



2 February 2015

Committee Secretary
Senate Economic References Committee
Parliament House
Canberra ACT 2600
economics.sen@aph.gov.au

Dear Sir/Madam

Submission of Transurban – Senate Economics References Committee inquiry into corporate tax avoidance and minimisation

We refer to your letter of 27 October 2014 and thank you for giving Transurban the opportunity to make a submission to the Senate Economics References Committee inquiry into corporate tax avoidance and minimisation.

1 Executive summary

Transurban delivers significant benefits to governments by funding critical infrastructure that connects its communities to drive economic growth. This requires heavy upfront investment and risk-taking by Transurban and its partners to deliver long-term infrastructure projects. This is optimally achieved through a holding structure that enables the delivery of benefits to shareholders whilst complying with accounting and tax rules. This leads to a point of tax capture at the shareholder level which would not otherwise be available under a single company structure.

Transurban has always been and continues to be committed to full compliance with both tax policy and tax laws. Our emphasis on ensuring compliance with the law is reflected in a Board-approved tax risk policy and long-standing co-operative relationship with the Australian Taxation Office (ATO). The ATO's view under its risk differentiation framework is that Transurban has a low risk of non-compliance. To that end, Transurban does not:

- have any entities located in tax havens;
- engage in transfer pricing to shift profits to low-tax jurisdictions;
- have artificial related party debt or foreign hybrid arrangements; or
- engage in transactions where the tax outcomes do not align with the economic outcomes.

Transurban is structured as a stapled group comprising a corporate entity and a trust because the initial heavy capital investment and associated debt funding required for its infrastructure investments leads to accounting losses being generated for the initial years, which prevents a company from paying dividends. A trust allows distributions to be made in the early years to investors who are then taxed on the distributions. In this way, the ATO collects tax earlier than would be the case under a corporate structure. Transurban's structure is therefore not designed to avoid tax.

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Transurban is an infrastructure business responsible for the ownership, funding, development and management of significant road networks, which are held as limited life road concessions. More than 90 per cent of these assets are located in Australia. Transurban's networks increase the productivity of the cities where they operate, by billions of dollars every year, through lower congestion, improved safety, improved travel time reliability and more sustainable transport.

The significant capital invested to develop Transurban's existing networks leading to concession ownership is amortised over the life of the asset, typically a period of up to 40 years, in line with Australian accounting rules and taxation law. In addition, interest costs associated with the funding of the development of the network is treated as an expense and deductible for taxation purposes. These amortisation and interest charges, together with initial lower traffic volumes and lower toll charges, give rise to accounting and tax losses through the early period of the concessions held by the business. This results in a lower effective tax rate in the early stages of the infrastructure project operation.

To be clear, this is not unique to the infrastructure business, this is common practice across all industries with significant and capital intensive start-up costs. Over the concession life, the effective tax rate rises as higher traffic and toll revenues rise relative to the amortisation charges.

As accounting losses are generated through the early period of the concessions, the business is structured as a stapled entity to enable distributions to be paid to investors through a trust. The distributions paid to investors are taxed in their hands, so it is incorrect to assert that there is no tax paid on the earnings of the group. At least 70 per cent of Transurban's investors are Australian superannuation fund managers and retail investors who are subject to Australian tax on their distributions. Non-Australian investors are subject to withholding tax on distributions on the same basis as all non-resident investors in Australian companies. As such 100 per cent of Transurban's distributions are subject to tax assessment in the hands of investors at their specified tax rates.

If Transurban had been established as a single corporate entity, it would not have been able to pay any dividends until 2009, and from then on, only minimal amounts of unfranked dividends would have been paid to investors compared to the trust distributions paid to date. The ability to attract funding for the initial capital investment of Transurban's concessions and associated development activities in these circumstances would also have significantly inhibited Transurban's ability to develop and enhance the Australian road networks, resulting in a significant negative impact on the productivity and job creation of the Australian economy.

It is important to emphasise that the deductibility of amortisation of capital investment and interest on its associated debt funding, which are central to Transurban's current tax position, is established under the Australian income tax legislation. These deductions are not unique to the infrastructure sector or Transurban's corporate structure, but arise through the application of general tax principles for the treatment of interest and capital investment. There are clear policy drivers related to stimulating investment, which are central to this tax treatment.

Transurban has a portfolio of 14 assets with an average remaining concession life of 26 years and continues to invest billions of dollars into its networks. The Transurban network still has a fairly young concession life cycle and this is reflected in its current effective tax rate. It takes decades to generate a return over the initial capital investment for these projects.

Transurban is an ASX-listed business with more than 70,000 security holders. Approximately 50 per cent of these security holders are Australian institutional investors and 20 per cent are Australian retail investors. Transurban provides a key vehicle for thousands of Australians to participate in infrastructure investment opportunities in Australia.

2 Transurban's business

2.1 Overview

Transurban is an ASX-listed Australian stapled group that designs, funds, constructs, operates and maintains urban toll road networks in Australia and the United States of America (**USA**). Transurban has no operations or entities in jurisdictions other than Australia and the USA.

Transurban is a core partner in the development and operations of roads with the NSW, Victorian, Queensland and Virginian (USA) governments. Over the next four years, Transurban and partners have committed to undertake nearly \$4 billion of capital upgrades to critical road projects, which will decrease congestion, increase productivity, enhance sustainability and improve safety on Australian roads.

Its key assets and current development projects include:

- CityLink in Victoria and CityLink Tullamarine Widening project investment (\$850 million investment to commence construction in October 2015);
- the Hills M2, Lane Cove Tunnel, Cross City Tunnel, majority interests in the Eastern Distributor and 50 per cent ownership of Westlink M7, NorthConnex project (\$2.9 billion project under construction) and M5 South West in New South Wales;
- majority interests in the Gateway Motorway, Logan Motorway, CLEM7, Go Between Bridge and Legacy Way (currently under construction) in Queensland; and
- majority interests in the 495 Express Lanes and 95 Express Lanes in Virginia, USA.

Given its asset portfolio and the expertise of its staff, Transurban provides both domestic and international investors with:

- an opportunity to gain exposure to a portfolio of mature roads of national significance and a strong pipeline of new developments that investors would not be able to access individually; and
- the benefits of Transurban's active management of the assets, with in excess of 1,000 staff managing and developing its toll road network and developing tolling systems that are at the forefront of the industry.

Transurban is 50 per cent owned by the largest superannuation funds in Australia, 20 per cent by Australian retail investors and 30 per cent by large global funds.

Further detail in relation to Transurban's business can be found at www.transurban.com.

2.2 Transurban's business is capital intensive and requires long-term investment and significant risk taking

The toll road networks into which Transurban invests are held through long-term government concessions, under which:

- Transurban is entitled to collect toll revenues in return for designing, constructing, operating and maintaining the toll road in accordance with strict Government requirements; and
- the road reverts to the relevant State Government for no consideration at the end of the concession period with specific handover conditions for the remaining asset life.

In this way, Transurban facilitates the development of nationally significant road networks that are critical in meeting Australia's transportation requirements, whilst relieving the financing burden on Federal and State Governments. Significant independent studies have demonstrated that the private operation and financing of infrastructure provides substantial value for money and improved service.

In other words, Transurban bears the upfront costs of building the roads in order to generate a return on its investment over time. Given the size of the upfront investment, it takes a significant period of time for the roads to mature and provide positive returns, as referred to above.

Further, as Transurban has to return the assets to Government at the end of the relevant concession period for no consideration and with specific conditions for the remaining asset life, Transurban must continue to invest in new projects to maintain and grow its business. The significant upfront investment associated with new projects can, for a period of time, offset the profits derived from the more mature projects. Across the Transurban networks, there has been approximately \$14 billion in committed investments since 2010 in road projects.

3 Transurban's corporate tax profile

Under Australian tax law Transurban's income is subject to tax at the investor level through trust distributions or by the Transurban corporate entity. Transurban only publicly reports the tax paid by the corporate entity and not the tax paid by investors on the trust distributions. The tax paid by the investors on trust distributions is the responsibility of the investors and governed by their relationship with the ATO. Transurban publishes annually on its website a Tax Guide for investors on how they should disclose their distributions in their tax returns.

This section provides further background in relation to Transurban's corporate tax position. We also take this opportunity to dispel some of the inaccuracies published by the Tax Justice Network Report (TJN Report)¹ in relation to Transurban's gearing levels and effective tax rate.

3.1 Structure

Transurban's stapled structure has always been designed and operated to allow Transurban to efficiently access equity and debt markets and to fund its obligations to Governments.

(a) *Transurban's structure facilitates investment to support the delivery of Australia's critical road infrastructure*

It is Transurban's belief that its investors want:

- to be able to invest in all elements of its business, including the roads themselves and Transurban's management team;
- to receive regular distributions, both from profits and through the return of invested capital; and
- the tax impact of their investment in Transurban to be the same, or as close as possible to, the tax outcomes if they invested into the assets directly. This represents the global standard treatment for investments in collective investment vehicles (**CIVs**), and can only be achieved under Australian tax law by using a flow-through trust.

Transurban is only able to meet the above requirements by operating through a stapled structure. A single holding vehicle would not allow Transurban to satisfy all of the above requirements.

Transurban would not have been able to make regular distributions to investors if it had been established as a single holding company. The Corporations Act 2001 (Cth) places significant restrictions on paying dividends and returning invested capital by entities such as Transurban which invest in infrastructure assets, due to the accounting losses that result from the amortisation of capital investment and interest payments on the associated debt funding. Transurban has accumulated accounting losses since 1996 yet has paid cash distributions which have been taxed in investors' hands. By way of example, based on an assumed security holder profile, we estimate that since 2002 approximately \$750 million of tax would have been paid on the cash distributed by Transurban to its investors.

Restrictions on making distributions would significantly limit Transurban's ability to raise capital on equity markets to fund future road investments.

By meeting investor expectations, Transurban's stapled structure provides maximum flexibility in attracting equity and debt funding. In turn, this allows Transurban to meet its obligations to Government throughout the life of its projects.

As referred to in the executive summary of this submission, we note that if Transurban had been established as a single corporate entity, it would have paid a significantly smaller amount of corporate tax (due to the existence of tax losses) than the tax estimated to have been paid by its investors on the distributions made to date. Also, it would not have been able to pay any dividends until 2009, and

¹ Who Pays for Our Common Wealth? Tax Practices of the ASX 200 – United Voice and the Tax Justice Network - Australia

from then on, only minimal amounts of unfranked dividends as a single corporate entity which would have resulted in minimal tax being paid by its investors. The ability to attract funding for the initial capital investment of Transurban's concessions and associated development activities in these circumstances would also have been significantly inhibited, and in turn, would have negatively impacted the productivity of Australia.

(b) Transurban uses an appropriate mix of debt and equity to meet its capital funding requirements

As noted above, given the maturity of Transurban's current assets and the extent of its development activities, Transurban has had and will continue to have significant capital funding requirements. Transurban utilises a combination of equity funding from its security holders and external debt to meet these funding requirements.

Each of Transurban's stapled entities have borrowings that are entirely consistent with the funding of its assets. The interest on borrowings is at arm's length and the majority is paid to non-related parties. Where interest is paid to a related party the interest income is assessable to the internal lender.

Transurban operates a prudent capital structure under high investment grade credit metrics as reflected by its range of strong credit ratings.

Further, Transurban's interest deductions are compliant with Australia's thin capitalisation and transfer pricing rules, and earnings stripping rules in the USA.

Finally, Transurban takes this opportunity to dispel misconceptions in the recent TJN report, which suggested that Transurban's debt levels were inappropriately high. The TJN report was fundamentally flawed and, in particular:

- shows misunderstanding of Transurban's gearing levels and its balance sheet. Transurban discloses its gearing every six months as part of its results and that shows a consistent gearing of between 35 per cent and 45 per cent. This is within acceptable parameters for listed and infrastructure entities;
- whilst they acknowledged that companies report large amounts of debt when they are embarking on a new project, they failed to link this acknowledgement with the capital-intensive nature of Transurban's business; and
- did not distinguish between legitimate economic debt and artificial debt created to shift profits to other jurisdictions.

3.2 Transurban has operated a stapled structure in substantially the same form since listing on the ASX in March 1996

Transurban's long-standing stapled structure consists of 3 entities that are stapled together, being:

- Transurban Holding Trust (**THT**), an Australian resident unit trust;
- Transurban Holdings Limited (**THL**), an Australian resident company; and
- Transurban International Limited (**TIL**), an Australian resident company.

(a) THT

THT operates as a flow-through trust, and qualifies as a managed investment trust (**MIT**). This means that THT does not pay tax itself, but instead investors pay tax based on their individual tax rates which include Australian resident individual investors paying tax at their marginal rates of up to 49 per cent (being well in excess of the corporate rate of 30 per cent).

(b) THL and TIL

THL and TIL are each corporate entities that pay corporate tax at 30 per cent on their taxable income. As explained above, these entities generate accounting and tax losses in the early years but start to pay tax when the concessions mature.

3.3 Effective tax rate

The TJN report also suggested that Transurban's effective tax rate was inappropriately low. Transurban considers that there were significant defects in the TJN report's methodology and displayed a lack of understanding of the corporate structuring employed. It also misinterpreted Transurban's financial statements and failed to take into account:

- that investors, rather than THT, pay tax on THT's income at marginal rates that can be higher than the corporate tax rate; and
- the difference between cash generated and accounting profit, which is determined under accounting standards, for infrastructure projects.

Transurban considers that, given its capital expenditure and the difficulties it would have had in distributing income to investors absent the stapled structure, the ATO has so far collected significantly more tax than it would have collected had Transurban implemented a simple corporate structure.

4 Tax governance

This section outlines the steps that Transurban has taken to ensure full compliance with tax laws and tax policy.

4.1 Tax risk management policy

A key principle of Transurban's approach to tax risk management is that Transurban only undertakes actual commercial transactions relevant to its business, and does not undertake transactions specifically to achieve tax outcomes. Transurban does not seek to transfer profits to low tax jurisdictions or tax havens and does not undertake transactions unless it is confident they will withstand ATO scrutiny.

Transurban takes its tax responsibilities seriously and, to that end, has implemented a Board-approved tax risk management policy (**TRMP**). The TRMP sets out the tax risk parameters to be adhered to by management with respect to tax matters in general and as applicable to specific transactions. The TRMP, which has been in place since 2008, ensures responsible decision-making on tax matters.

As part of the TRMP, the Board has ongoing involvement in tax developments and their impact on Transurban.

4.2 ATO interaction

Transurban has a positive, long-standing and co-operative relationship with the ATO. Transurban attends regular meetings with the ATO to discuss general business updates, specific transactions and any expected tax outcomes. This reflects Transurban's preference to ensure that the ATO is well briefed and has the opportunity to interrogate all aspects of Transurban's tax position to confirm that Transurban is compliant with Australian taxation law. Transurban also frequently seeks private tax rulings from the ATO in relation to transactions to confirm the tax treatment that will be adopted over the life of the asset, and class rulings when undertaking public market transactions.

Transurban is categorised by the ATO as a 'key taxpayer' indicating that it has a low risk of non-compliance.

5 Responses to terms of reference

(a) The adequacy of Australia's current laws;

Transurban fully supports the actions of the Government and the ATO in pursuing those entities undertaking inappropriate tax avoidance or evasion.

Transurban's view is that Australia's current laws provide a strong regime for this purpose, and Transurban expects that such a view would be widely held by a range of fully-informed stakeholders. In particular, Transurban considers that the current laws include strong safeguards against inappropriate tax outcomes, particularly in respect of:

- entities claiming capital allowance deductions for expenditure that they did not incur economically;
- using transfer pricing to shift profits out of Australia;
- using inappropriate gearing levels to obtain excessive interest deductions and minimise tax payable, levelling the playing field between Australian resident entities and non-residents;
- deferring the receipt of income for tax purposes;
- utilising tax losses where the losses were not incurred by the underlying owners or in the same line of business; and
- using controlled offshore entities to achieve favourable tax outcomes.

These safeguards are strongly supported by the general anti-avoidance rules in the Australian tax legislation.

(b) Any need for greater transparency to deter tax avoidance and provide assurance that all companies are complying fully with Australia's tax laws;

Transurban is not in a position to provide detailed comments in relation to the need for greater transparency to deter tax avoidance and ensure compliance with tax law.

Transurban is aware that the *Tax Laws Amendment (2013 Measures No. 2) Act 2013* amended the Australian tax law and required the Commissioner of Taxation to publish certain taxation information regarding specific categories of entities from the 2013/14 year onwards.

If further transparency is considered necessary in deterring tax avoidance and providing public assurance of Australian company tax compliance following the Senate's inquiry, Transurban recommends that any such transparency laws are aligned with agreed OECD principles, minimise administrative costs and guard against publication of information that could be misleading and confusing.

(c) The opportunities to collaborate internationally to address the problem;

Transurban encourages Australia to continue its significant involvement with the G20 and the OECD Base Erosion and Profit Shifting project. In particular, Transurban supports this collaboration because it will help to ensure that any cross-border tax measures are addressed in a coordinated, multilateral manner and with due regard to the economic objectives of the various jurisdictions involved. However, Australia's policy on these matters should always be to not disadvantage complying Australian companies and to ensure that the tax environment promotes economic growth and productive investment.

(d) The performance and capability of the Australian Taxation Office (ATO) to investigate and launch litigation, in the wake of drastic budget cuts to staffing numbers;

Transurban has not, in its extensive dealings with the ATO, experienced a decrease in the ATO's performance and capability after the relevant budget cuts.

Transurban is not in a position to provide any comment on the effect that budget cuts will have on the performance and capability of the ATO more generally.

However, Transurban commends the ATO on its recent developments and changes in management structure, including a greater focus on mediation and other alternative means of dispute resolution.

(e) The role and performance of the Australian Securities and Investments Commission in working with corporations and supporting the ATO to protect public revenue;

Transurban is not in a position to comment on the role of the Australian Securities and Investments Commission in supporting the ATO to protect public revenue.

(f) Any relevant recommendations or issues arising from the Government's White Paper process on the 'Reform of Australia's Tax System'; and

Transurban has no recommendations in relation to the Government's White Paper process on the 'Reform of Australia's Tax System' but will participate in accordance with any published terms of reference where required.

(g) Any other related matters.

As stated in our opening statement, Transurban welcomes the opportunity to make a submission to the Senate Economics References Committee Inquiry into corporate tax avoidance and minimisation. We believe a clearer understanding of all stakeholders will create a better system and outcome for Australia. We hope that the inquiry will take a positive approach for interactions with Australia's largest corporates while fulfilling their remit.

Given the level of inaccuracy in the recent TJN report, we welcome the opportunity to ensure the Committee and the community more broadly develops a greater understanding of the legitimate tax position of a number of Australian corporations including Transurban.

Transurban has no comments regarding any other related matters.

Transurban's tax arrangements, including its effective tax rate and its tax minimisation strategies

Please refer sections 1 to 4 above.

Yours sincerely

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