

Special Determination 29B: Application of the Financial Arrangements Rules to a Public-Private Partnership

Issued: 17 December 2020

S29B

This determination relates to an arrangement involving the finance, design, construction and on-going provision of operation and maintenance services under a public-private partnership agreement. This determination replaces *Special Determination 29A: Application of the financial arrangements rules a public-private partnership* (Inland Revenue, 2015) to take the 2020 Amendments into account.

Determination

This determination may be cited as *Special Determination S29B: Application of the Financial Arrangements Rules to a Public-Private Partnership*.

1 Explanation (which does not form part of the determination)

1. This determination varies and replaces *Special Determination S29: Application of the financial arrangements rules to a public-private partnership* to take the 2020 Amendments into account.
2. This determination relates to an arrangement (the Project) involving the finance, design, construction and on-going provision of operation and maintenance services in respect of the Facility by the Partnership under a public-private partnership agreement (the Project Agreement) with the Crown. The Holding Partnership will be the sole limited partner in the Partnership, holding 100% of the Partnership. The limited partners in the Holding Partnership are Limited Partners A, B and C. This determination does not apply to Limited Partner C.
3. The Project Agreement comprises three basic components:
 - a) a design and construction phase (the D&C Phase) under which the Partnership agrees to design and construct the Facility for the Crown in consideration for a fixed lump-sum payment (the Original D&C Payment), payable on completion of the D&C Phase;
 - b) a Facility Lease in which the Partnership and the Crown enter and under which the Partnership pays an amount representing the rental under the Facility Lease to the Crown (the Rental Prepayment); and
 - c) an operations and maintenance phase (the O&M Phase) under which the Partnership will provide operation and maintenance services to the Crown over a 25-year term in consideration for monthly payments (the Unitary Charge).
4. The Partnership has entered into:
 - a) a Construction Agreement with a contractor (the Contractor), under which the Contractor will design and construct the Facility in consideration for monthly and milestone payments; and

- b) an Operation and Maintenance Contract (the O&M Contract) with a service provider (the Service Provider), under which the Service Provider will provide the on-going operation and maintenance (and other) services in consideration for monthly payments.
5. Under the original arrangements:
 - The Partnership raised external debt from a range of third-party financiers (the Bank Debt) and Limited Partner C provided a term debt facility (the Term Debt Facility) to the Partnership to supplement the Bank Debt.
 - The Holding Partnership received funding from Limited Partner C during the D&C Phase in the form of a convertible debt instrument (the Convertible Note). Limited Partners A and B provided investment support during the D&C Phase in the form of a letter of credit to the external lenders.
 - The Partnership entered into Interest Rate Swaps in respect of the Bank Debt.
6. The Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and O&M Contract are all excepted financial arrangements. The D&C Phase of the Project Agreement, Bank Debt, Term Debt Facility and Swaps are financial arrangements to which the Partnership is a party. The Project, including all of these agreements, is a wider financial arrangement.
7. In 2020, the Partnership and the Crown entered into the 2020 Amendments that (among other things):
 - extended the duration of the D&C Phase and provided for additional payments to be made for the design and construction work (the Additional D&C Payments); and
 - provided for certain Unitary Charge payments to be paid by the Crown to the Partnership before the O&M Phase commences.
8. The 2020 Amendments included various additional amendments to the Project, as described in the Private Rulings.
9. *Special Determination S27B: Convertible Notes in Respect of a Limited Partnership* applies to the Convertible Notes. *Special Determination S28B: Application of the Financial Arrangement Rules to the Design and Construction Phase in a Public-Private Partnership* applies to the D&C Phase.

10. This determination prescribes:
 - a) the amount of consideration that is solely attributable to the Facility Lease;
 - b) how the financial arrangements rules apply to the O&M Phase of the Project Agreement, the Construction Agreement and the O&M Contract; and
 - c) the method for spreading the payments made under the Bank Debt, Term Debt Facility and Interest Rate Swaps.

2 Reference

This determination is made under s 90AC(1)(bb) and (i) of the Tax Administration Act 1994.

This determination varies and replaces *Special Determination S29A: Application of the financial arrangements rules a public-private partnership*.

3 Scope of determination

1. This determination applies to the Partnership in respect of the Project (which is set out in detail in the Private Rulings), including the following arrangements:
 - The D&C Phase of the Project Agreement, under which the Partnership agrees to design and construct the Facility for the Crown and will receive a fixed lump-sum payment (the Original D&C Payment) once the Facility is ready for operation and Additional D&C Payments periodically from the Effective Date of the 2020 Amendments. The D&C Phase is the subject of *Special Determination S28B*.
 - The O&M Phase of the Project Agreement, under which the Partnership will provide on-going operation and maintenance services for 25 years to the Crown in consideration for monthly payments.
 - The Facility Lease, under which the Partnership will lease the Facility from the Crown for 25 years and make the Rental Prepayment to the Crown. The Rental Prepayment will be equal to and will offset the Original D&C Payment.
 - A Construction Agreement with the Contractor, under which the Contractor will design and construct the Facility in consideration for payments under the Construction Agreement.
 - An O&M Contract with the Service Provider, under which the Service Provider will provide the on-going operation and maintenance (and other) services in consideration for payments under the O&M Contract.

- Bank Debt, under which the Partnership borrowed an agreed sum from external lenders for a term of seven years from financial close of the Project (Financial Close). The Bank Debt was structured as a capitalising, interest only senior debt facility that converts to an amortising senior tranche on the Conversion Date that was expected to be refinanced within seven years of Financial Close, and every seven years thereafter over the term of the Project. Under IFRS (as the standards apply at the date of this Determination), the Bank Debt (and any subsequent re-financings) was initially recognised at fair value plus integral fees, and subsequently measured using the amortised cost using the effective interest method (regardless of whether hedge accounting is applied), and has not be treated as a hedge of another financial arrangement. Principal payments have commenced under the Bank Debt. With effect from the date the 2020 Amendments becomes effective, the Bank Debt will be extended for two years.
 - Interest Rate Swaps, under which the Partnership pays a fixed rate of interest to the swap counterparties, and receives a floating rate in return.
 - Term Debt Facility under which the Partnership borrowed an agreed sum from Limited Partner C during the D&C Phase for a market rate of interest that converts to an amortising senior tranche on the Conversion Date. The Term Debt Facility is recognised under IFRS as a financial liability and was initially recorded at fair value plus integral fees. Subsequent measurement will be at amortised cost using the effective interest method.
 - Convertible Notes issued by the Holding Partnership to Limited Partner C for the duration of the D&C Phase. On a single date or several nominated dates during the D&C Phase, the Convertible Notes will convert (by way of mandatory set off) into a partnership interest in Holding Partnership for Limited Partner C (which is the subject of *Special Determination S27B*).
2. In 2020, the Partnership and the Crown entered into the 2020 Amendments that (among other things):
- extended the duration of the D&C Phase and provided for additional periodic payments to be made for the design and construction work (the Additional D&C Payments).
 - provided for certain Unitary Charge payments to be paid by the Crown to the Partnership before the O&M Phase commences.
3. The 2020 Amendments included various additional amendments to the Project, as described in the Private Rulings.

4. This determination is made subject to the following conditions:
 - Limited Partners A and B use IFRS to prepare financial statements.
 - Limited Partners A and B recognise income derived from the Crown during the D&C Phase of the Project Agreement and the O&M Phase of the Project Agreement, and will deduct expenditure incurred in relation to the Facility Lease, Construction Agreement and O&M Contract, in each case, under the relevant provisions of the Income Tax Act 2007 (outside the financial arrangement rules).
 - Limited Partners A and B do not use the fair value method for the Bank Debt or Term Debt Facility if the Bank Debt or Term Debt Facility is treated as a hedge of another financial arrangement under IFRS and use for the other financial arrangement a method that is neither the IFRS financial reporting method nor the method required under *Determination G29: Agreements for Sale and Purchase of Property Denominated in Foreign Currency: Exchange Rate to Determine the Acquisition Price and method for spreading income and expenditure* (Inland Revenue, 1996).
 - Limited Partners A and B recognise income and expenditure in respect of the Convertible Notes in the manner prescribed by *Special Determination S27B*.
 - Limited Partners A and B recognise income in respect of the Original D&C Payment in the manner prescribed by *Special Determination S28B*.
 - The Private Rulings continue to apply.

4 Principle

1. The Facility Lease is an excepted financial arrangement under s EW 5(9). Any amount that is solely attributable to an excepted financial arrangement described in s EW 5(2) to (16) is not an amount that is taken into account under the financial arrangement rules (s EW 6(2)). This determination specifies the amounts that are solely attributable to the Facility Lease that are not taken into account under the financial arrangement rules.
2. The O&M Phase, Construction Agreement and O&M Contract are “short-term agreements for sale and purchase” as defined in s YA 1, and are excepted financial arrangements under s EW 5(22). Any amount that is solely attributable to an excepted financial arrangement described in s EW 5(17) to (25) that is part of a financial arrangement, is an amount that is taken into account under the financial arrangements rules (s EW 6(3)). This determination specifies that no amounts payable to or by the Partnership in respect of the O&M Phase, Construction Agreement and O&M Contract

are required to be spread under the financial arrangements rules in accordance with this Determination.

3. The D&C Phase, Bank Debt, Interest Rate Swaps and Term Debt Facility are “financial arrangements” under s EW 3. This determination specifies that the payments made to or by Limited Partners A and B, in proportion to their share in the Holding Partnership, under the Bank Debt, Interest Rate Swaps and Term Debt Facility must be spread under the financial arrangements rules in accordance with this determination.
4. This determination does not deal with the treatment of the D&C Payment or the Convertible Notes, which are subject to separate determinations (*Special Determination S27B* and *Special Determination S28B*).
5. The 2020 Amendments do not impact on the application of the financial arrangements rules to any of the matters considered in this Determination.

5 Interpretation

In this determination, unless the context otherwise requires:

- All legislative references are to the Income Tax Act 2007, unless otherwise stated.
- Capitalised terms have the same meaning as set out in the Project Agreement.
- **IFRS** means International Financial Reporting Standards as defined in s YA 1.
- **Private Rulings** means BR Prv 20/64 and BR Prv 20/65, issued on 17 December 2020, and includes any private rulings issued to replace those Rulings, provided that the change to the relevant Ruling does not affect the application of this Determination.

6 Method

1. The Rental Prepayment paid in respect of the Facility Lease, and the property interest granted to the Partnership under the Facility Lease, are solely attributable to the Facility Lease and are not taken into account under the financial arrangement rules.
2. Limited Partners A and B are not required to spread any amounts under the financial arrangements rules in accordance with this Determination in respect of the:
 - O&M Phase of the Project Agreement;
 - Construction Agreement; and
 - O&M Contract.

3. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than “non-integral fees” as defined in s YA 1) over the term of the Bank Debt, and none of the restrictions for application of the IFRS financial reporting method contained in s EW 15D(2B) apply.
4. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than “non-integral fees” as defined in s YA 1) in respect of any subsequent refinancing of the Bank Debt over the term of the relevant refinancing, provided the terms of any such refinancing are materially similar to the terms of the Bank Debt. This determination paragraph does not affect Limited Partner A’s or Limited Partner B’s obligation to perform a base price adjustment under s EW 31 at the time of each refinancing.
5. The IFRS financial reporting method in s EW 15D may be used to allocate income and expenditure (other than “non-integral fees” as defined in s YA 1) over the term of the Term Debt Facility. None of the restrictions for the application of this reporting method in s EW 15D(2B) apply.
6. The expected value method in s EW 15F may be used to allocate income and expenditure (other than “non-contingent fees” as defined in s YA 1) over the term of the Interest Rate Swaps, provided the swaps are not treated as a hedge of other financial arrangements for which the “fair value method” is used. None of the mandatory spreading methods in s EW 15H or s EW 15I apply to the Interest Rate Swaps.
7. This determination does not affect Limited Partner A’s or Limited Partner B’s obligation to perform base price adjustments under s EW 31 in respect of the Interest Rate Swaps.

7 Example

This example illustrates the application of the method set out in this determination.

This example is based on the following parameters:

Commencement of D&C Phase	1 July 2014
Completion of D&C Phase	21 November 2021
Completion of O&M Phase	30 June 2044

Original D&C Payment from the Crown	\$1,000
Aggregate payments to the Contractor	(\$850)
Facility Lease prepayment	(\$1,000)
Monthly payments from the Crown during the O&M Phase	\$30
Monthly payments to the Service Provider	(\$15)
Annual interest on the Bank Debt	(\$85)
Annual interest on the Term Debt Facility	(\$7)
Annual interest (& inflation adjustment) on the Convertible Note	(\$15)
Annual net payments in respect of the Interest Rate Swaps	(\$7)

The Partnership is not required to spread any amounts under the financial arrangements rules in respect of the Facility Lease, O&M Phase of the Project Agreement, Construction Agreement and O&M Contract.

The amounts that must be spread under the financial arrangement rules are:

- interest on the Bank Debt calculated in accordance with the IFRS financial reporting method in s EW 15D;
- interest on the Term Debt Facility calculated in accordance with the IFRS financial reporting method in s EW 15D;
- payments in respect of the Interest Rate Swaps calculated in accordance with the expected value method in s EW 15F;
- amounts in respect of the Convertible Note as specified in *Special Determination S27B*;
- amounts in respect of the D&C Payment as specified in *Special Determination S28B*.

This Determination is signed by me on the 17th day of December 2020.

Howard Davis
Group Leader, Tax Counsel Office

About this document

The Commissioner may determine certain matters relating to financial arrangements. A taxpayer may wish to apply for a determination to ascertain the tax treatment of a particular financial arrangement.