Australian Securitisation Forum

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To:
Mr Cullen Smythe
Chief Commissioner of State Revenue
Revenue NSW
Cullen.Smythe@revenue.nsw.gov.au

Copy to:
The Honourable Daniel Mookhey, MLC
Treasurer
52 Martin Place
Sydney NSW 2000

AUSTRALIAN SECURITISATION FORUM SUBMISSION

SECTION 8(1)(b)(ix) OF THE DUTIES ACT 1997 (NSW)

1 The Australian Securitisation Forum ("**ASF**") is the peak body representing the securitisation and covered bond industries in Australia. Its role is to promote the development of securitisation in Australia by facilitating the formation of industry positions on policy and market matters, representing the industry to local and global policymakers and regulators and advancing the professional standards of the industry through education and market outreach opportunities.

2 The ASF is concerned about the potential scope of new section 8(1)(b)(ix) of the *Duties Act 1997* (NSW) ("**Duties Act**"). As set out in this letter:

(a) there is currently uncertainty, emphasised by the introduction of section 8(1)(b)(ix), as to whether stamp duty is payable in relation to certain aspects of securitisation and covered bond transactions;

(b) the ASF remains of the view that stamp duty should not be payable in respect of any part of a securitisation or covered bond transaction;

(c) the above uncertainty impacts the entire finance industry (including non-bank lenders, credit unions / building societies; regional banks and major banks);

(d) if stamp duty is payable, for example, on the extinguishment of equitable interests in receivables, it will be highly impractical, given the nominal amounts of duty involved and it will be inconvenient to manage and administer; and

(e) the below proposal seeks to remove any uncertainty and make clear that stamp duty is not payable on:

   (i) the creation of equitable interests in a securitisation or covered bond special purpose vehicle;

   (ii) the assignment and reallocation of those interests; or

   (iii) the extinguishment of those interests.

3 The ASF would be grateful if the Chief Commissioner of State Revenue ("**Commissioner**") would confirm the prevailing view that section 8(1)(b)(ix) of the Duties Act does not subject the equitable assignment of mortgages held over land in NSW to, and any later reallocation or extinguishment of those interests in mortgages within, securitisation special purpose vehicles ("**SPV**s") to duty. Similar issues arise in relation to covered bonds.

4 In particular, the ASF would be grateful for the inclusion of an express exemption in the *Duties Regulation 2022* (NSW) ("**Duties Regulation**") for such situations, to provide certainty to securitisation industry and covered bond industry participants.

5 The ASF would be happy to discuss this submission with Revenue NSW, including through a face-to-face meeting, if that would be useful.

<u>Context</u>

6 The traditional securitisation structure involves the creation of an insolvency-remote SPV. That SPV issues one or more classes of debt securities to investors and uses the proceeds of that issuance to acquire a pool of receivables or other income-generating assets. The income generated by those assets is used to fund payments on the debt securities, and principal payments on those assets are applied to pay down the principal owed on the debt securities.

7 Where an SPV is established to issue mortgage-backed securities, both loan receivables and the associated mortgages are typically assigned in equity to the SPV for an amount equal to the amount of principal.

8 The transfer of the loan receivables to the SPV is clearly not subject to duty under the Duties Act. This is because loan receivables are not dutiable property as defined in section 8 of the Duties Act.

9 The receivables and the related mortgages are generally assigned only in equity. The parties generally do not use the procedure in section 12 of the *Conveyancing Act 1919* (NSW) for legal assignments and the transfer of the mortgages is generally not registered at the land registry. There is therefore no change in the registered mortgagee. The transaction documents provide for a legal assignment of the receivable, and the registered transfer of the mortgages, only in very limited cases (e.g. if the assignor becomes insolvent).

10 The equitable assignment creates a new equitable interest in the mortgage in the hands of the special purpose vehicle ("**equitable interest**").

11 The Duties Act provides certain exemptions from duty for the issuance of mortgage-backed securities in sections 282 and 283.

12 The issue concerns the nature of the equitable interests in the hands of the SPV and whether their creation (by the transfer of the mortgages in equity), subsequent reallocation or extinguishment trigger a liability to duty in New South Wales.

13 Similar considerations arise in relation to covered bonds, a form of secured funding utilised by authorised deposit-taking institutions ("**ADI**"). Very broadly, under a covered bond arrangement, the ADI will issue bonds (unsecured debt obligations of the ADI) on-market via a bond trustee. A trust SPV is established which acquires the beneficial interest in a pool of mortgages known as the "cover pool" from the ADI. The trustee of the SPV guarantees the issuer ADI's payment obligations to bondholders. That obligation is secured by a security interest over the cover pool in favour of a Security Trustee, which holds the benefit of that security on trust for the bondholders. If the issuer ADI fails to pay bondholders, payments of guaranteed amounts are funded by the cash flows from the cover pool.

Section 8(1)(b)(ix) of the Duties Act

14 Section 8(1)(b)(ix) of the Duties Act was enacted by the *State Revenue and Fines Legislation Amendment (Miscellaneous) Act 2022* (NSW) and came into effect from 19 May 2022.

15 Section 8 of the Duties Act lists the transactions concerning dutiable property which attract duty under Chapter 2. New section 8(1)(b)(ix) imposes duty on:

> another transaction that results in a change in beneficial ownership of dutiable property, other than an excluded transaction.

16 "Change in beneficial ownership" is defined in section 8(3) as including:

> (a) the creation of dutiable property,
>
> (b) the extinguishment of dutiable property,
>
> (c) a change in equitable interests in dutiable property,
>
> (d) dutiable property becoming the subject of a trust,
>
> (e) dutiable property ceasing to be the subject of a trust.

17 "Dutiable property" is relevantly defined in section 11 as:

> (a) land in New South Wales,
>
> …
>
> (l) an interest in any dutiable property referred to in the preceding paragraphs of this section, …

18 "Land" is defined in the Dictionary to the Duties Act to "include… a stratum". The term is also defined in section 21 of the *Interpretation Act 1987* (NSW) ("**Interpretation Act**") to include "messuages, tenements and hereditaments, corporeal and incorporeal, of any tenure or description, and whatever may be the estate or interest therein". The term is otherwise undefined, such that it takes on its general law meaning.

19 Similarly, "interest" is defined in the Dictionary as "includ[ing] an estate or proprietary right". Being otherwise undefined, the term takes on its general law meaning.

21 Section 8(1)(b)(ix) excludes “excluded transactions”. “Excluded transactions” are defined in section 8(3)(k) to include:

> a transaction of a kind prescribed by the regulations.

22 Regulation 4(1)(e) of the Duties Regulation prescribes certain kinds of transactions to be “excluded transactions” including:

> the grant, creation, variation or extinguishment of a mortgage, charge or other security over land.

23 On 1 November 2022, the Chief Commissioner of State Revenue (“**Commissioner**”) issued the practice note “CPN 025: Change in Beneficial Ownership” (“**CPN 025**”), which provides some practical examples of the application of section 8(1)(b)(ix).

Are the equitable interests of registered mortgages an “interest in land”?

24 “Mortgage” is not defined in either the Duties Act or the Interpretation Act. However, “mortgage” is defined under section 3 of the *Real Property Act 1900* (NSW) (“**Real Property Act**”) as:

> Any charge on land (other than a covenant charge) created merely for securing the payment of a debt.

25 Section 57 of the Real Property Act provides that a mortgage “has effect as a security but does not operate as a transfer of the land mortgaged or charged”.

26 The decision in *Zafiropoulos v Recchi* (1978) 18 SASR 5 held that a registered mortgagee under the Torrens system may be considered a registered proprietor of an interest in land under Torrens legislation. In particular, Zelling J held (emphasis added):

> Nevertheless even in the original Act of 1857 <u>there are some indications that a mortgage did provide some interest in land</u>. Thus, for example, the definition of ‘mortgage’ in s 3 is: “‘mortgage’ shall be applicable to every charge on, or interest in land, created merely for securing a loan.”
>
> […]
>
> A mortgage has also been held to be an interest in land, in this Court in the judgment of Napier J. in Hargrave v. Carey and in New South Wales by Jacobs J. (then of the Supreme Court of New South Wales) in Re Bittar and the Conveyancing Act where he said:
>
>> “It is true that a mortgagee under the *Real Property Act* system has no estate in the land but I think he has an interest sufficient to cause the benefits under a covenant to run with his interest in the same way as it runs with other estates or interests in the land.”

27 Given the above, Torrens system mortgages may constitute an “interest in land” (and therefore be dutiable property) for the purposes of the Duties Act.

Equitable assignment of mortgages into the SPV

28 The ASF would be grateful if the Commissioner could confirm the prevailing view that the creation of equitable interests in the SPV is covered by section 65(1)(d), which specifically exempts from duty under Chapter 2 of the Duties Act (emphasis added):

> a dutiable transaction over dutiable property arising from the <u>discharge or transfer of a mortgage</u> or declaration of trust over a mortgage (and a reference in this paragraph to a mortgage includes a reference to a charge and an interest in a mortgage).

29 The Dictionary to the Duties Act defines “transfer” to include “an assignment and an exchange”, which in our view includes both an equitable and a legal assignment. There is

nothing in the text, context or purpose of the provision which would limit its meaning to a legal assignment only. The equitable assignment is a dutiable transaction over dutiable property, being the transfer of a mortgage.

30 We note that in the alternative, section 8(1)(b)(ix) specifically excludes equitable assignments of real property mortgages. Regulation 4(1)(e) of the Duties Regulation provides that “excluded transactions” include:

> the grant, creation, variation or extinguishment of a mortgage, charge or other security over land.

31 The words “or other security over land” are broad enough to capture an equitable interest in a mortgage or charge.

32 These words should be understood as including things which are of the same kind as the class established by the preceding words in the list. The class established by the preceding words “mortgage or charge” are security interests in land (cf. security interests of other types, such as notes, debentures or bonds). An equitable interest in a mortgage or charge which arises under a trust is an interest in property and confers on the beneficiary the benefit of the rights held by the mortgagee or chargee.

33 Further, section 11(1)(l) of the Duties Act provides that an interest in dutiable property is also dutiable property. Consistently with this, the references to mortgages and charges in regulation 4(1)(e) should also be understood as extending to interests in mortgages and charges.

34 It is the clear intent of the exclusions from section 8(1)(b)(ix) of the Act and the exclusions in the Duties Regulation that duty is not to be imposed on the transfer of security interests over land. This also strongly supports a construction of regulation 4(1)(e) which includes equitable interests in mortgages or charges within its scope.

35 As such, while the equitable assignment is clearly not the “grant” or “creation” of a mortgage, the creation of the interest in the hands of the trustee of the SPV, by way of the equitable assignment of the mortgage, is the “creation of an … other security over land”. This would exempt the transaction from duty under section 8(1)(b)(ix).

Extinguishment of the equitable interests

36 During the life of a securitisation transaction, or at the cessation of the SPV, the equitable interests may be extinguished.

37 This is properly characterised as the “extinguishment of an … other security over land”: a transaction exempt from duty under regulation 4(1)(e) of the Duties Regulation. Please refer to paragraphs 29 to 34 above in respect of the ASF’s view on the application of regulation 4(1)(e) in this context.

Reallocation case

38 Some securitisation arrangements involve the reallocation of assets, including equitable interests, from one SPV to another within the same group. This may occur, for example, where the relevant assets are moved from a warehouse trust to a term trust. The same external trustee will often act as trustee for each of the trusts. Such reallocation is generally undertaken via a reallocation notice.

39 The prevailing view is that the reallocation notice is an instrument which "was executed for the purpose of creating, issuing or marketing mortgage-backed securities" and therefore exempt from duty under section 283 of the Duties Act.

40 Such a reallocation may nevertheless fall within the scope of section 8(1)(b)(ix) unless an exemption applies. Accordingly, we would be grateful if Revenue NSW could please confirm that section 283 would apply in this situation.

Practical consequences of the application of section 8(1)(b)(ix) if duty did apply

41 In each case, the creation of the equitable interest in the SPV, the extinguishment of the interest upon the cessation of the SPV or upon the repurchase of the mortgage by the originating lender and the reallocation of the interest between trusts causes a change in the equitable interests in the underlying mortgages (being dutiable property). If the exemption under the Duties Regulation does not apply, this would trigger an obligation to lodge documents with the Revenue NSW and pay duty.

42 However, mortgages have no or only nominal value in and of themselves. This is because any value associated with the mortgage is attached to, and dependent on, the value of the underlying loan receivable secured by the mortgage.

43 If the assignment or extinguishment transactions are dutiable, section 273 of the Duties Act would therefore apply to impose the minimum amount of duty at $10 on the total number of mortgages being equitably assigned, or the interests being extinguished. That is, if the interest in one thousand mortgages were extinguished, the dutiable value of the mortgages on an aggregate basis would be 1,000 x $0 = $0. As such, there would only be $10 duty payable.

44 It would be exceptionally inconvenient (both in terms of time and processing costs) for taxpayers to arrange for stamping and payment on potentially many transactions, including multiple transactions for the same securitisation or covered bond arrangement, where there may exist a power for the originating lender to repurchase mortgages at any time. It would be equally inconvenient (both in terms of time and processing costs) for Revenue NSW to process such stamping applications and payments, where the financial benefit to the revenue is minimal.

Proposed amendment to Duties Regulation

45 The prevailing view is that section 8(1)(b)(ix) does not apply to the transactions described above.

46 We propose the following amendment to regulation 4(1)(e) of the Duties Regulation to clarify this issue:

> the grant, creation, variation or extinguishment <u>or any other transaction that changes the beneficial ownership</u> of a mortgage, charge or other security over land, <u>or interest therein</u>.

47 In addition to an amendment to the Duties Regulation and if it could be done sooner, specific comment could be made on this issue in CPN 025, however this would not provide the same degree of certainty as a legislated exemption.

Concluding remarks

48 The ASF would be pleased to discuss this submission with you in greater detail at your earliest convenience.

Yours sincerely

Chris Dalton
Chief Executive Officer | Australian Securitisation Forum