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ASX Release

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ATO Position Paper – Frequently Asked Questions

On 21 December 2012, Sydney Airport Holdings Limited announced that the Australian Tax Office (ATO) had delivered to the Sydney Airport Trust 2 (SAT2) Tax Consolidated Group (the TCG) a position paper related to the tax years ended 31 December 2010 and 31 December 2011. The position paper forms part of a specific issue tax audit by the ATO on the tax deductibility of distributions on certain redeemable preference shares (RPS) issued by members of the TCG to Sydney Airport Trust 1 (SAT1). Following are answers to frequently asked questions in relation to the position paper announcement.

1. What are "RPS"?

RPS stands for Redeemable Preference Shares and, in this case, are non-voting securities issued by subsidiaries of SAT2. The RPS carry a priority entitlement to a fixed cumulative return and are treated as debt interests for tax purposes (so that distributions are tax deductible when paid).

2. On what basis is the ATO challenging the tax deductibility of distributions on certain RPS issued by members of the SAT2 TCG to SAT1?

The ATO is reviewing the tax deductibility of payments under a specific provision of the tax law (section 974-80). This provision can, in certain circumstances, recharacterise an instrument such as RPS to be an equity interest for income tax purposes and hence any distribution on the instrument would not be tax deductible.

Very broadly, the provision may recharacterise an instrument as an equity interest for tax purposes where it can be shown that:

- the instrument is held by a "connected entity" of the issuing company; and
- there is a scheme "designed to operate" so that the return on the instrument funds a return on an instrument held by another person, being "the ultimate recipient"; and

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- the instrument held by or return of the other person has ‘equity qualities’ e.g. profit dependent, convertible.

The position paper indicates that the ATO is seeking to apply section 974-80 to some of the RPS issued by subsidiaries of SAT2 in respect of distributions on those RPS paid to SAT1 in the tax years ended 31 December 2010 and 31 December 2011. SAT2, as head entity of the tax consolidated group, has claimed those distributions as deductible. The ATO is seeking to argue those distributions are not tax deductible.

3. Why has the ATO issued a position paper prior to finalising the audit?

SAHL is unable to comment on ATO practices and their approach to the specific issue tax audit.

It is however worth highlighting that different RPS instruments have been issued by different entities and at different times, as shown in the structure diagram (refer Appendix). The relevant tax law provision (Answer 2) must be considered in respect of each RPS instrument, based on the relevant facts and circumstances applicable to that instrument.

4. What is the maximum total historic income tax liability in relation to the position paper? Does this include interest and penalties?

The ATO has not quantified a tax payable amount in the position paper.

If the conclusions of the position paper carry forward to an adverse determination by the ATO, and that determination is ultimately sustained, SAHL estimates that it may result in additional primary income tax payable of up to $79 million by the SAT2 TCG for the years ended 31 December 2010 and 31 December 2011. The estimated tax payable amount excludes any interest or penalties.

5. When will the position paper be due for payment?

A payment is not certain as the ATO has not issued an amended assessment. It is, therefore, impossible to predict a potential payment amount (if any), date or timeframe for any resolution of the matter.

6. Will you continue to claim deductions in relation to the disputed RPS in the 31 December 2012 tax return?

SAHL remains confident that distributions made on the RPS are tax deductible (on a paid basis) and so expects to continue to claim deductions in SAT2's tax return for the year ended 31 December 2012.

7. Will the ATO review any of the years from 2002-2009?

The ATO has confirmed that it will neither review nor issue any section 974-80 position papers to the TCG for any years prior to the tax year ended 31 December 2010.

8. How will you fund any initial up-front payment?

ASX-listed Sydney Airport has debt facilities in place which are available to fund any potential initial up-front payment.

9. If an up-front payment is to be funded with debt, does it place restrictions on your ability to pay equity distributions?

ASX-listed Sydney Airport expects to be able to continue to pay distributions to its investors in the event that it draws on certain debt facilities to fund an up-front tax liability.

10. Are you considering a negotiated settlement with the ATO?

The Directors of SAHL, as Responsible Entity (RE) for SAT2, and its advisers are currently considering the full range of available options in relation to the position paper. Given no amended assessment has been received, it is premature to comment on likely decisions.

SAHL is confident that the relevant distributions on the RPS are tax deductible. If the position paper results in an amended assessment being issued, SAHL will consider all available options to protect the interests of investors.

11. If ultimately sustained, how do the ATO's findings affect future cash flows to investors?

Cash flows from Sydney Airport's operating business (i.e. SCACH and its subsidiaries) are not affected by the position paper or the specific issue tax audit.

Based on the current structure, if the ATO's findings were ultimately sustained, the future cash flows from ASX-listed Sydney Airport to investors would likely be reduced to the extent any RPS deductions were disallowed for tax purposes. While pre-tax cash flows would likely be affected in this scenario, Australian tax residents should be able to make use of franking credits which would be attached to distributions paid.

12. Has the Board considered alternative structures to preserve investor value?

It is premature to speculate about potential restructures. However as part of ordinary governance procedures, the Directors of SAHL (as RE for SAT2) are considering the full range of available options in relation to the position paper.

13. How confident is SAHL of winning a legal challenge? What advice have you received from your lawyers and accountants in respect of the outcome?

SAHL is confident that the relevant distributions on the RPS are tax deductible. ASX-listed Sydney Airport has retained legal and accounting firms to provide professional advice and assist with the process. Professional advice remains confidential and is subject to legal privilege.

14. When will the ATO finalise its draft tax ruling outlining their views on when entities in a stapled group will be 'connected entities' for the purposes of section 974-80?

There is general market uncertainty around the interpretation of section 974-80 following the release of the draft ruling in July 2012. Numerous tax practitioners and professional bodies disagree with the interpretation adopted by the ATO and a number of contrary submissions have been lodged with the ATO. We understand that the ATO is currently reviewing the submissions received. The ATO has not provided a release date for the final ruling.

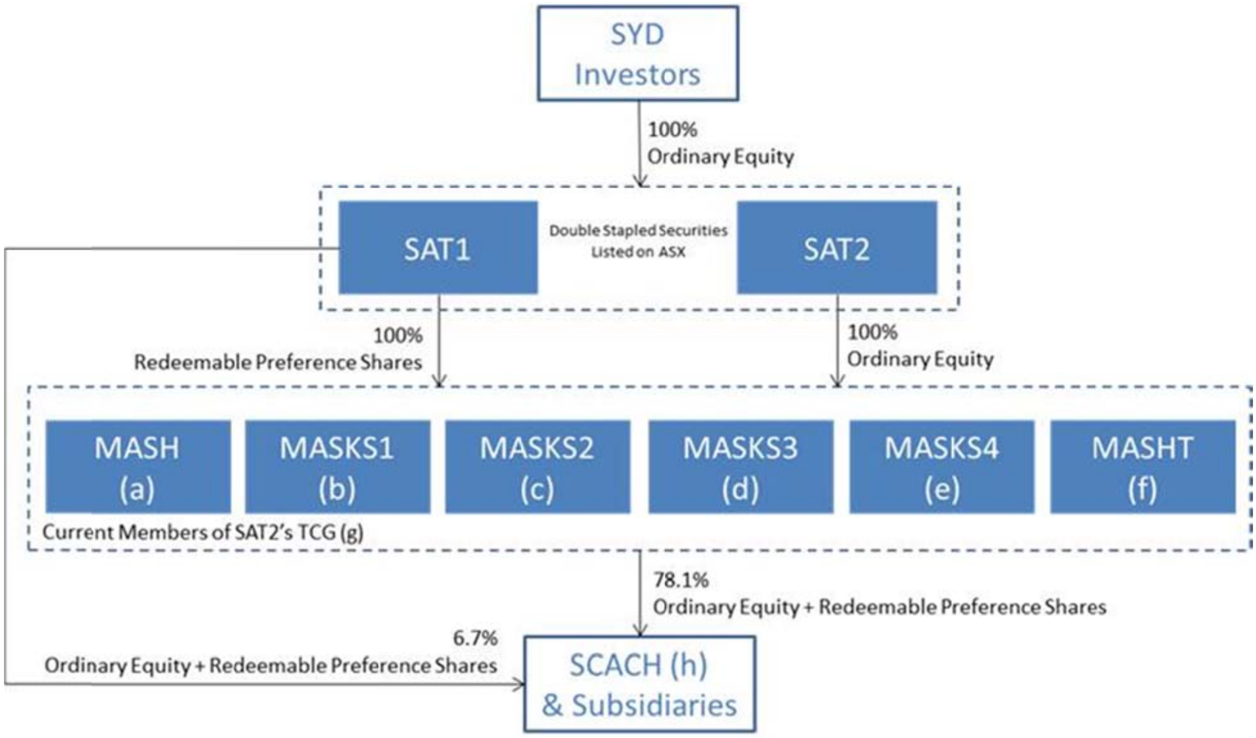
ATO taxation rulings represent its position on the interpretation of relevant legislation and are not law.

15. Is there any update on the proposed amendments to Section 974-80 as announced by the Federal Treasurer in May 2011? What implications does this have for the ATO's current challenge?

The effect of the proposed amendments could be to remove the basis of challenge to the RPS. The terms of the proposed amendments have not been released.

Appendix: Structure Diagram and Notes

A simplified diagram of the current holding structure is shown below:



Notes:

(a) MASH RPS currently total $872m, and are subject to the position paper.

(b) MASKS1 RPS currently total $249.1m, of which $76.1m was issued in October 2011 as part of the Asset Swap transaction.

(c) MASKS2 RPS currently total $1,165.8m, of which $319.4m was issued in October 2011 as part of the Asset Swap transaction.

(d) MASKS3 RPS currently total $88.4m, of which $29.1m was issued in October 2011 as part of the Asset Swap transaction.

(e) MASKS4 RPS currently total $496.2m, of which $146.2m was issued in October 2011 as part of the Asset Swap transaction.

(f) MASHT RPS currently total $241.6m, of which $85.0m was issued in November 2011 as part of the Asset Swap transaction.

(g) Each of these companies are currently part of the SAT2 TCG. MASKS1, MASKS4 and MASHT only became part of the SAT2 TCG in December 2011, as part of the corporate simplification.

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(h) SCACH is the head entity of its own tax consolidated group; it is not part of the SAT2 TCG. Neither the position paper, nor the specific issue tax audit, relate to or impact upon SCACH or its subsidiaries. Subsidiaries of SCACH include the airport operating company and the borrowers of senior debt facilities.

Further information on the SAT2 TCG RPS can be found in note 13.2 of the ASX-listed Sydney Airport Financial Report for Year Ended 31 December 2012.

For further information, please contact:

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