



Downer

Relationships creating success

TAX REPORT 2016

For the year ended 30 June 2016 | 9 December 2016

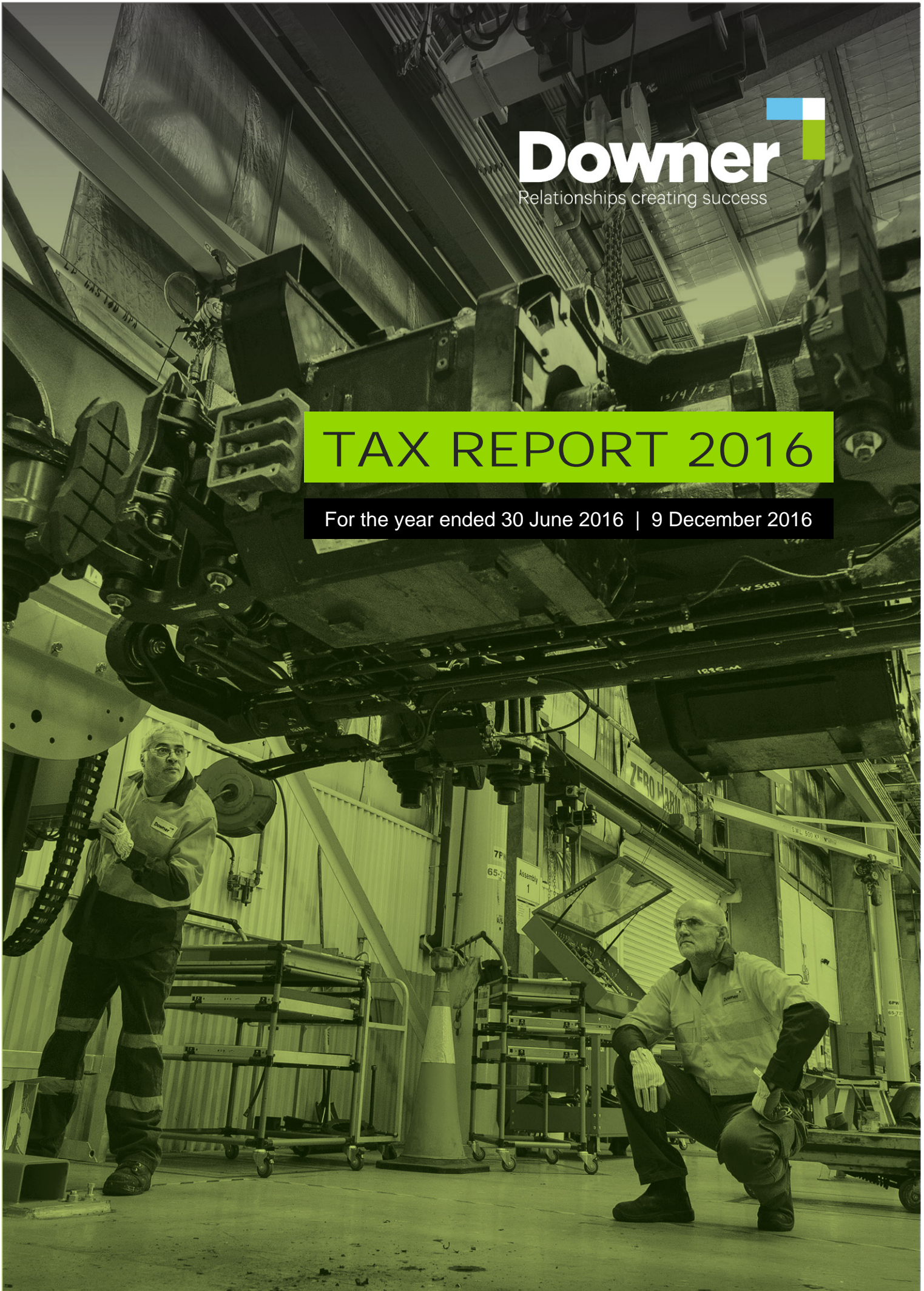


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1. CHIEF FINANCIAL OFFICER'S INTRODUCTION

I am pleased to present Downer Group's (Downer or the Group) Tax Report for 2016. This is Downer's second Tax Report and continues Downer's commitment to the increasing global view that effective tax risk management is an essential part of good corporate governance.

Downer makes a wide range of tax-related payments to tax authorities in the various jurisdictions in which it operates and pays the appropriate amount of tax in each jurisdiction under the tax law. Downer's tax liability is primarily payable in Australia and New Zealand (NZ). The profits earned by Downer are taxed at the applicable tax rate. Imputation credits are generated from the payment of Australian income tax by Downer, which are then passed on to shareholders on payment of dividends (franking credits).

Downer is also subject to fringe benefits tax (FBT), goods and services tax (GST), payroll tax, land tax, stamp duty and other taxes. As well as being subject to the above taxes, Downer also collects and pays 'pay as you go' (PAYG) taxes on behalf of its employees and withholding tax.

In the 2016 financial year, Downer paid, collected and remitted \$1.1 billion in taxes to tax authorities.

Additionally, Downer has signed up for the voluntary tax transparency code (TTC) as released by the Board of Taxation in May 2016. This 2016 Downer Tax Report complies with the disclosure requirements of the voluntary TTC.

This report provides information on Downer and in particular:

- Section 2 – Downer Group overview;
- Section 3 – Tax strategy and governance;
- Section 4 – Taxes paid, collected and remitted by the Downer Group;
- Section 5 – Income taxes disclosed in Downer's 2016 Annual Report;
- Section 6 – International related party dealings; and
- Section 7 – Australian Taxation Office (ATO) tax transparency disclosures.

The information in this report is additional to information already published in the Notes to Downer's 2015 and 2016 Annual Reports, which were prepared in accordance with Australian Accounting Standards and comply with the International Financial Reporting Standards.

Signed

Michael Ferguson
Chief Financial Officer

2. DOWNER GROUP OVERVIEW

Downer is a leading provider of services to customers in markets including: Transport Services; Technology and Communications Services; Utilities Services; Engineering, Construction and Maintenance (EC&M); Mining; and Rail. Downer employs about 19,000 people across more than 200 sites and projects, mostly in Australia and New Zealand, but also in the Asia-Pacific region, South America and Southern Africa.

The majority of Downer's profits are earned within Australia and New Zealand. Downer also earns profits in various overseas jurisdictions, which contribute to less than 2% of the Group's profit. Refer to note F4. Controlled entities of the 2016 Annual Report for details of the Group's controlled entities.

Downer reports its results under the following six service lines:

- Transport Services – comprises the Group's road, rail infrastructure, bridge, airport and port businesses;
- Technology and Communications Services – comprises the Group's fibre, copper and radio network infrastructure businesses;
- Utilities Services – comprises the Group's power, gas, water and renewal energy businesses;

- EC&M – comprises the Group's industrial and commercial construction and maintenance businesses and resource based consultancies;
- Mining – includes open cut mining, underground mining, mine planning, blasting and tyre management; and
- Rail – provides total rail asset solutions including freight and passenger build, operations and maintenance, component overhauls and after-market parts to a range of public and private sector customers.

For Australian tax law, Downer has elected to form a tax consolidated group (the Downer Tax Consolidated Group). The Downer Tax Consolidated group is made up of Downer EDI Limited (as the Head Company of the Tax Consolidated Group) and its wholly owned Australian corporate subsidiaries. For income tax purposes, the members of the Downer Tax Consolidated Group are treated as if they were a 'single taxpayer'.

3. TAX STRATEGY AND GOVERNANCE

Downer's tax strategy is focused on providing high quality tax management and tax governance, which results in ensuring that Downer pays the appropriate amount of tax within each region that it operates.

Downer implements this strategy through the tax risk management principles within the Group's Risk Management Framework. This framework is approved by Downer's Board and is supported by governance processes, which ensure the framework is implemented effectively. The framework and supporting governance processes outline key tax risks and the appropriate courses of action required to ensure that all tax risks are managed appropriately and effectively.

Part of this risk framework is zero tolerance for non-compliance with laws, which includes tax.

Further, Downer's Board does not sanction or support any activities that seek to aggressively structure Downer's tax affairs.

As Downer operates in overseas jurisdictions, it is required to consider the appropriate structures to enter the jurisdictions. This includes balancing the commercial, cost (including tax), investor and legal factors. Downer ensures that the appropriate tax is paid in each jurisdiction.

Outside of Australia, New Zealand is the only country in which Downer has significant operations and its corporate tax rate of 28% is lower than Australia's corporate tax rate. Downer discloses the impact of this in the Tax Note of the Annual Report ("Effect of tax rates in foreign jurisdictions") to highlight the impact of the different tax rates applied in relation to the profit from offshore activities.

Given the size of Downer, the ATO has undertaken various tax risk reviews, which have been undertaken in an open, cooperative and transparent manner. In completing these reviews, Downer has provided all information requested and the ATO has not made any adjustments to submitted tax returns based on these reviews.

Additionally, Downer is committed to maintaining the highest standards of corporate governance. The adoption of the voluntary TTC aligns with these standards and assists in the facilitation of public debate through greater transparency.

4. TAXES PAID, COLLECTED AND REMITTED BY THE DOWNER GROUP

The tables below illustrate the types of taxes paid, collected and remitted by Downer in the 30 June 2016 and 30 June 2015 financial years to the Australian (Federal and State) and New Zealand tax authorities. The majority of Downer's operations are in Australia and New Zealand.

Tax Authorities	Taxes paid			Taxes collected / remitted			
	Corporate income tax \$'m	Employer / payroll taxes ¹ \$'m	Total taxes paid \$'m	GST (net of recoveries) \$'m	Employee taxes remitted ² \$'m	Total taxes collected / remitted \$'m	Total taxes paid, collected / remitted \$'m
2016							
Australia (Federal)	33.6	6.2	39.8	247.8	603.4	851.2	891.0
Australia (State)	-	108.2	108.2	-	-	-	108.2
NZ ³	-.4	3.6	3.6	61.6	76.0	137.6	141.2
Total	33.6	118.0	151.6	309.4	679.4	988.8	1,140.4
2015							
Australia (Federal)	33.0	8.5	41.5	214.1	581.3	795.4	836.9
Australia (State)	-	104.4	104.4	-	-	-	104.4
NZ ³	14.7	3.5	18.2	53.1	67.5	120.6	138.8
Total	47.7	116.4	164.1	267.2	648.8	916.0	1,080.1

Notes

- Note 1 – Consists of payroll and employer taxes paid resulting from Downer's role as an employer including Australian and NZ FBT. Figures represent payroll tax and NZ FBT for the 30 June year and Australian FBT for the 31 March year.
- Note 2 – Employee taxes remitted to tax authorities for the 30 June year.
- Note 3 – NZ taxes paid have been presented in Australian dollars.
- Note 4 – During the year Downer's NZ operations received a tax refund in respect of the 2015 year, which offset tax payments made during the year.

5. INCOME TAXES DISCLOSED IN DOWNER'S 2016 ANNUAL REPORT

INCOME TAX EXPENSE

Income tax expense (ITE) is an accounting concept, which represents the amount of income tax accrued for accounting purposes. Usually, there will be differences between the ITE and the amount of tax paid for the period to relevant tax authorities. This is due to the ITE including amounts which are not likely to be paid / received in the current period (commonly referred to as deferred tax expense). The ITE may also be affected by the impact of overseas jurisdictions, whether it is due to differential tax rates or the inability to recover tax losses from these jurisdictions. Further, for accounting purposes, ITE includes only taxes on profits and excludes other types of taxes such as GST, FBT and PAYG tax paid on behalf of employees.

Downer reported a Global ITE expense of \$63.3 million in the 2016 financial year. The reported statutory effective tax rate (ETR) of 26.0% constitutes the ITE as a percentage of Downer's total profit before tax. The primary drivers of the ITE and ETR are as follows (split between Australian and international operations):

2016	Australia \$'m	International \$'m	Global \$'m
Profit before income tax	187.8	56.1	243.9
Tax using the Company's statutory tax rate ¹	56.4	16.8	73.2
Effect of tax rates in foreign jurisdictions ²	-	(1.2)	(1.2)
Non-deductible expenses	0.6	0.2	0.8
Profits and franked distributions from joint ventures (JV) and associates ³	(4.7)	(0.9)	(5.6)
Non-taxable government grant ⁴	(3.0)	-	(3.0)
Other items	(1.5)	0.8	(0.7)
(Over) / under provision of income tax in previous year	0.1	(0.3)	(0.2)
Total ITE	47.9	15.4	63.3
ETR	25.5%	27.5%	26.0%

Notes

- Note 1 – Australian statutory tax rate is 30%.
- Note 2 – NZ profits taxed at 28%; other foreign jurisdictions taxed at different tax rate to the Australian statutory tax rate.
- Note 3 – Represents JV profits that have already been subject to tax.
- Note 4 – Represents Research & Development (R&D) grant income in Downer's Profit & Loss that is not subject to tax (recognised within EBIT in "Other Revenue").

RECONCILIATION OF ITE TO INCOME TAX PAID

2016	\$'m
Income tax expense per Annual Report (profit and loss statement)	63.3
Adjust for:	
▪ Deferred tax (expense) / benefit	(38.4) ¹
▪ Tax payments made greater / (less) than current tax expense	11.0
Income tax paid (agrees to Cash flow statement per the 2016 Annual Report)	35.9

Notes

Note 1 – The deferred tax expense for 2016 primarily consists of movements in the following deferred tax balances (due to different accounting and tax treatments):

- Trade and other receivables (\$34.3m) – Accounting income recognised that is not taxable until derived for tax purposes.
- Trade and other payables (\$17.2m) – Accrued expenses not deductible for tax until incurred.
- Property, Plant and Equipment (PPE) (\$9.6m) – PPE being depreciated faster for tax than accounting.
- Provisions \$17.4m – Provisions expensed but not deductible for tax until incurred.

6. INTERNATIONAL RELATED PARTY DEALINGS (IRPD)

Where Downer operates in foreign jurisdictions, it generally operates through legal entities in those jurisdictions and is subject to the local tax regime. These entities and foreign jurisdictions are disclosed in the Annual Report (note F4. Controlled entities).

Downer reports its income in the country where the services are performed and reports expenses in the country where the costs are incurred. As the Group predominantly operates in Australia and New Zealand, the Group's main IRPD impacting the Australian taxable income of the Downer Tax Consolidated group is the management fee charged to New Zealand, which is summarised below.

Main IRPD	2016 \$'m
Management fee to NZ	6.5
Total	6.5

Downer EDI Limited, as the holding company of the Downer Group, is required to charge a management fee in relation to costs incurred and services performed referable to managing and supporting the business portfolio.

The recovery of corporate head office costs referable to supporting the business portfolio is a requirement to comply with taxation legislation.

The approach adopted in calculating and charging the management fee is in accordance with ATO and Organisation for Economic Cooperation and Development transfer pricing rulings and guidelines and has been signed off by external tax advisors.

7. ATO TAX TRANSPARENCY DISCLOSURES

In early December 2016 the ATO published tax information for large taxpayers in respect of the 2015 tax year (ATO tax transparency measures).

The information published by the ATO includes taxable income and tax payable, which are based on concepts outlined under Australian tax law. Taxable income is generally based on accounting profit with adjustments for tax timing differences, and for amounts included in accounting profit that are not included in taxable income. Unused tax losses from prior years can also be deducted from taxable income in later years. Tax payable is generally 30% of taxable income but this amount is then reduced for available tax offsets. These offsets include franking credits and the R&D tax offset (40% of eligible R&D expenses).

For the 2015 year, Downer's taxable income was \$192.7 million with a tax payable of \$4.7 million. This is principally due to the following items:

	Taxable income / (deduction) \$'m	Tax payable / (offset) \$'m
Taxable income	192.7	57.8
The investment of \$100.0 million in R&D for innovation programs ¹	(133.3)	(40.0)
The exclusion of income, which had already been taxed at Downer's JV level ²	(10.5)	(3.2)
Tax offsets for tax prepaid in 2015 and prior years applied in the 2015 year ³	(32.5)	(9.7)
The exclusion of foreign income which had already been taxed in foreign jurisdictions ⁴	(0.8)	(0.2)
Tax payable	15.6	4.7

Notes

- Note 1 – Under the tax legislation, this is the tax offset Downer was eligible for under the R&D incentive program (tax offset capped at \$40.0 million).
- Note 2 – Franking credits received from Downer's JV distributions that had already been subject to corporate tax.
- Note 3 – Franking deficit tax (FDT) paid, which results in a tax offset (FDT is essentially prepaid tax).
- Note 4 – The foreign income tax offset for foreign tax already paid on the foreign profits included in Downer's taxable income.

The following table provides a comparison of the information published by the ATO against information contained in Downer's Annual Report.

2015	ATO published information (ATO)	2015 Annual Report (Annual Report)	Explanation
Total Income	\$5,816,965,428	\$7,041,000,000	<p>ATO – The total income published is based on the Downer Tax Consolidated Group's lodged tax return (which only includes Australian entities).</p> <p>Annual Report – The income is Downer's Consolidated income which includes NZ and other overseas income. This consists of 'Total revenue and other income', 'Share of net profit of joint ventures and associates' and 'Finance income'.</p>
Taxable Income (Downer profit before tax as comparative)	\$192,682,506	\$279,800,000	<p>ATO – The taxable income published is the accounting profit for the Downer Tax Consolidated Group adjusted for the following material tax adjustments:</p> <ul style="list-style-type: none"> ▪ Tax timing differences; ▪ Add back of non-deductible R&D expenditure; and ▪ The recoupment of carried-forward and acquired tax losses. <p>Annual Report – The profit is Downer's Consolidated profit which includes NZ and other overseas profit.</p>
Tax payable (Downer income tax paid (per cash flow statement) as comparative)	\$4,668,204	\$49,000,000	<p>ATO – The Australian tax payable published was reduced to \$4.7 million as a result of the utilisation of tax offsets and credits (the R&D offset - \$40 million, franking credits from JV dividends - \$3.2 million, FDT offset - \$9.7 million and foreign income tax offset - \$0.2 million).</p> <p>Annual Report – Downer's income tax paid per the cash flow statement of the Annual Report includes Downer's global tax payments primarily relating to Australia (\$33.0 million), NZ (\$14.7 million) and other overseas jurisdictions (\$2.0 million).</p>

8. BASIS OF REPORT PREPARATION

SECTION 4

Taxes and other payments to Australian and New Zealand tax authorities are presented in this Report in Section 4 on a cash paid and cash received basis for the years ended 30 June 2015 and 30 June 2016. This Report includes all such payments paid by controlled entities within the Downer Group. Tax payments made by equity accounted investments and joint ventures are excluded.

Taxes paid to Australian and New Zealand tax authorities, net of refunds, are referred to in this Report include the following categories:

Corporate income tax

Payments to tax authorities based on taxable profits under legislated income tax rules, including withholding taxes on dividends and interest.

Employer / payroll taxes

Payments to tax authorities resulting from Downer's role as an employer, including Payroll Tax, Australian FBT and New Zealand FBT. Figures shown represent payroll tax and New Zealand FBT for the 30 June 2015 and 30 June 2016 years and Australian FBT for the 31 March 2015 and 31 March 2016 years being the most recent annual data.

GST (net of recoveries)

Tax payments made to, or received from, Australian and New Zealand tax authorities in the nature of Value Added Tax and Goods and Services Tax.

Employee taxes remitted

Tax payments remitted to tax authorities on behalf of our employees. These payments have been presented in this Report for information purposes only.

SECTION 5

The financial statement disclosures in Section 5 have been extracted from the Downer Annual Report for 2016 which was prepared under Australian Accounting Standards and complies with International Financial Reporting Standards.

SECTION 7

ATO tax transparency disclosures in Section 7 reflect total income, taxable income and tax payable contained in the Downer 30 June 2015 Australian tax consolidated group's annual return submitted to the ATO.



Independent Audit Report to the Directors of Downer EDI Limited

Opinion: What we found

In our opinion, the tables presented in Sections 4 to 7 of Downer EDI Limited's ("Downer") 'Tax Report 2016' (the "Report") are prepared, in all material respects, in accordance with the Basis of Report Preparation set out in Section 8 of the Report, for the year ended 30 June 2016.

Basis for Opinion and Auditor's responsibilities

We performed an audit in order to express an opinion as to whether the tables presented by Downer in Sections 4 to 7 (the "Tables") of the Report, were prepared in accordance with the Basis of Report Preparation, for the year ended 30 June 2016.

We conducted our work in accordance with Australian Auditing Standards.

According to those Standards, we must:

- Comply with relevant ethical requirements; and
- Plan and perform the audit to obtain reasonable assurance about whether the Tables are free from material misstatement due to fraud or error.

We performed procedures to obtain audit evidence about the information contained in the Tables. We used our judgement to select procedures, including our assessment of the risks of material misstatement of the Tables, whether due to fraud or error.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these tables.

We do not express an opinion on Downer's internal controls. However, we do consider relevant internal controls in the design of our audit procedures.

We also evaluated the appropriateness of the Basis of Report Preparation in relation to the Tables.

We believe that the evidence we obtained provides a sufficient and appropriate basis for our opinion.

Basis of Report Preparation

The Basis of Report Preparation, set out in Section 8 of the Report, is of such importance that it is fundamental to your understanding of the Tables. This has not caused us to modify our opinion.

Management's responsibility for the Report

Management of Downer is responsible for:

- The preparation and presentation of the Report;
- Determining that the Basis for Report Preparation set out in Section 8 meets the needs of the Directors of Downer and that the Report is prepared in accordance with the Basis of Report Preparation; and
- Establishing internal controls and processes that enable the preparation and presentation of Report that is free from material misstatement, whether due to fraud or error.

Use of this audit report

This independent audit report has been prepared for the Directors of Downer in accordance with our engagement letter and is intended solely for the Directors of Downer. We disclaim any assumption of responsibility for any reliance on this audit report, or the Report to which it relates, to any person other than the Directors of Downer, or for any purpose other than that for which it was prepared.

KPMG
Sydney

9 December 2016



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