Sydney Airport

30 January 2015

Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Attn: Dr Kathleen Dermody

Dear Dr Dermody

**Re: Submission for the inquiry into corporate taxation avoidance and minimisation**

We refer to your letter for the 'Inquiry into corporate taxation avoidance and minimisation' dated 29 October 2014. Sydney Airport welcomes the opportunity to make a submission for the Committee's consideration. This letter has been prepared by Sydney Airport Limited (**SAL**) as head entity of the SAL tax consolidated group.

As the owner of Australia's largest airport, a major employer in NSW and a major generator of economic activity, Sydney Airport recognises the role that it plays as a member of the broader community to support an equitable, transparent taxation environment and a strong national and international taxation system. Sydney Airport unequivocally supports the OECD and G20 aspirations to address Base Erosion and Profit Shifting practices and the improvement of tax systems globally.

Sydney Airport has a history of demonstrating good corporate practice in transparency and in investing significant efforts in fostering its open and transparent relationship with the Australian tax authorities and revenue collectors, in addition to contributing to the Australian and NSW economies through the payment of its taxes in a responsible manner. This is evidenced by the fact that in 2014, the Australian Taxation Office (**ATO**) positively commented that Sydney Airport was a willing participant in the tax system.

As is explained further in this letter, Sydney Airport recently undertook a simplifying restructure which was subject to significant ATO scrutiny and resulted in a class ruling for security holders and a number of private binding rulings being issued. These rulings confirmed the Australian tax outcomes arising from the current structure. Sydney Airport routinely obtains tax rulings on major transactions. Moreover, Sydney Airport is subject to regular review by the ATO and is pleased to assist the ATO with these reviews.

**Sydney Airport's business**

Sydney Airport is the owner and operator of Australia's largest domestic and international airport. The airport serves Australia's largest population centre and financial capital. Sydney

Airport does not invest overseas nor does it own any foreign operational assets, as its sole focus is Sydney (Kingsford Smith) Airport.

Sydney Airport is a major employer and makes a direct and indirect contribution of $27.6 billion, equivalent to 6% of the NSW economy. This economic contribution is forecast to increase to over $42 billion by 2033. The airport also generates or facilitates direct and indirect employment of more than 283,000 jobs, 28,000 of which are on-airport. This is forecast to increase to over 400,000 jobs by 2033. Additionally, Sydney Airport collects on behalf of the ATO substantial Goods and Services Tax in respect of its business operations (approximately $118m in 2014).

Sydney Airport has continued to invest in capacity to keep pace with changing technology and increasing demand. Since 2002, approximately $2.6bn has been spent on capacity related investments. Over the next four years a capital expenditure program of approximately $1bn is expected. The forecast capital expenditure program will deliver significant capacity expansion in many areas of the airport including aprons, airfield, terminals and ground transport as well as enhance efficiency and improve the customer experience.

**Overview of Sydney Airport structure**

ASX listed Sydney Airport is comprised of an Australian unit trust (Sydney Airport Trust 1 (**SAT1**)) whose units are stapled to the shares of an Australian company (SAL), which together are listed on the Australian Securities Exchange (**ASX**) under the issuer code SYD. The units in SAT1 and shares in SAL are traded as stapled securities.

Sydney Airport has a market capitalisation of approximately $11bn and over 90,000 investors, including a mix of Australian and overseas individuals, companies, superannuation funds, institutional investors and government bodies.

Currently, the approximate allocation of resident and non-resident Sydney Airport stapled security holders is 63% residents and 37% non-residents. Under the Airports Act 1996 and Airports (Ownership Interests in Shares) Regulations 1996, the foreign ownership of Sydney Airport cannot exceed 49%.

***Stapled structures generally***

A stapled structure is a common vehicle for investors to hold economic infrastructure assets and real estate assets in Australia. The stapled structure has been the preferred structure in the most recent high profile State Government privatisations with Port Botany, Port Kembla and Port of Newcastle receiving positive endorsement from the NSW State Government and the ATO. The Port of Melbourne is also expected to be a stapled structure.

In a stapled structure, the company is a taxpayer but the income derived by the trust is taxed in the investors' hands. This occurs on the proviso that the trust does not attract corporate taxation under the regimes designed to protect the imputation system. This pre-tax profile means that income tax is collected from investors in the stapled trust and not the listed entity and impacts upon calculations of the effective tax rate of the stapled group.

Due to the dividend distribution restrictions that existed prior to the recent amendments of section 254T of the Corporations Act, it was difficult for a company owning economic infrastructure to pay sufficient levels of dividends to shareholders due to insufficient profit levels which are characteristic of such projects in their initial years. The stapled structure allows cash to pass to investors as a regular income stream in compliance with the Corporations Act and the deed of the stapled trust. The income derived by investors is then subject to tax in the hands of those investors.

### *Sydney Airport Trust 1*

SAT1 partially finances the operations of Sydney Airport and its income is derived from that activity.

SAT1 is a public unit trust that is treated as a flow through entity for income tax purposes (i.e. tax transparent) under Division 6 of the Income Tax Assessment Act 1936 (**ITAA 1936**). A public unit trust can be taxed like a company should it carry on a trading business, or control another entity that carries on a trading business, under Division 6C of the ITAA 1936. SAT1 does not carry on or control an entity that carries on a trading business and therefore Division 6C of the ITAA 1936 does not apply to SAT1. This was confirmed in a private binding ruling that was issued by the ATO as part of the recent simplifying restructure of Sydney Airport.

Given that Division 6C of the ITAA 1936 does not apply to SAT1, the beneficiaries of SAT1 (i.e. the unit holders or investors) should be subject to Australian income tax on the taxable income of SAT1 rather than tax being levied on the trust itself (i.e. the taxable income of SAT1 will "flow through" SAT1 to its investors who will pay tax). The responsible entity calculates the net income of SAT1 at the end of each income year, and a unit on issue in SAT1 at the end of an income period entitles its holder to a pro-rata proportion of that net income.

### *Sydney Airport Limited*

SAL is an Australian resident company and its taxable income is subject to the corporate income tax rate of 30%. SAL is the head entity of a tax consolidated group. Sydney (Kingsford Smith) Airport is the core income-generating business of SAL. Its income is sourced from revenues generated through its provision and management of airport facilities at Sydney (Kingsford Smith) Airport. Activities at these airport facilities include aviation operations, commercial operations and property management.

The main revenues of SAL are:

- **Aeronautical revenue**: which is derived from charges applying to a range of aviation activities;
- **Aeronautical security recoveries**: which include recharges in relation to security services provided on both international and domestic sectors (such as checked bag screening, passenger screening, counter terrorist first response and additional security measures);
- **Retail revenue**: which comprises rental from tenants whose activities include the sale of duty free, food and beverage and other retail products as well as the provision of foreign exchange and advertising services;
- **Property and car rental revenue**: which relates to rent from airport property, including Terminal 3, aircraft hangars, buildings and other leased areas; and
- **Car parking and ground transport revenue**: which includes time-based charges from public and staff car parking, as well as ground access fees.

The main cost categories for operating the airport facilities are employee costs, services and utilities, property and maintenance and recoverable security expenses.

### *Debt Capital*

In addition to the above cost categories, SAL incurs significant interest expense arising from a variety of third party debt obligations including bank debt, medium term notes, capital indexed bonds and a loan from SAT1. As at 31 December 2014, SAL is funded with approximately 50% interest bearing debt (based on SAL's market capitalisation of approximately $8.9bn). The long term core debt funding reflects the long term nature of the airport asset and its strong stable cash flows that are typical of infrastructure assets. That is, infrastructure assets typically provide predictable long term stable cash flows that allow a high level of debt funding to provide appropriate returns to equity investors.

As mentioned previously, over the next four years a capital expenditure program of approximately $1bn is expected. This capital expenditure program is expected to be fully debt funded and will mean increased interest costs for the airport.

Sydney Airport is a party to a Tripartite Deed between its secured lenders and the Commonwealth. The Tripartite Deed is designed to recognise and protect the interests of all parties in the continuing operation of Sydney Airport in the event of a financial or operational default. Sydney Airport reports its debt levels to the parties on an annual basis, which reflects the approval by all parties that debt capital is the most efficient way to fund the airport's expansion.

### *Thin capitalisation*

Sydney Airport does not have any foreign operating assets, nor is it controlled by a foreign entity. These factors are relevant in determining whether Australia's thin capitalisation rules apply to a taxpayer. Accordingly, Sydney Airport is not currently subject to Australia's thin capitalisation rules and therefore Australia's tax system does not restrict Sydney Airport to the current 60% safe harbour thin capitalisation limit for interest bearing debt. The thin capitalisation rules were designed to limit profit shifting (via interest bearing debt) between Australian and international related parties, which is not applicable to Sydney Airport.

In the past Sydney Airport held interests in a number of foreign airports, and now retains ownership of a small number of foreign subsidiary companies that are all now dormant. Historical exposures arising from indemnities given to acquirers of Sydney Airport's previously-owned offshore assets and ongoing foreign litigation has prevented Sydney Airport from winding-up these overseas subsidiaries. Sydney Airport plans to eliminate these foreign entities when practicable.

## Sydney Airport Simplification

Sydney Airport originally had a multi-asset base of Australian and non-Australian airports. All non-Australian airports were progressively sold a number of years ago. As a result, Sydney Airport undertook a simplifying restructure during 2013 to reflect its sole focus on its ownership of Sydney (Kingsford Smith) Airport.

This restructure broadly involved the following steps:

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Phase I. Acquisition of the minority unlisted interests in Sydney Airport; and
Phase II. Simplification of the group including the establishment of a new listed holding company (i.e. SAL).

Prior to the restructure, units in SAT1 were stapled to units in Sydney Airport Trust 2. As a result of the simplification, SAT1 is now stapled to SAL.

Additionally, prior to the restructure, the listed Sydney Airport entities held a combined interest of around 85% in the Southern Cross Airports Corporation Holdings Limited (**SCACH**) group with other non-affiliated entities holding the remaining 15% interest in the SCACH group. The simplifying restructure resulted in Sydney Airport moving to a 100% ownership of the SCACH group and therefore Sydney (Kingsford Smith) Airport.

As set out in the Independent Expert's Report contained in the Explanatory Memorandum for the proposal to restructure Sydney Airport (refer to the SYD ASX release dated 25 October 2013), the simplifying restructure was fundamental to achieve the following commercial outcomes:

- Increase the foreign ownership threshold from 40% to 49% pursuant to the Airports Act 1996 and Airports (Ownership Interests in Shares) Regulations 1996;
- Increase attractiveness to investors;
- Simplify the ownership structure in line with Sydney Airport's single airport asset base;
- Give stapled security holders direct exposure to the Sydney Airport investment; and
- Implement administrative cost-savings, increased efficiency and governance improvements associated with a simplified structure.

Execution of the simplifying restructure required a class ruling for security holders and a number of private binding rulings from the ATO. Sydney Airport's policy of obtaining tax rulings reflects its objective to obtain certainty on its compliance with the Australian tax system.

**Effective tax rate for SAT1 and SAL (Sydney Airport)**

The effective tax rate calculated for Sydney Airport and published in the report titled "Who Pays For Our Common Wealth? Tax Practices of the ASX 200" by the Tax Justice Network on 29 September 2014 is not accurate. This is explained below.

***Sydney Airport Trust 1***

As previously mentioned, SAT1 is a flow through trust. This means that it is not an entity that typically pays tax, rather tax is levied upon its investors with the net income of the trust taxed in their hands. It is not possible to calculate an effective tax rate for SAT1.

***Sydney Airport Limited***

SAL's tax depreciation profile, high levels of interest bearing debt funding, and associated carry forward tax losses mean that it will not become a tax paying entity until its tax losses are exhausted. SAL (and prior to the restructure, SCACH), has historically incurred tax losses due to SAL's expenses in operating the airport (which includes interest on all loans and tax depreciation on buildings and plant and equipment) exceeding its income generated from operating the airport.

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However, given the ongoing capacity related investments and airport expansion it is forecast that revenue from the operation of the airport will significantly increase and that SAL will become tax paying in the future.

### *Tax paid by investors*

Sydney Airport's stated policy is to distribute 100% of net operating receipts. This represents a continuing commitment to returning cash to investors which will be taxed in their hands based on their personal tax profile.

## Concluding comment

Sydney Airport is happy to assist in this inquiry in whatever way possible. It continues to support a strong and robust tax system and is comfortable for the Senate Economics References Committee to engage directly with the ATO in relation to Sydney Airport, as required.

Yours sincerely

**Kerrie Mather**

Managing Director and Chief Executive Officer

Sydney Airport Limited