Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

Release Document

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

29 June 2018

Tax Working Group Secretariat

Wellington

New Zealand

BY EMAIL: submissions@taxworkinggroup.govt.nz

Dear Members of the Tax Working Group

Submission on Nationally Significant Infrastructure

Following discussions with a number of members of the Tax Working Group (**TWG**) we would like to make a further specific submission in relation to the need for a concessional Nationally Significant Infrastructure regime.

Introduction

The New Zealand Superannuation Fund (the **Fund**) invests money, on behalf of the Government, to help pay for the increased cost of universal superannuation entitlements in the future. The Fund is managed by a Crown entity, the Guardians of New Zealand Superannuation (the **Guardians**).

Pursuant to its legislation the Fund is unable to control an operating business. This restriction coupled with our limited internal infrastructure operational resource available to implement and manage investments, results in the Fund having to form like-minded consortia of infrastructure investors with operational expertise, experience and financial capacity to carry out any significant New Zealand direct infrastructure investment.

Given the relatively small size and generalist nature of the resident investment funds in New Zealand and the need for co-investors with the Fund to have sufficient financial resources and similar long-term investment horizons and alignment, logical co-investors for the Fund are non-resident Sovereign Wealth Funds (**SWF**) and Global Pension Funds.

In addition, the co-investors may have specific skills and experience not currently found in New Zealand.

The recent unsolicited proposal to the Government by the Fund and its joint venture partner, the global Canadian pension and sovereign fund asset manager - Caisse de depot et placement du Quebec (**CDPQ**), in relation to the proposed Auckland Light Rail project is a case in point. CDPQ has net assets under management of US$238 billion and has extensive experience in infrastructure development, operation and ownership, in addition to investment, globally. It has directly relevant experience in light rail projects given its experience developing, and now building, Montreal's 67 km light rail network.

New Zealand requires significant new infrastructure to meet its growing population, repair its aging existing infrastructure and deliver the wider socio-economic benefits a fit-for-purpose infrastructure network should enable. To deliver this new infrastructure New Zealand will need significant new sources of capital and funding, construction skills and other operational resources and possible changes to current regulatory settings.

International institutional investors are very interested in infrastructure assets as they look to match their long term liabilities. These investors have choices about where they invest and value certainty of the regulatory and tax environment, particularly as these tend to be very long duration assets. Other countries have been active in looking to provide that environment to attract long term investors, and New Zealand needs to make sure it is at least as attractive as those countries to attract the investment in infrastructure that we need.

Other jurisdictions, most notably Australia (given its proximity to New Zealand and therefore competition for capital and resources), have dedicated tax regimes to support and incentivise nationally significant infrastructure projects (see the Appendix for details of the specific regimes offered in other countries). These jurisdictions provide long term certainty for investors and tax settings to encourage investors which ensure that the tax environment does not act as a barrier to investment. As the investor for such projects is really choosing between jurisdictions for its investment this suggests that the tax settings may need to be adjusted to ensure that expectations as to both the certainty of and the required return on investment are met. Similar outcomes are achieved in other jurisdictions either through a combination of a lower corporate tax rate or concessional entity taxation (e.g. sovereign immunity or full deductibility on non-recourse funding).

Nationally significant infrastructure expertise established in New Zealand by the Fund will open opportunities internationally allowing the Fund to be part of offshore consortia and qualify for similar offshore SWF exemptions .

Submission

The TWG should consider recommending the implementation of a specific nationally significant infrastructure regime to provide certainty for investors and ensure New Zealand can compete with other jurisdictions in attracting long term capital that brings with it world-class expertise. We believe that such a regime is preferable over other options as it ensures that any regime is targeted to the specific issue, thus limiting the potential for unintended consequences.
Specific criteria would be established in relation to Government project approval including but not limited to:

- Project size i.e. a minimum spend is required.
- Infrastructure projects that pass the “public utility test” and for which there is a specific agreement with the government such as public transit systems, large scale housing development, communication, energy and water reticulation assets etc .
- Demonstrated capability to deliver world-class projects.
- Commitment to contribute project expertise.
- Alignment with the Treasury’s living standards framework.

Subject to meeting required deliverables of approval, the project will receive:

- A tax rate substantially less than the prevailing corporate tax rate, say half or less, set for a meaningful part of the life of the asset.
- No further tax impost on profit distribution to both domestic and foreign investors.
- Full deductibility of third party non-recourse funding.
- If tax laws are changed prior to the expiry of the term of the concession, the tax conditions relating to Nationally Significant Infrastructure are grand-parented until the end of the concession term. For example, in the event that a capital gains tax was introduced in New Zealand, Nationally Significant Infrastructure would be eligible for a capital gains exemption on exit.
- Ability to fast track other required regulatory approvals e.g. RMA approvals, the provision of foreign skilled labour to enable rapid construction.
- Approval is project specific i.e. it survives any change of ownership.

In designing a Nationally Significant Infrastructure regime we need to ensure international investors are provided with certainty in relation to their tax position prior to them investing and that complexity[1] is kept to a minimum.

Please advise if the TWG requires any further information or clarification in relation to our submission. The Fund and its joint venture partner are available to discuss at a time deemed appropriate by the TWG.

Yours sincerely
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Matt Whineray
Chief Executive Officer

John Payne
Head of Tax

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[1] The Australian Nationally Significant Infrastructure regime is complex with the need to bifurcate an asset and allocate the income accordingly.

Appendix

Australia – National Significant Infrastructure Tax Regime (announced in March 2018)

Purpose: to ensure Australia retains competitive tax settings for nationally significant infrastructure projects and providing increased certainty for businesses and investors.

- Nationally significant infrastructure projects need to be specifically designated / approved as such by the Federal Government Treasurer following an application from an Australian Government Agency which can include a State Government or Territory.

- Criteria:
    - The estimated capital expenditure on the asset is A$500 million or more
    - Asset is an economic infrastructure asset (defined as either transport, energy, communications or water infrastructure for public purposes)
    - Infrastructure for public purposes is either available for use by the public, used for the provision of services to the public or used to transport goods that are available for use by or sale to the public. Include roads, ports and electricity generation, transmission and distribution facilities.
    - In granting approval the Treasurer may consider whether the economic benefits resulting from the asset outweighs the economic costs and whether Infrastructure Australia agrees that the asset is nationally significant infrastructure under the Infrastructure Australia Act 2008.
    - Need to be new assets no recycling of current infrastructure.

- Investment to facilitate productivity enhancing projects.

- Effectively limits tax on the income from the asset to 15% for a 15 year period[i]. Thereafter the income will be taxed at the corporate tax rate (currently 30% but forecast to be reduced to 25%).

- Capital gains tax on disposal is also limited to 15%.

China

- Key public infrastructure projects (such as construction of harbours, airports, highways, power plants or water conservation projects) are exempt from income tax in the first 3 years and taxed on 50% of the taxable income in the following 3 years (starting from the year in which the first amount of business revenue is generated).

- Projects engaged in environmental protection, energy or water saving are exempt from income tax in the first 3 years and taxed on 50% of the taxable income in the following 3 years (starting from the year in which the first amount of business revenue is generated).

Brazil

- Purpose: To increase investment in new infrastructure projects in the areas of energy, transport, basic sanitation, irrigation and other areas deemed to be a high-priority by the Government. Existing projects may also be included in the event that an expansion takes place, if the expansion is treated as a new project and segregated in a specific purpose company.

- Criteria:
    - Investments must be made through special purpose companies, either publicly traded or closed capital, and divided into shares.
    - The fund cannot have less than five unit holders, but each unit holder cannot hold more than 40% of its units or receive earnings exceeding 40% of the fund's total earnings.
    - They must at least adhere to the corporate governance practices established by the Brazil Securities and Exchange Commission for companies invested by equity interest investment funds.
    - Must participate in the decision-making process of the invested company, with effective influence in the definition of its strategic policies and management, notably through the appointment of members to the board of directors, the holding of shares that are part of the respective control block, the execution of a shareholders' agreement, the execution of an agreement of a different nature, or the adoption of a procedure that assures the fund effective influence in the definition of its strategic policy and management.

- Incentives are granted for 5 years from the approval of the project. Income from redemption of quotas, including liquidation, is taxed at 15%. Any gain on disposal of the related fund's quotas will be taxed (i) at 0% for individuals who carry out these operations on or outside the stock exchange; and (ii) at 15% for legal entities, whether in operations on or outside the stock exchange.

United States – Qualified Foreign Pension Fund (QFPF) exemption (announced in December 2015)

Purpose: To spur investments in US infrastructure and real estate by qualifying foreign pension funds by putting them on a similar footing from a tax perspective as domestic funds.

- Criteria:
    - Meet the definition of a QFPF, which includes governmental and private pension funds.
    - Assets must be real property, which typically includes infrastructure and real estate assets.
    - Removes the requirement of owning a non-controlling stake in the asset.

- Tax incentive:
    - Exempts capital gains.
    - Exempt real estate investment trusts (REITs) from withholding on REIT distributions.

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[i] Achieved via a stapled trust structure where asset ownership is separated from the operating entity and rent is levied by asset ownership trust on operating business resulting in the majority of the overall income from the business being taxed as passive rental income at the 15% managed investment trust rate.