HMRC - CFM97200 - Infrastructure: The Income Test

TIOPA10/S433(2)-(4)

The first condition required to be met in order to be a qualifying infrastructure company (QIC) is the public infrastructure income test. This is a test of income recognised for accounting purposes.

To meet the public infrastructure income test, all or all but an insignificant proportion of a company’s income for an accounting period must derive from:

qualifying infrastructure activities carried on by the company,

shares in a QIC, or

loan relationships or other financing arrangements to which the only other party is a QIC.

For the purposes of the public infrastructure income test:

Activities carried on by a company include those carried on by a partnership or other transparent entity in which the company has an interest (s447);

Interest generated by cash reserves, held as a requirement of unrelated lenders, can be considered to facilitate provision of a public infrastructure asset and therefore to arise from a qualifying infrastructure activity;

Interest generated by cash reserves held as working capital can be considered to facilitate the provision of a public infrastructure asset. It may be necessary to hold such an asset to provide for expenditure in the build phase of a project where no income is being generated. Considering whether such income is ancillary the cash reserves held should not be excessive compared to the working capital requirements of the project.

Income arising from shares in a decommissioning fund, or loan relationships or other financing arrangements to which a decommissioning fund is party, is ignored (s448).

If a QIC does not have any income in a period it is treated as having passed the public infrastructure income test.

Meaning of insignificant

The test of insignificance is both an absolute and relative test. Where an amount of income is insignificant in absolute terms then it is ignored. Otherwise, income is ignored if it constitutes an insignificant proportion of the company’s total income in that accounting period.

Whether an amount is insignificant will depend on the particular facts and circumstances. An amount is unlikely to be insignificant if it would be of relevance to shareholders or lenders. Income is more likely to represent an insignificant proportion of the total, or be insignificant in absolute terms, if its absence would make no difference to the market value of the company, and if it is merely happenstance that the company earns the income.

Example

A company is as a special purpose company (SPC) to bid for a private finance initiative (PFI) contract to design, build, finance, maintain and operate a waste facility.

In its first accounting period from incorporation, costs are incurred by the SPC during the tender process run by a local authority. The SPC is not performing any income generating activity at any point in this period and no income is recognised for accounting purposes. The public infrastructure income test is passed.

In its second accounting period, the SPC recognises income of £100m in respect of construction of a public infrastructure asset under the PFI contract it has successfully bid for. This is considered income derived from a qualifying infrastructure activity. The company is also required to hold cash reserves as a condition of its borrowing from its senior lenders. Interest is generated on these cash reserves totalling £500k in this second accounting period, which is insignificant in relative terms. The public infrastructure income test is passed in this period.

In the third accounting period, the waste facility is complete. The SPC recognises £80m from its PFI contract with the local authority. It also generates £4m interest income from lending to its shareholders. The latter is not considered derived from a qualifying infrastructure activity. The £4m is significant both in absolute terms and relative to the £80m generated from its PFI contract. Consequently, the public infrastructure income test is failed.

The meaning of insignificant for these purposes can be altered by a group infrastructure election.

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