assigned licence payments. This is financed by the long-term debt.

6. An equalisation swap confirmation is entered into between Project Trust and Finance Co (under an International Swaps and Derivative Association (ISDA) master agreement), under which
– Finance Co's financing costs, as modelled at the outset of the agreement, are paid to Project Trust, and
– Finance Co's actual financing costs, taking into account any increase or decrease in financing costs as a result of any refinancing of the debt, are paid by Project Trust to Finance Co.

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Key transactions of a standard form social infrastructure PPP

The transactions between government, Project Trust and Finance Co in each phase of the standard form PPP.

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Phase 1: Design and construction

1. Finance Co borrows money from third-party D&C financiers in the form of loans or facility agreements. The money may be borrowed

entirely up front, or in stages (such as through a facility arrangement).

2. Finance Co uses that money to fund the D&C Loan to Project Trust. The interest payments on this loan are capitalised.

3. Project Trust uses the money from the D&C Loan to fund the design and construction of the infrastructure asset, including payments to the D&C subcontractors.

The abovementioned transactions are illustrated in Figure 1 below.

Figure 1: D&C phase key transactions

Figure 1 diagram depicts key transactions and flow of funds expected at the beginning of Phase 1 of a standard form social infrastructure PPP, being the design and construction phase.

End of design and construction phase

On completion of the D&C phase, the existing financing is unwound, and new long-term financing put in place for the O&M phase. The key transactions to give effect to this are:

4. Finance Co borrows money from third-party O&M financiers in the form of long-term loans or facility agreements.

5. Finance Co uses that money to fund the receivables purchase payment to the government.

6. The government uses the receivables purchase payment to finance the construction payment to Project Trust.

7. Project Trust uses the construction payment to repay the D&C Loan with Finance Co, plus the capitalised interest.

8. Finance Co uses the repayment of the D&C Loan to repay the D&C financiers.

The transactions expected at the end of the D&C phase are illustrated in Figure 2 below.

Figure 2: End of D&C phase key transactions

Figure 2 diagram depicts key transactions and flow of funds expected at the end of the design and construction phase.

Phase 2: Operation and maintenance

9. The government pays availability payments (also known as 'service payments') to Project Trust over the life of the O&M phase. The amount of these payments is calculated to be sufficient to:
   – cover the interest and principal payments incurred by Finance Co to the third-party O&M financiers
   – pay subcontractors to operate and maintain the infrastructure and cover related costs during the O&M phase, and
   – provide a return on equity to the consortium members.

10. Project Trust pays some of the money received from the availability payments to subcontractors to operate and maintain the infrastructure and to fund a return on equity.

11. An amount is paid by Project Trust to the government in the form of licence payments.

12. Securitised licence payments are passed to Finance Co under the securitisation agreement between the government and Finance Co. In practice, therefore, Project Trust pays the licence payments directly to Finance Co.

13. Finance Co uses the securitised licence payments to fund the repayment of principal and interest to the third-party O&M financiers. As discussed above, the licence payments are calculated to be sufficient for Finance Co to repay its debt to the third-party O&M financiers.

14. Cash flows under the equalisation swap result in any increase in Finance Co’s cost of financing being paid by Project Trust to Finance Co. Any decrease in Finance Co’s cost of financing is paid by Finance Co to Project Trust.

The transactions expected during the O&M phase are illustrated in Figure 3 below.

Figure 3: O&M phase key transactions

Figure 3 diagram depicts key transactions expected during the operation and maintenance phase.

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Income tax implications of a standard form social infrastructure PPP

Finance Co and Project Trust income tax implications plus other tax considerations to be aware of.

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The income tax implications for each special purpose entity in the standard form model of the social infrastructure PPP are detailed below.

Finance Co income tax implications

External loans/facility agreements entered by Finance Co and third-party financiers (alternatively referred to as D&C financiers and O&M financiers)

The income tax implications are as follows:

- Subject to thresholds, the Taxation of Financial Arrangements (TOFA) rules apply under section 230-45 of the *Income Tax Assessment Act 1997* (ITAA 1997).
- There will be a loss from those arrangements under TOFA to the extent that the payments made to the financiers reflect a return on those financiers' investment.

- Unless Finance Co makes an election under Division 230 of ITAA 1997, the accruals or realisation method in Subdivision 230-B will apply to the loss.
- Except in unusual circumstances (such as the project's viability being unclear, or the government potentially defaulting on its obligations), the accruals method would apply to that loss.
- We will generally accept that the TOFA accruals method could be satisfied by Finance Co relying on the effective interest method as defined in Accounting Standard AASB 9 (which supersedes AASB 139), provided this is applied consistently by Finance Co across its financial arrangements.
- The interest payable on these loans may qualify for section 128F of the *Income Tax Assessment Act 1936* (ITAA 1936) withholding tax-free status in some circumstances. The requirements of section 128F include, but are not limited to, the offer being properly and widely made, and not being made to one or more 'associate' lenders or 'associates' of the company. We may examine whether withholding tax-free status pursuant to section 128F applies.

D&C Loan entered by Finance Co and Project Trust

The income tax implications are as follows:

- Subject to thresholds, the TOFA rules apply.
- There will be a gain for Finance Co from that arrangement under TOFA, to the extent that the payments made to Finance Co reflect a return on its investment.
- Unless Finance Co makes an election under Division 230 of ITAA 1997, the accruals or realisation method in Subdivision 230–B will apply to the gain.
- Except in unusual circumstances (such as the project's viability being unclear, or the government potentially defaulting on its obligations), the accruals method would apply to that gain.
- We will generally accept that the TOFA accruals method could be satisfied by Finance Co relying on the effective interest method as defined in Accounting Standard AASB 9 (which supersedes AASB 139), provided this is applied consistently by Finance Co across its financial arrangements.

Securitisation agreement entered by Finance Co and the government

The income tax implications are as follows:

- Subject to thresholds, the TOFA rules apply as though
  - the receivables purchase payment was the equivalent of a principal investment, and
  - the securitised licence payments were the equivalent of the repayment of that principal with interest.
- This means that there should be a gain to which the accruals method under TOFA will apply (unless the unusual circumstances mentioned above arise).
- As with the above, we generally accept that the TOFA accruals method could be satisfied by Finance Co relying on the effective interest method as defined in Accounting Standard AASB 9 (which supersedes AASB 139), provided this is applied in a consistent manner across its financial arrangements.

Thin capitalisation

- The thin capitalisation rules may not apply to Finance Co where an exemption under section 820-39 of ITAA 1997 is available, even if the consortium members are non-residents. Refer to the thin capitalisation section for more details.

The equalisation swap entered by Finance Co and Project Trust

The income tax implications are as follows:

- Under the equalisation swap
  - net receipts of Finance Co will be assessable income, and
  - net payments made by Finance Co will be deductible.
- For completeness, we have general concerns with the use of swaps and other instruments which shift economic returns between entities. Specific guidance should be sought in relation to swaps outside this limited context.

Project Trust income tax implications

Construction payments and availability payments received by Project Trust from the government

The income tax implications are as follows:

- These are assessable, under section 6-5 of ITAA 1997, to Project Trust on the basis that both payments constitute 'income' according to ordinary concepts in the hands of Project Trust. They are not capital in nature.
- The TOFA rules do not apply to either payments because they involve the obligation to procure the design and construction of the infrastructure.
- In determining the timing recognition of assessable income, a method of accounting which has the effect of allocating, on a reasonable basis, the ultimate profit or loss made by Project Trust in relation to the construction over the years taken to complete the construction will be acceptable. This is consistent with the ideas and principles set out in Taxation Ruling TR 2018/3 *Income tax: tax treatment of long-term construction contracts*. However, the conditions and provisos around the reasonability and consistency of the method chosen as set out in TR 2018/3 would similarly apply in this situation.
- To avoid doubt, the profit on the construction (if any) should be assessable over the construction phase, not over the term of the overall project.
- We would expect once an acceptable method has been adopted for Project Trust, it is to be applied consistently to all income years.

Payments made by Project Trust to the D&C and O&M subcontractors

The income tax implications are as follows:

- The payments to the subcontractors are made for Project Trust to fulfil its contractual obligations to build and operate the infrastructure assets, and thus earn the assessable income referred to above. Therefore, the expenditure should fall within the first limb of section 8-1 of ITAA 1997.
- Additionally, the incurring of the construction costs will not result in any tangible asset or enduring benefit for Project Trust because it is

not the legal owner of the infrastructure asset (legally the government owns the relevant asset).

- Therefore, the expenditure should not fall within the capital-related negative limb of section 8-1 of ITAA 1997, and as a result, will remain deductible to Project Trust.
- In relation to the timing of deductions for payments made to the D&C contractor, it is acceptable, as described above, to allocate, on a reasonable basis, the ultimate profit or loss made by Project Trust over the years taken to complete the construction.

The licence payments made by Project Trust to the government

The income tax implications are as follows:

- The licence payments are purportedly made periodically to secure Project Trust's ongoing right to access the land. The payments will be set at a level able to be sold (securitised) by the government to fund the construction cost. The ATO will not seek to challenge the licence characterisation, provided the standard form securitised licence structure described above is followed.
- With respect to their deductibility, the recurrent licence payments meet Project Trust's continuous need to access the land and do not enlarge Project Trust's profit-yielding structure or secure any enduring benefit. As a result, the expenditure should not fall within the capital-related negative limb of section 8-1 of ITAA 1997 and should therefore be deductible.

Capital allowance under Division 40 of ITAA 1997

The income tax implications are as follows:

- Project Trust will not be entitled to capital allowances under Division 40 of ITAA 1997 because it will not 'hold' any depreciating assets under section 40-40.
- Neither will there be deductions under Division 43 of ITAA 1997 because neither the payments to government nor the subcontractors constitute capital expenditure (subsection 43-70(1)).
- The fact that there are no capital allowances also means that Division 250 of ITAA 1997 has no application (subsection 250-15(d)).

The equalisation swap entered by Finance Co and Project Trust

The income tax implications are as follows:

- Under the equalisation swap
  - net receipts of Project Trust will be assessable income, and
  - net payments made by Project Trust will be deductible.
- For completeness, we have general concerns with the use of swaps and other instruments which shift economic returns between entities. Specific guidance should be sought in relation to swaps outside this limited context.

Other tax considerations

- Part IVA
- Thin capitalisation – Section 820-39 of ITAA 1997

Part IVA

Subject to the provisos outlined in this guidance, the Commissioner would not generally apply compliance resources to the application of Part IVA of ITAA 1936 to the standard form securitisation PPP arrangement outlined in this guidance. This is not confirmation that the Commissioner will never look to apply Part IVA of ITAA 1936 to transactions adopting the above 'standard' social infrastructure PPP structure.

The following aspects arising in relation to a standard form transaction structure would generally not attract our compliance resources:

- The application of the exemption for special purpose entities in section 820-39 of ITAA 1997 to Finance Co.
- Project Trust securing greater deductions under section 8-1 of ITAA 1997 than the deductions it would have obtained under Divisions 40 and 43 of ITAA 1997 under a counterfactual in which Project Trust
  - constructs the assets
  - retains title to it (or otherwise holds it for capital allowances purposes), and
  - transfers it to the government at the end of the O&M phase.

However, there may be aspects of the pricing, terms and conditions of the transactions, as well as the wider circumstances, that cause us to consider the application of Part IVA of ITAA 1936 to a standard form structure. Without limitation, we consider that increased scrutiny and possible compliance activity may be warranted where:

- the tax outcomes as between Project Trust and Finance Co are asymmetric
- there are material timing differences in the recognition of assessable income or allowable deductions
- there is inconsistent or non-arm's-length pricing of arrangements between those entities.

We are also concerned if your arrangement uses, or seeks to use, existing cash flows (referred to as a 'fabricated PPP arrangement').

We discourage taxpayers from entering into structures or transactions that depart from the standard form structure other than the 2 variations outlined later in this guidance.

However, we acknowledge that there may be other proposed variations to the standard form structure. If such variations are to be proposed, we would want to understand their nature and commercial rationale and expect that you would approach us to discuss your proposal.

Thin capitalisation – Section 820-39 of ITAA 1997

Section 820-39 of ITAA 1997 exempts certain bona fide securitisation and origination entities from the application of the thin capitalisation rules.

Taxation Determination TD 2014/18 *Income tax: can the exemption in section 820-39 of the Income Tax Assessment Act 1997 apply to the special purpose finance entity established as part of the 'securitised licence structure' used in some social infrastructure Public Private Partnerships?* acknowledges, in certain circumstances, the exemption in section 820-39 of ITAA 1997 may apply to entities in the position of Finance Co, that is, to special purpose finance entities established as part of the 'securitised licence structure' used in some social infrastructure PPPs.

The application of the section 820-39 exemption in this context is subject to 4 important qualifications as follows:

1. Paragraph 820-39(3)(a) of ITAA 1997 is satisfied in the situation outlined in TD 2014/18 because Finance Co is investing in securitised licence payments. If Finance Co did not invest in a securitised cash flow or did anything in addition to investing in a securitised cash flow, then TD 2014/18 could not be relied on.
2. The total value of the debt provided to Finance Co must be at least 50% of the total value of Finance Co's assets to satisfy paragraph 820-39(3)(b). This will mean that a variation where equity is invested into Finance Co may mean Finance Co is no longer exempt from the thin capitalisation rules.
3. For paragraph 820-39(3)(c) of ITAA 1997 to be satisfied, Finance Co must be an 'insolvency-remote special purpose' entity according to criteria of an internationally recognised rating agency that are applicable to its circumstances. Where the applicable rating agency criteria apply to both Project Trust and Finance Co on a consolidated project basis, the ATO would expect the analysis of insolvency-remoteness to be undertaken in relation to both entities, and not merely in relation to Finance Co on a stand-alone basis.
4. The ATO considers there to be a high risk of non-compliance in circumstances of any variation to the above transaction where Project Trust provides any form of financing to Finance Co, or where the investors or any related party of the investors provide any form of financing directly or indirectly through interposed entities to Finance Co. Such a variation may put Finance Co outside the scope of TD 2014/18 and the requirements of paragraphs 820-39(3)(a) and 820-39(3)(c) of ITAA 1997. Further, where it appears that Project Trust is providing financing to Finance Co for the dominant purpose of obtaining a tax benefit, Part IVA of ITAA 1936 may also apply in such a case.

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Variations to the standard form model

Variations to the standard form social infrastructure PPP model may have different income tax implications.

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Variation 1: Use of a progressive securitisation

Under a progressive securitisation model, the government pays construction payments to Project Trust during the construction period, according to whether certain milestones are achieved. These construction payments are financed by the receivables purchase payment paid to the government by Finance Co, and similarly, paid progressively over the course of the construction period instead of at the end of the construction period.

All the other aspects of this model are materially the same as the standard form model. In this variation, the construction payments are used by Project Trust to finance the licence payments. These securitised licence payments are used by Finance Co to repay third-party financiers.

The result of this approach is that it minimises the extent to which Project Trust incurs deductible capitalised interest expenses without having assessable income to set off against those expenses. This causes Project Trust's carry-forward loss balance to be reduced.

Consequently, this reduces the adverse consequences for Project Trust should it become limited in its ability to carry-forward losses in the event there is a change of ownership in the D&C phase and the business continuity test cannot be satisfied.

Finance Co income tax implications

Consistent with the standard form model, the TOFA rules will apply to the securitisation agreement composed of:

- the receivables purchase payment that is paid in instalments (similar to a loan being gradually drawn down), and
- the securitised licence payments (similar to a loan gradually being repaid with principal and interest).

Consistent with the accounting treatment of the securitisation, it is not necessary for Finance Co to start accruing under TOFA the entire gain it will make from the securitisation agreement from the time the first receivables purchase payment is made. Rather, the gain under TOFA is worked out by applying a rate of return to an outstanding balance.

Project Trust income tax implications

Consistent with the standard form model, the construction payments are to be included in the assessable income of Project Trust in the year in which they are derived or otherwise treated consistently with the principles set out in Taxation Ruling TR 2018/3 *Income tax: treatment of long-term construction contracts*. We would expect once an acceptable method has been adopted for Project Trust, it is to be applied consistently to all income years.

Variation 2: Government contribution

As part of a social infrastructure PPP, the government may provide its own contributions. The form these contributions may take, and their tax outcomes, are outlined below.

Cash payment to Project Trust that must be used for certain purposes

The income tax implications are as follows:

- The cash payment is included in assessable income of Project Trust under section 6-5 of ITAA 1997 if it is paid on condition that it be used either
  - as part of the D&C of the asset, or
  - as part of the O&M of the asset.
- In working out the timing of the recognition of this income, noting the ideas and principles set out in TR 2018/3, allocating, on a reasonable basis, the ultimate profit or loss made by Project Trust in relation to the construction over the years taken to complete the

construction will be acceptable. However, the conditions and provisos around the reasonability and consistency of the method chosen as set out in TR 2018/3 would similarly apply in this situation.

- We expect you to engage with us if you consider that one or more payments are not assessable income under section 6-5 of ITAA 1997.

Payment to Project Trust on completion of design and construction

The income tax implications are as follows:

- The government may pay for a portion of the design and construction of the asset at the completion of the D&C phase. These typically commence after either a set amount or set proportion of the progressive construction payments that were financed by the receivables purchase payments have been made.
- Consistent with the analysis above in relation to construction payments, these payments should be included in assessable income of Project Trust under section 6-5 of ITAA 1997.

Early completion payments to Project Trust

The income tax implications are as follows:

- The government may agree to pay an amount as an incentive for early completion of the D&C phase. This is an amount that is usually pro-rated depending on the number of days or weeks early the D&C phase was completed. Early completion payments should be assessable income of Project Trust under section 6-5 of ITAA 1997.

Lending to Finance Co to enable purchase of securitised licence receivables

The income tax implications are as follows:

- The government may lend money to Finance Co to enable it to finance the receivables purchase payment. The tax treatment of the government lending to Finance Co is the same as the treatment of the D&C Loan and the O&M Loan as detailed above.

Buy-back of securitised licence payments

The income tax implications are as follows:

- The government and Finance Co might agree that, after a few years following the commencement of the O&M phase, the government will purchase a portion of the securitised licence payments and pay a lump sum to Finance Co as consideration. This lump sum payment will, in turn, be used by Finance Co to make an early repayment on the loan to the O&M financiers.
- The repurchase of the securitised licence payments, however, will usually be on satisfaction of certain benchmarks for the O&M phase as set out in the project deed. The price paid for the buy-back may or may not vary depending upon prevailing interest rates, or the need for the government to use the price paid to provide the consortium with an incentive to satisfy certain benchmarks.
- We will accept that the TOFA rules will apply to the securitised licence payments and the receivables purchase payments as though they were part of the one financial arrangement.
- The presence of the potential right to buy back the securitised licence payments should generally be disregarded when working out whether the accruals method provided for in Subdivision 230-B of ITAA 1997 applies, and the amount of any accrual. Once there is a buy-back, however, there may be additional implications under the TOFA rules.

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GST implications of a standard form social infrastructure PPP

These include valuation, attribution rules and administrative matters.

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> GST treatment

In determining the taxable supplies and creditable acquisitions associated with social PPP arrangements, careful consideration needs to be given to the precise terms of the relevant agreement.

Characteristics of social PPPs from a GST perspective

- The design and construction stage
- The O&M phase

Not all arrangements will be the same and the creation of different rights and obligations can result in different GST implications. However, in relation to the standard form 'social infrastructure' PPP arrangement as outlined in this guide, we have assumed that:

- the relevant infrastructure project being built or developed by the government is not used to make input-taxed supplies
- the PPP entities that are party to the arrangements
  - are registered for GST purposes
  - make supplies in carrying on their enterprises and that those supplies are connected with the indirect tax zone, and
- Finance Co exceeds the financial acquisition threshold.

In the context of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) it is necessary to identify the relevant supplies being made. Figures 4 and 5 below identify the key supplies that will arise in a standard form PPP arrangement during the D&C and O&M phases. Note that Figures 4 and 5 represent the same transactions as outlined in the **key transactions** section of this guidance, but with an emphasis on the supplies that are pertinent for GST analysis.

The design and construction stage

The key supplies in the D&C phase for GST purposes are as follows:

1. The D&C financiers supplying a loan to Finance Co, either up front, or in stages (such as through a facility arrangement). Finance Co will subsequently repay that loan to the D&C financiers over time.

2. Finance Co supplying a loan to Project Trust. Project Trust will subsequently repay the loan to Finance Co over time.
3. D&C subcontractors supply construction services to Project Trust.
4. Project Trust supplying D&C services to the government.

Figure 4: Expected supplies from a standard form PPP during D&C phase

Figure 4 diagram depicts the expected financial supplies during the design and construction phase of a standard form PPP.

The O&M phase

The key supplies in the O&M phase pertinent for GST purposes are as follows:

5. The government granting a licence to Project Trust for the right to access the Crown land for the operational and maintenance services to be undertaken on, for which it receives licence payments as consideration.
6. Project Trust supplying ongoing operational and maintenance services to the government.
7. The government assigning its right to receive the licence payments to Finance Co under the securitisation agreement (and noting that Finance Co pays the receivables purchase payment under this agreement).
8. The O&M financiers providing long-term loans or facilities to Finance Co.
9. Finance Co and Project Trust exchanging rights to make a payment based on Finance Co's financing cost, being the equalisation swap.

Figure 5: Expected supplies from a standard form PPP during the O&M phase

Figure 5 diagram depicts the expected financial supplies during the operation and maintenance phase of a standard form PPP.

GST treatment

- Funding arrangements between Finance Co and the third-party financiers

- Funding arrangement between Finance Co and Project trust
- Securitisation arrangement between the government and Finance Co
- Equalisation swap agreement between Finance Co and Project trust
- Attribution rules
- Valuation
- Administration matters

The typical GST treatment for the standard form PPP arrangement is expected to be as follows:

- The loans or other financial facilities with the external financiers, or by Finance Co to Project Trust, are input-taxed financial supplies by both the relevant lender and borrower.
- The securitisation agreement involving the supply of the right to receive cash payments under an agreement will also be an input-taxed financial supply by the government.
- The supplies by the D&C subcontractors to Project Trust are taxable supplies by those subcontractors. These supplies also constitute creditable acquisitions by Project Trust and Project Trust is entitled to claim the corresponding GST credits.
- The supply of D&C services by Project Trust to the government is a taxable supply. The construction payments paid by the government are consideration for that supply. As a result, GST is payable on the taxable supply by Project Trust, and the government can claim a corresponding GST credit.
- The licence over real property granted by the government is a taxable supply. Project Trust as the recipient makes a creditable acquisition from the government. As a result, GST is payable on the supply by the government and Project Trust will be entitled to claim a GST credit for this acquisition.
- Project Trust makes a taxable supply of the ongoing O&M of the project infrastructure to the government. The availability payments paid by the government are consideration for the taxable supply made by Project Trust. As a result, GST is payable on the taxable

supply by Project Trust, and the government is entitled to claim the corresponding GST credit.

- The payments (made by either Finance Co or Project Trust to each other) that arise under the equalisation swap represent additional consideration for the initial supply of the rights in the equalisation swap. These supplies are input-taxed financial supplies as they are the supply of a derivative made by both Finance Co and Project Trust.

Funding arrangements between Finance Co and the third-party financiers

When Finance Co enters a debt funding arrangement (on either a short-term or long-term basis) with the third-party financiers, the ATO accepts that:

- Finance Co acquires an interest in a credit arrangement for consideration and makes an input-taxed financial supply
- Finance Co is not liable to pay GST on this supply and generally has no entitlement to a GST credit for anything acquired or imported to make the supply (unless the thing acquired or imported qualifies as a reduced credit acquisition).

Funding arrangement between Finance Co and Project trust

When Finance Co enters a D&C loan with Project Trust, the ATO accepts the following:

- Finance Co provides an interest in a credit arrangement to Project Trust for consideration and has made an input-taxed financial supply to Project Trust.
- Finance Co is not liable to pay GST on this supply and generally has no entitlement to a GST credit for anything acquired or imported to make the supply (unless the thing acquired or imported qualifies as a reduced credit acquisition).
- Project Trust, in acquiring an interest in a credit arrangement from Finance Co for consideration, also makes an input-taxed financial supply to Finance Co.
- While Project Trust is not liable to pay GST on this supply, it may be entitled to a GST credit on things acquired or imported to make the

supply. This is due to Project Trust being able to enjoy the benefit of either the financial acquisition threshold or ‘borrowings rule’ concessions.

- Where Finance Co has a right against Project Trust to ‘on-charge’ the costs it incurs (as a principal) in borrowing funds from the external financiers, the payment of this amount by Project Trust to Finance Co may be further consideration for financial supplies depending on the documentation (see paragraphs 191–197 of Goods and Services Tax Ruling **GSTR 2002/2** *Goods and services tax: GST treatment of financial supplies and related supplies and acquisitions)*.

Securitisation arrangement between the government and Finance Co

When the government enters into the securitisation agreement with Finance Co for the securitisation of the licence fee payments that Project Trust is required to make to the government, the ATO accepts the following:

- The government is not liable to pay GST on this securitisation supply and will be entitled to a GST credit for anything acquired or imported to make the supply, where it is able to take advantage of the financial acquisition threshold concession.
- Where the government is not able to access this concession, it will generally not be entitled to a GST credit for anything acquired or imported to make the supply (unless the thing acquired or imported qualifies as a reduced credit acquisition).
- Whether the government is entitled to GST credits on the acquisition of the asset being designed and constructed by Project Trust depends upon whether the acquisition is found (based on an objective assessment of the facts and surrounding circumstances) to have a sufficient connection to the financial supply that the government makes to Finance Co under the terms of the securitisation agreement.
- Goods and Services Tax Ruling **GSTR 2008/1** *Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?* provides our views on when an entity acquires or imports anything solely or partly for a creditable purpose. In this case, based on the facts and circumstances described, and the guidance provided by GSTR 2008/1, the ATO

considers that the government would be entitled to a GST credit in respect of the asset as the acquisition does not have a sufficient connection to the financial supply that the government makes to Finance Co.

- Finance Co, in acquiring an interest in a debt from the government for consideration, also makes an input-taxed financial supply to the government.
- Finance Co is not liable to pay GST on this supply and generally has no entitlement to a GST credit for anything acquired or imported to make the supply (unless the thing acquired or imported qualifies as a reduced credit acquisition).
- The assignment of the licence fee income stream does not change the underlying supply of the licence over real property that the government provides to Project Trust for these payments. The government retains the obligation to make this supply and remit any GST liability in respect of that supply. So long as the government continues to make the underlying supply, it will be entitled to claim GST credits on its acquisitions to make that supply in much the same manner as before the assignment occurred.

Equalisation swap agreement between Finance Co and Project trust

When Finance Co and Project Trust enter into an equalisation swap under the ISDA master agreement, the ATO considers the following to apply:

- Both parties exchange rights to make a payment dependent upon the value of Finance Co's financing costs. This constitutes each party making an input-taxed financial supply of rights under the equalisation swap, which are derivatives, to the other for the consideration of the rights exchanged.
- For Finance Co, it is not liable for GST on this supply and generally has no entitlement to a GST credit for anything acquired or imported to make the supply (unless the thing acquired or imported qualifies as a reduced credit acquisition).
- For Project Trust, it is similarly not liable for GST on this supply, but will be entitled to a GST credit on things acquired or imported to make the supply if it is able to take advantage of the financial acquisition threshold concession.

- No GST consequences arise from either party making a payment to the other in discharge of its equalisation swap obligation.

Attribution rules

The timing of an entity's GST liabilities and GST credit entitlements is driven by the tax period (either monthly or quarterly) to which that obligation or entitlement is attributed.

In the context of a PPP, where a party to the PPP accounts for GST on a non-cash basis, a GST liability or a corresponding GST credit entitlement is attributable to the earliest tax period in which either:

- any of the consideration or payment (monetary or non-monetary) is received, or
- an invoice is issued.

An entity must also hold a tax invoice for the creditable acquisition when it claims the GST credit.

If the arrangement provides for the payment of an amount for the licence or the operating rights to be made on a progressive or periodic basis, then the rules in Division 156 of the GST Act about progressive and periodic supplies will apply to attribute any GST liability and GST credit on a progressive basis.

Understanding when a GST liability is triggered in these types of arrangements assists the developer to ensure that they have adequate cash flow for the life of the project.

Valuation

PPP arrangements can also raise issues regarding how to determine the appropriate market value of any non-monetary consideration provided.

We accept that parties dealing with each other at arm's length can use a reasonable valuation method as agreed between them to determine the GST inclusive market value of any non-monetary consideration for supplies arising in the context of a PPP.

Administration matters

We maintain running balance accounts for various taxes. These taxpayer accounts record obligations, payments, and credit entitlements under tax laws.

In general, where the taxpayer is due a credit entitlement or refund of payment, this amount may be reduced due to **offsetting**. Use of the term ‘offsetting’ describes when an amount that we owe to the taxpayer is applied or allocated against another debt owed by the taxpayer, therefore reducing their refund.

For completeness, in circumstances where a taxpayer has no outstanding tax debts or other Commonwealth liabilities to offset, we are required to refund the credit to the taxpayer.

For more on this subject, see Practice Statement Law Administration PS LA 2011/21 *Offsetting of refunds and credits against taxation and other debts*.

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Tax treatment for investors in PPPs

Explains the tax treatment and implications for PPP consortium members.

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On this page

How is the investment structured?

Typically, the PPP structure will be established as a holding trust (Project Hold Trust) which will hold all the equity in an operating entity (Project Trust), as illustrated in Figure 6.

Typically, each consortium member will subscribe for equity in a Special Purpose Vehicle (Investor SPV) which will in turn subscribe for equity in Project Hold Trust, or alternatively the consortium member may invest directly in Project Hold Trust (illustrated in Figure 6). Some of the consortium members may initially invest into Project Hold Trust for a purpose of making a profit from the sale of their interests within a few years after the end of the D&C phase. Other members will have longer investment horizons.

In some PPP structures, the equity in Finance Co will be held by a charitable trust, potentially via a holding company (depicted as 'Australian Charity' and 'Finance Hold Co' in Figure 6). Again, for clarification, a charitable trust is a trust that distributes its income entirely to one or more charities.

Figure 6: Typical consortium structure

Figure 6 diagram depicts the typical holding and investment structure of a standard form PPP.

Tax treatment of the investment

This section will examine the tax treatment for investors in a social infrastructure PPP.

- The Charity
- The Australian long-term investor
- The Australian short-term investor
- Investor 1 SPV and Investor 2 SPV

The Charity

If Finance Hold Co makes a profit, there may be a distribution to the Australian Charity. A discussion on the taxation arrangements applying to charities is outside the scope of this guidance and is dealt with in the **not-for-profit** section of our website.

Where the taxable income allocated to the Australian Charity aligns with its economic result (for example, the Australian Charity receives distributions of income broadly aligning with the profit of Finance Hold Co or its net income (if trusts are used)), Part IVA of ITAA 1936 is unlikely to apply.

The Australian long-term investor

Treatment of distributions received from Project Hold Trust

Where the Australian long-term investor (or its special purpose vehicle) is presently entitled to a distribution from Project Hold Trust, the assessable income of the Australian long-term investor (or its vehicle) will include its proportionate share of the net income of Project Hold Trust. The net income of Project Hold Trust is typically defined to be equal to its taxable income.

Division 6 of ITAA 1936 sets the framework around the taxation of trusts.

Tax deferred distributions

In some income years, the distributions by Project Hold Trust may be comprised of accounting income in excess of the net income of Project Hold Trust determined under Division 6 of ITAA 1936. The extent to which the distribution is in excess of the net income is a 'tax-deferred distribution' (TDD).

Under our compliance approach, on the assumption that the Australian long-term investor holds its investment in Project Hold Trust on capital account, the TDDs will generally be treated as non-assessable amounts under the capital gains tax (CGT) cost base and reduced cost base rules (see our compliance approach).

The Australian short-term investor

The Australian short-term investor purchases the units in Project Hold Trust (either directly or through its special purpose vehicle) with a view to selling those units for a profit within a few years after purchasing them (usually after the end of the D&C phase).

Often one of the consortium members will also be the D&C contractor. It may be the case that the D&C contractor's purpose in being a participant in the project is to make a short-term profit from the construction of the asset, with no intention of maintaining ownership in Project Hold Trust during the O&M phase.

In this circumstance, the units are held on revenue account, and any gain or loss from the sale of them may be treated as ordinary income under section 6-5 or deductible under section 8-1 of ITAA 1997. See

Taxation Ruling **TR 92/3** *Income tax: whether profits on isolated transactions are income* for an explanation as to when this may occur.

Under our compliance approach, TDDs will generally not be assessed as ordinary income provided that the TDD, including CGT concessional amounts, are fully taken into account in working out revenue gains and losses on those units (see our **compliance approach**).

Investor 1 SPV and Investor 2 SPV

The tax treatment of Investor 1 SPV and Investor 2 SPV will depend upon whether they are managed investment trusts (MITs) as defined in section 275-10 of ITAA 1997.

If the trusts are not managed investment trusts

If Investor 1 SPV and Investor 2 SPV are not MITs for a particular income year, then Division 6 of ITAA 1936 and CGT will apply similar to the way those provisions apply to the Australian investors.

However, the beneficiaries of Investor 1 SPV and Investor 2 SPV in Figure 6 are non-residents. As a result, the trustee of Investor 1 SPV and Investor 2 SPV will be taxed in relation to the beneficiaries. The trustee is taxed to assist in the collection of Australian tax on relevant income.

Specifically, under section 98 of ITAA 1936, the trustee of the trusts will be liable to pay tax on the non-resident investor's share of the net income of those trusts. For more information, see **Tax on trust distributions to non-resident beneficiaries**.

If the trusts are managed investment trusts

Investor 1 SPV and Investor 2 SPV may be MITs as defined in section 275-10 of ITAA 1997 for a particular income year.

For more information, see **Management investment trusts – overview**.

If the trust is a MIT for a given income year, then a special MIT withholding rate on distributions of fund payments may apply and if so, the trustee assessment under section 98 of ITAA 1936 as mentioned above will not occur.

However, one of the key issues regarding whether Investor 1 SPV and Investor 2 SPV will be MITs relates to the requirement that these trusts do not control (directly or indirectly), or are not able to control (directly or indirectly), a trading business. In this regard, we observe that:

- the business of Project Trust in a social infrastructure PPP is a trading business, and
- if Investor 1 SPV and Investor 2 SPV control the affairs and operations of Project Trust through control of Project Hold Trust, then Investor 1 SPV and Investor 2 SPV will not meet the requirements to be MITs.

Additionally, in determining whether Investor 1 SPV and Investor 2 SPV qualify as withholding MITs, particular care should be taken to ensure that:

- the trust is a managed investment scheme (within the meaning of section 9 of the *Corporations Act 2001*), and
- the trust carries out a significant proportion of its investment management activities in Australia throughout the income year.

We may apply compliance resources to ascertain whether purported MITs or withholding MITs satisfy these requirements.

Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Act 2019 introduced several measures to limit access to concessions currently available to foreign investors for passive income.

Relevantly it provides that distributions from a trading trust (or a partnership or trust that would satisfy the definition of a trading trust) to a MIT (either directly or indirectly through a chain of flow-through entities) are treated as non-concessional MIT income and subject to MIT withholding at a rate of 30% (instead of 15% that would generally apply, depending on the country the beneficiary is resident in).

Project Trust is likely to be a trading trust because it carries on a trading business. Accordingly, income derived by Investor 1 SPV and Investor 2 SPV from Project Hold Trust will be subject to the 30% MIT withholding rate.

For details of the tax rates that apply to particular types of beneficiaries and types of investments, see **Withholding tax arrangements for managed investment trust fund payments**.

The foreign resident investors

If the trust that the foreign investors hold their Project Hold Trust units in (that is, Investor 1 SPV and Investor 2 SPV in Figure 6) is not a MIT for the given income year, the tax assessed to the trustee in relation to the foreign resident investors (as non-residents) is generally not a final tax. If the trustee is assessed under subsection 98(3) of ITAA 1936 in respect of an individual or company beneficiary, those beneficiaries are assessed under subsection 98A(1) and allowed a credit under subsection 98A(2) for tax paid by the trustee.

Where offshore beneficiaries are assessed under subsection 98A(1) and allowed a credit under subsection 98A(2) for tax paid by the trustee, the ATO would be concerned to ensure arrangements such as those outlined in Taxpayer Alert **TA 2020/3** *Arrangements involving interposed offshore entities to avoid interest withholding tax* are not entered into.

If the trustee is assessed under subsection 98(4) of ITAA 1936 in respect of a trustee beneficiary, the trustee beneficiary and any later trustee in the chain of trusts is not assessed again on that amount under sections 98, 99 or 99A. However, an amount may be taxed to an ultimate individual or company beneficiary under sections 97, 98A(3) or 100, with the beneficiary allowed a credit under section 98B for the tax paid by the trustee.

However, if the trust is a MIT, and MIT withholding tax has applied to the distribution, then to that extent the distribution will be non-assessable non-exempt income for the foreign resident investor.

Tax treatment upon exit of the investment

The tax outcomes if an investor exits their investment are outlined below.

- The long-term Australian investor
- The short-term Australian investor
- The long-term foreign investor
- The short-term foreign investor

The long-term Australian investor

CGT event A1 will generally occur if the long-term Australian investor (or its special purpose vehicle) sells the units held in Project Hold Trust.

In working out the capital gain from CGT event A1 (including any reduction in cost base under CGT E4), TDDs would need to be taken into account, as outlined above.

The short-term Australian investor

Because the units in Project Hold Trust are held on revenue account, any gain or loss from the sale of them may be treated as ordinary income under section 6-5 or deductible under section 8-1 of ITAA 1997.

However, for the short-term Australian investor to avail themselves of our compliance approach in relation to TDDs as outlined above, those TDDs must be taken into account in working out revenue gains and losses on those interests.

The long-term foreign investor

Generally, CGT will not apply to the long-term foreign investors selling their units in Investor 2 SPV. This will be true so long as, consistent with the example being used, the assets of the Project Hold Trust do not constitute taxable Australian property as defined in section 855-15 of ITAA 1997.

The short-term foreign investor

An exemption for the gain upon the sale of the units in Investor 1 SPV will not apply if any income from their sale is treated as ordinary income under section 6-5 of ITAA 1997. In working out the amount of ordinary income, consistent with our compliance approach in relation to TDDs, the amount of any TDD should be taken into account.

The fact that there is an amount of ordinary income does not automatically mean that the gain is taxable in Australia.

Where the short-term foreign investor is a non-resident, any income from the sale will only be taxable in Australia to the extent that the income is from an Australian source. In determining whether the income from the sale is from an Australian source, the question is not dependent solely on where the purchase and sale contracts are executed in respect of the sale of the units.

Relevantly, the Full Federal Court of Australia considered the source of income derived from the sale of shares in *Commissioner of Taxation v Resource Capital Fund IV LP [2019] FCAFC 51*. The Court found that, though the agreements were negotiated outside of Australia, as a practical matter of fact the proceeds of the share sale had an Australian source. This finding was based on the:

- proximate origin of the rights to that income
- nature of the investment strategy including the active management of the investment
- location, extent and nature of the involvement of any employees and decision-makers in the investment strategy and active management of the investment
- location of any board members appointed to relevant entities by the investors
- location, nature and extent of income earning operations of the underlying business
- location, nature and extent of income earning property of the underlying business.

We consider an assessment of these factors will be relevant to determining the source of income derived from the sale of the units in Investor 1 SPV.

While issued in the context of the sale of the shares by a private equity fund, Taxation Determination **TD 2011/24** *Income tax: is an 'Australian source' in subsection 6-5(3) of the Income Tax Assessment Act 1997 dependent solely on where purchase and sale contracts are executed in respect of the sale of shares in an Australian corporate group acquired in a leveraged buyout by a private equity fund?* outlines some of the other factors we will consider when determining the source of the income from the sale of the units.

Where the short-term foreign investor is a resident of a country with which Australia has a tax treaty, the business profits article will likely determine which country has the taxing rights in respect of any profit (assuming the disposal is not 'land rich' and covered by the disposal of real property article). It is generally the case that only the country of residence of the profit maker will be entitled to tax those profits, although this may depend upon whether the interests of the short-term foreign investor are held at or through a permanent establishment located in Australia.

If there is no Australian permanent establishment, the short-term foreign investor in treaty countries will not usually be subject to tax on their Australian sourced business profits (although this will depend upon the terms of the relevant business profits article).

That said, if the gain on disposal is not taxed under section 6-5 of ITAA 1997, any residual application of CGT, subject to the provisos outlined above, would need to be considered.

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If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

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