16th February 2007

Mr Peter Hallahan
Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Mr Hallahan

RE: Taxation Laws Amendment (2006 Measures No. 7) Bill 2006

The Asia Pacific Loan Market Association **(APLMA)** would like the opportunity to provide its views in relation to the proposed amendments to section 128F of the *Income Tax Assessment Act 1936* proposed by *Taxation Laws Amendment (2006 Measures No. 7) Bill 2006*. The members of the Australian Branch of the APLMA represent all the significant financial institution participants in the syndicated loan finance market in Australia.

We previously made a submission to Mr Dutton's office dated 21 December 2006. A copy of that submission is attached. Since making that submission representatives of APLMA along with certain other interested organisations have had the opportunity to meet with Mr Dutton and separately with Treasury officers. As a consequence of these further meetings, the Australian Bankers' Association **(ABA)** has made a submission dated 16 February. APLMA has had the opportunity to review the ABA submission and APLMA fully endorses the approach suggested in it.

As outlined in greater detail in our 21 December submission, APLMA's major concern lies with the uncertainty that the Bill has caused in respect of the treatment of what may broadly be referred to as "syndicated loans". Our concern has been both in respect of the ongoing treatment of such loans and, to the extent that the ongoing treatment is not clarified appropriately, potential retrospective denial of withholding tax exemption in respect of drawdowns on pre 7 December 2007 128F compliant facilities. The suggested approach in the ABA submission, if adopted, would address our concerns on these matters.

Should you wish to discuss this matter, please do not hesitate to contact the undersigned.

Yours faithfully

Wayne Green
Chairman
Asia Pacific Loan Market Association Limited
Australian Branch
Ph: (02) 9619 6364

Attachment
cc. Phil Lindsay, Office of the Minister
Michael Rawstron, Treasury

Asia Pacific Loan Market Association Limited, Australian Branch
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C/- BNP Paribas
GPO Box 269
Sydney NSW 2001

21 December 2006

The Hon Peter Dutton MP
Minister for Revenue and Assistant Treasurer
Parliament House
CANBERRA ACT 2600

Dear Mr Dutton

RE: Taxation Laws Amendment (2006 Measures No. 7) Bill 2006

Introduction

We are writing to you to seek clarification on several matters of significant concern to the finance industry which have resulted from the introduction of *Taxation Laws Amendment (2006 Measures No. 7) Bill* 2006 (**"the Bill"**).

The Asia Pacific Loan Market Association (**"APLMA"**) was founded in August 1998 by a number of international banks. It now has 131 members. The Australian branch was established in June 1999 and the Australian members represent all significant financial institution participants in the syndicated finance market in Australia. APLMA is the only pan-Asian association that is dedicated to promoting growth and liquidity in the primary and secondary loan markets of the Asia-Pacific region. Among APLMA's main objectives are the standardisation of primary and secondary loan documentation, the promotion of liquidity in the market and prudent banking practices, the organisation of educational and social functions for syndicated loan professionals and acting as a liaison between major loan market players and regional regulators.

The loan market is a major source of debt capital for Australian enterprises, with recorded deal volume for the nine months to 30 September 2006 totalling $40 billion. The market consists of banks, investment banks and other financial institutions including funds. The market is a global one: the numbers of participants with offices in Australia are limited, available capital in Australia is limited, and it is important for Australian entities to have access to the depth, liquidity and competitive pricing of the wider international market, and not to be confined to the Australian loan market. The ability to " sell down" loan participations to overseas participants is a major way in which Australian banks and others are able to spread the credit risk and reduce their exposure to borrowers

APLMA fully supports amendments to section 128F of the *Income Tax Assessment Act 1936* to the extent that such amendments provide further clarity to the law and prevent unintended consequences or tax avoidance transactions.

However, it is concerned to make sure that the importance of the market as a major source of capital is recognised in the policy of the section and in its application

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Unfortunately the manner in which the Bill has been introduced has caused significant uncertainty and concern in finance markets. The power to issue regulations under the section as proposed gives rise to the possibility of recognition of the market and transactions which access it, but also to the possibility of uncertainties and denial of that access. APLMA submits that the section should be written and administered so as to maintain efficiency and parity between the debt markets to which Australian enterprises have access, and not to prefer one over the other simply because of the nature of the instrument used.

Background

As you are aware the Bill was introduced for debt interests issued on or after Thursday 7 December 2006. Relevantly the amendments provide that the exemption from withholding tax under section 128F will only be available for:

- debentures unless prescribed by regulation as not eligible for exemption;
- shares which are treated as debt for tax purposes (ie non-equity shares) such as certain redeemable preference shares; and
- other debt interests which qualify for exemption by regulation.

Our understanding from discussions with Treasury officers is that the regulations which determine whether a debt interest will qualify for exemption are unlikely to issue prior to February next year. In respect of the regulations which may deny exemption for debentures we understand that that regulation making power will only be used to the extent that specific abuses emerge which are seen as problematic on a case by case basis.

The Uncertainty faced by Finance Markets as a result of the Bill

This failure to issue regulations has led to a great degree of uncertainty. It is impossible for legal advisors to give opinions which offer any clarity on eligibility for withholding tax exemption under section 128F in the absence of any regulations. We believe this is inconsistent with the stated aim of section 128F of ensuring that Australian business does not face a higher cost of capital as a consequence of the imposition of interest withholding tax (see paragraph 2.9 of the Explanatory Memorandum to the Bill).

The Explanatory Memorandum to the Bill in respect of the regulation making power under sections 128F(1C) and 128F(2A) to make certain debentures ineligible for exemption states:

> "*2.10 ... Savings accounts, transaction or current accounts, term deposits and non-transferable certificates of deposit would not generally be regarded as debentures or securities. However, on a strict legal form assessment, it is possible that certain financial instruments that have not traditionally been regarded as debentures could be interpreted as such.*
>
> *2.11 To safeguard against this outcome, and <u>provide clearer guidance to the market in relation to the eligibility of debentures for interest withholding tax exemption</u>* [our emphasis], *a regulation-making power has been included. This will enable the exclusion from eligibility for exemption of interest on certain financial instruments, where a particular outcome is not supported by the overall policy intent for these provisions. However, it is not intended that regulations be made to upset long held and accepted market views as to what constitutes a debenture. Rather, this power could be expected to be utilised in response to the future emergence of a markedly broader legal interpretation of 'debenture' or where a financial instrument is declared to be a debenture but has characteristics or features more in keeping with financial instruments for which exemption has not traditionally been claimed and would not be*

appropriate. In both circumstances, consideration could be expected to be given to those financial instruments, beyond matters of legal form (including transferability or negotiability), that do not seem to fulfil an arm's-length offshore capital raising function nor seem reasonably likely to be associated with a shifting of the incidence of interest withholding tax. Such a circumstance could be expected to include efforts to broaden debenture to incorporate a range of non-negotiable, routinely available, wholesale and retail financial instruments or products."

However, the failure to issue regulations concurrently with the introduction of the Bill, or indeed (if as we understand the case to be from informal discussions with Treasury) not until a specific abuse is highlighted does not "provide clearer guidance to the market". In fact, it introduces uncertainty into an issue regarded as settled ie that debentures qualify for section 128F exemption.

In respect of the regulation requirement for non-debenture debt interests made pursuant to sections 128F(1)(f)(ii), 128F(1A)(e)(ii), 128F(1B)(c)(ii), 128FA(1)(b)(ii) or 128FA(2)(a)(ii), the Explanatory Memorandum states:

> *"2.13 The amendments clarify the range of interest payments to non-residents on non-debenture debt interests that qualify for interest withholding tax exemption, consistent with the policy intent at the time the original amendments were introduced in 2005. At that time, the Government had intended providing eligibility for hybrid financial instruments regarded as debt under Division 974 of the ITAA 1997. The most obvious example is a non-equity share, such as a redeemable preference share. The inclusion of a regulation-making power in the amendments to prescribe further eligible debt interests will enable other (possibly yet to be developed) hybrid instruments to be made eligible where they perform a similar capital rising role in similar circumstances to currently eligible debentures and debt interests. Regulations could also be made to provide transitional arrangements, as appropriate, in relation to debt interests issued since the 2005 amendments."*

In the absence of any regulations this gives little comfort. Furthermore, the Minister's Press Release (and Second Reading Speech which is of similar effect) is insufficiently specific to give a level of certainty acceptable to the market:

> *"Current business practices in relation to eligibility for IWT exemption for interest on debentures are not expected to be affected….."*

We note that this reassurance does not extend to non-debenture debt interests so that there is no express comfort that commonly used non-debenture fund raising techniques currently in question, such as syndicated loan facilities will continue to be acceptable.

It does not seem appropriate that, absent regulations, redeemable preference shares apparently qualify for the interest withholding tax exemption but a syndicated loan facility does not.

Current Market Practice

Whilst it is not the only method, typically, the usual way in which enterprises seek significant funds in debt markets is through syndicated loans. The marketing of these transactions to potential lenders can take a variety of forms, but usually it would involve an enterprise approaching a number of potential lenders through arrangers or underwriters (who are typically banks or investment banks who are themselves participants in the market) or directly through the borrower's own financial advisers. After the initial syndication of the loan, participations are often traded in the secondary market. Standard documentation and

platforms exist for this to be done, and standard syndicated loan documentation provides for it.

The amendment of section 128F in 1998 gave Australian enterprises access to debt markets internationally. From that time loans were documented as loan notes, which are "debentures" for the purposes of section 128F. While some syndicated loans have been offered to the market through public screen trading facilities like Reuters or Bloomberg, the usual method is for a direct approach (with offer letter and electronic or printed information memorandum) to a number of unassociated potential lenders who participate in the market. That number would range from 10 to many dozen, depending on the size and marketability of the transaction. As the loans are documented as debentures, and the offer satisfied the letter and spirit of the public offer test in section 128F(3) , these transactions have been able to qualify for exemption under section 128F. The use of such structures has been a standard feature of market practice for many years and it is a practice which is acceptable to the Australian Taxation Office ("**ATO**").

However, some issues arose in marketing these transactions to banks less familiar with Australian borrowers and Australian law. Though it is common in some jurisdictions to evidence loans made under syndicated facilities as notes, some overseas participants are less familiar with form of the loan note documentation used in Australia, and this limited the participation by those institutions in Australian syndicated loan transactions. For that reason, and generally to simplify the documentation for syndicated loans, when amendments in 2005 extended the scope of the section 128F exemption to include debt interests (ie as well as debentures), a number of participants took the opportunity of documenting transactions as simple loan facilities without the need to create debentures. In the context of the law as it currently exists these arrangements were expressly considered to be acceptable by the ATO (refer ATO Interpretative Decisions 2006/195 and 2006/231, as referred to further below). On the strength of the extended scope of section 128F and those published Decisions, a number of transactions were documented without the use of debentures.

The Bill affects "debt interests" issued after 7 December 2006. This can affect not only transactions signed on or after that date but also loans made under loan agreement signed well before that date.

Some loans, particularly project finance loans in the resources and infrastructure sector, and construction facilities, are progressive drawdown loans, meaning the loans are drawn down over a construction or development period which may be up to four years, or possibly longer.

A significant proportion of other loan facilities, particularly corporate facilities, are revolving facilities under which loans can be repaid and redrawn. Typically revolving loan facilities will be entered into for a period of some years under which lenders are obliged to keep providing loans within the facility limit. The loans are provided for short periods of between one and six months, and if the borrower still needs the funds at the end of such a short period, it must redraw those loans so that they roll over.

An important feature of such syndicated arrangements is that the participating creditors are able to transfer their commitments to other persons. Creditors take advantage of this "tradability" feature, by selling down into the secondary market, so as to reduce their credit exposure to particular borrowers, to rebalance their global portfolios, to manage doubtful debts, etc.

ATO Interpretative Decision 2006/231 confirms that revolving facilities will also potentially qualify under section 128F for exemption from withholding tax. Importantly, whilst it is the facility which needs to be offered in one of the ways contemplated by section 128F(3) (rather than each drawdown needing to be so offered) it is the redraw which is the "debt interest" and

not the facility itself. This means drawdowns under facilities offered prior to 7 December 2006 will nonetheless be governed by the proposed rules if they are made on or after 7 December 2006.

The Bill has had the effect that transactions currently being negotiated and certain revolving facilities entered into prior to the introduction of the Bill, face a significant level of tax law uncertainty in respect of the withholding tax position. "Clean" legal sign off is not possible in the absence of regulations. This is particularly worrying bearing in mind the very significant sums involved. APLMA believes that the current uncertain situation is untenable and ought not be allowed to continue until regulations are issued.

It appears that if the Bill is passed in its present form, and if no regulation is introduced, loans under facilities documented as loan notes will continue to qualify for exemption, but those which are not so documented will not so qualify. APLMA submits that as a policy matter, the actual form of the document used in the transactions should not be relevant, what should be relevant is the access to international debt markets. If legitimate attempts are made to have public access to a debt market which is a major source of debt capital, the form of instrument or debt, be it bond, note, loan note or loan, should be irrelevant. There should be no discrimination.

The size and volume of the market, including syndicated financing transactions by Australian borrowers which involve offshore financial institution participation and which are therefore potentially impacted by the amendments to section 128F, is significant. At least 60 offshore domiciled financiers participate on a regular basis in financings with Australian borrowers. We are happy to provide further details if requested.

It is important to note that the participation of the offshore domiciled banks is vital to the success of these capital raisings. Their participation ensures the completion of financings for which sufficient capital is not available within the Australian debt markets alone.

Further, substantial market disruption would arise if regulations were to be made to prescribe the use of “debentures” in relation to syndicated facilities, so as to deny the availability of section 128F relief. Such action would have the consequence that foreign banks (other than US or UK based banks) would be effectively precluded from participating in syndicated funding to Australian borrowers. Ultimately, this would seriously reduce the depth and liquidity of that market, which would only lead to higher funding costs for Australian borrowers.

An additional aspect of the Australian syndicated loan markets is the secondary trading of loans. Although these are done mostly on a bilateral basis (hence statistics are not available) anecdotal evidence indicates it is often offshore banks that join bank syndicated loans via such secondary trades. Australian arrangers, underwriters and participants rely on the knowledge that where section 128F has been complied with, this will allow them to trade these loans offshore at points in the future in order to manage their loan portfolios.

A significant point is that the facilities that offshore banks often participate in are project financings and infrastructure financings providing the necessary capital to facilitate significant growth of the Australian economy. Some recent (2006) examples are as follows:

- Millmerran Power Station (QLD) (refinancing)
- RiverCity Motorway (North South Bypass Tunnel – Brisbane (greenfields project)
- CLP Australia – funding of CLP portfolio of power assets in Australia (refinancing)
- Dampier Bunbury Natural Gas Pipeline (refinancing)

Confirmations sought from the Minister

APLMA has two requests to resolve the uncertainty and to recognise and clarify access to such an important capital market. Given the uncertainty, and the fact that they affect current live transactions, we ask that it be attended to as a matter of urgency.

Our requests are as follows:

1. We would encourage the Minister to announce a change to the effective date so that the new measures only take effect once the regulations are introduced (which conceivably could be done to coincide with enactment);

2. We request that the Minister please confirm the following:

   (a) loan facilities are an acceptable form of debt interest, and this will be recognised under the regulations which will be made pursuant to sections 128F(1)(f)(ii), 128F(1A)(e)(ii), 128F(1B)(c)(ii), 128FA(1)(b)(ii) or 128FA(2)(a)(ii),

   (b) regulations will not be introduced which would prejudice loan facilities documented as loan notes, that is, it is not intended that they would be considered to be debentures which would-be unacceptable arrangements under sections 128F(1C) or 128FA(2A).

APLMA believes that it is essential in order to avoid undue disruption to financial markets that any regulations that may issue are in appropriate form and reflect market practice. APLMA respectfully requests that any regulations are released in draft form for consultation so that any issues may be resolved prior to their formal introduction. APLMA would like to be involved in any such consultations which could be undertaken with key stakeholders on a confidential basis.

Should you wish to discuss this matter, please do not hesitate to contact the undersigned. We look forward to hearing from you.

Yours faithfully

Wayne Green
Chairman
Asia Pacific Loan Markets Association Limited
Australian Branch
Ph: 9619 6364
Fax: 9619 6544

cc. Mr Philip Lindsay

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