New Zealand Market

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Finance and Expenditure Committee
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BY EMAIL

TAXATION (ANNUAL RATES FOR 2023-24, MULTINATIONAL TAX, AND REMEDIAL MATTERS) BILL

1. Summary

Overview

1.1 This letter sets out the Australian Securitisation Forum's (**ASF**) submissions on the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill (**Bill**).

1.2 The ASF is the leading industry body representing participants in the securitisation and covered bond markets in Australia and New Zealand. A securitisation is a funding arrangement involving the transfer of receivables to a special purpose vehicle which then issues debt securities backed by the expected cash flows from those receivables. Securitisation provides an important source of funding for a range of financial institutions by allowing them access to wholesale debt markets for their funding needs on competitive terms, thereby serving as an alternative to the provision of funding from the major banks. Tax or other impediments to securitisation transactions will therefore reduce competition in the financial sector, to the detriment of New Zealand businesses and consumers. More information about the ASF is set out in the Appendix.

1.3 We wish to be heard in support of this submission. We would also be available to discuss our submissions (and proposed drafting to reflect our submission points) with officials if that would be helpful.

1.4 Statutory references are to the Income Tax Act 2007.

Summary of submissions

1.5 In summary, we submit that:

(a) Trustee tax rate proposals in Bill: Exceptions from the trustee tax rate proposals in the Bill are required for securitisation trusts. In particular:

(i) The proposed 39% tax rate for trustee income of a trust (clause 62 of the Bill) should not apply to trustee income derived by the trustee of a securitisation trust. Instead, a 28% rate should apply to such income to avoid over-taxation.

(ii) The proposal to treat beneficiary income derived by certain closely-held companies as trustee income (clause 39 of the Bill) should not apply to beneficiaries of securitisation trusts.

(See section 2 below.)

(b) Other remedial amendments are required to address the taxation of securitisation trusts: As previously noted to this Committee,[1] the following further remedial amendments should be made to the taxation of securitisation trusts:

(i) a person should not be associated with a securitisation trust (or treated as holding related-party debt) simply because the person (or an associate of the person) is a settlor of the securitisation trust, has the power to appoint or remove the trustee, or is a beneficiary, settlor or person with a power of appointment or removal of a security trust;

(ii) it should be possible to elect to use the debt funding special purpose (DF SPV) regime where receivables are transferred to a DF SPV by an entity (other than the originator) that would be eligible to elect, but has not elected, into the regime;

(iii) notes issued by a securitisation trust should be excluded from section GC 18 (Loan features disregarded by rules for transfer pricing arrangements); and

[1] See the ASF submission to the Finance and Expenditure Committee on the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill dated 29 October 2021.

(iv) securitisation trusts should be excluded from the thin capitalisation rules.

(See section 3 below.)

2. Submissions on trustee tax rate proposals in Bill

Background

2.1 The ASF advocates for policy settings that will facilitate securitisation transactions in Australia and New Zealand. Securitisation transactions are fundamental to the non-bank lender/financier sector. They lower the cost of financing for non-bank lenders/financiers and allow access to term funding. This in turn facilitates more financing options for consumers and businesses and greater competitiveness in the New Zealand financing sector.

2.2 A securitisation is a transaction in which receivables (such as loans to consumers or businesses) originated by a sponsor (typically a finance company) are transferred to a special purpose vehicle (**SPV**) trust.[2] The SPV trust issues debt securities to funders/investors, payments on which are supported by the cash-flows from the receivables that have been securitised. The lender/financier provides services to the SPV, in the form of SPV management services and servicing of the receivables. Any residual profit in the SPV trust after financing costs, service charges and other expenses is paid to the sponsor, typically in the form of a trust distribution.

2.3 For funders/investors to be prepared to provide debt financing to SPV trusts, it is critical that the SPV trust has no unanticipated liabilities, including tax liabilities. The desired approach is that the SPV trust is "tax neutral", which means that all taxable profit of the SPV trust is taxed in the hands of the sponsor as beneficiary income. As the beneficiary of an SPV trust is almost always a company, the taxable profit is taxed 28%. A confirmation of tax neutrality is always a condition precedent to draw down of funding by the SPV, illustrating the commercial importance of the tax treatment.

2.4 Certain SPVs achieve tax neutrality through the application of section HR 9. However, not all SPVs can avail themselves of that regime and there is a large body of SPVs that are taxed under the ordinary tax rules for trusts in subpart HC. If tax neutrality fails for

[2] Securitisations in New Zealand typically comprise warehouse securitisations (in which receivables accumulate in a SPV that has one or a small number of lenders), and term outs of those warehouse securitisations (to SPVs with a larger number of lenders). Registered banks also have internal residential mortgage-backed securities (RMBS) and covered bond programmes. For clarity, this submission relates to all types of securitisation transaction.

an SPV trust, and it is not possible to vest such income in the beneficiary,[3] a portion of the net income of the SPV is treated as trustee income, which is currently taxed at 33%.

2.5 Against this background, aspects of the Bill will compound the potential for over-taxation of SPV trusts. These are discussed below.

Trustee rate for securitisation trusts should reduce to 28% (rather than increase to 39%)

2.6 Clause 62 proposes to increase the tax rate for trustee income (Schedule 1, part A, clause 3) from 33% to 39% (other than trustee income in relation to disabled beneficiary trusts and certain estates). This proposal will exacerbate the current risk of over taxation where tax neutrality of the SPV trust fails. Under the proposal, such income will be taxed at 39%, which is 11% higher than the tax rate of the corporate beneficiary of the SPV.

2.7 We submit that schedule 1, part A should include a new paragraph 6D, which provides for a 28% rate of tax for trustee income derived by the trustee of a securitisation trusts that have a single corporate beneficiary (provided the beneficiary is not a look-through company). This addition will avoid over-taxation of securitisation trusts by ensuring that trustee income is taxed at a rate no higher than the tax rate of the corporate beneficiary, in the event of a tax neutrality failure for the trust.

2.8 Dividends paid by the sponsor group that were sourced from beneficiary income from a SPV trust would be subject to tax based on the marginal rate scale, similar to all other corporate profits (with relief provided for tax paid within the corporate group through the imputation rules).

Beneficiary income of corporate beneficiaries of a securitisation trust should not be treated as trustee income

2.9 In clause 39, an amendment is proposed to treat beneficiary income derived by certain closely-held companies as trustee income, in circumstances where a settlor of the trust has natural love and affection for a person holding a voting interest or market value interest in the relevant company. Settlor has a broad definition meaning that where the settlor is a closely-held company, certain natural person shareholders in the company will also be treated as settlors (section HC 28(4)). The deemed trustee income would attract tax at the rate of 39%.

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[3] For a discussion of the circumstances in which Inland Revenue has suggested it may not be possible to vest trustee income in a beneficiary for tax purposes, see Inland Revenue *Interpretation Statement IS 12/02* "Income tax – whether income deemed to arise under tax law, but not trust law, can give rise to beneficiary income".

2.10 This proposal will undermine the viability of securitisation transactions for sponsors that are closely-held companies. The proposal could apply to beneficiary income derived by a closely-held corporate beneficiary of a SPV trust, creating permanent over taxation. This issue would not apply to a corporate beneficiary from a sponsor group that was not a closely-held company – beneficiary income would be taxed at 28% in such a case.

2.11 Proposed section HC 38 therefore should not apply to beneficiary income derived by a company that is the beneficiary of a securitisation trust. To achieve this, the opening wording of section HC 38 could be amended to read as follows:

> This section applies when a close company that is not a Māori authority, a tax charity or a securitisation trust beneficiary derives an amount of beneficiary income…

2.12 In addition, the following supporting definitions could be added to section YA 1. The suggested definition of "securitisation trust" adopts the existing definition of "debt funding special purpose vehicle", but with amendments to reflect the fact the securitisation trust would not necessarily be consolidated with the originator for financial reporting purposes:[4]

> **securitisation trust** means a trustee of a trust:
>
> (a) that meets the definition of debt funding special purpose vehicle, disregarding paragraphs (a), (b) and (f) of that definition, and read as if:
>
> (i) in paragraphs (c)(i) and (ii) of that definition, the reference to paragraph (b) is replaced with a reference to paragraph (e); and
>
> (ii) in paragraph (d)(i) of that definition, the word "originator" is replaced with "a person who transferred some or all of their assets to the trustee"; and
>
> (b) the sole beneficiary of which is a company.
>
> **securitisation trust beneficiary** means a beneficiary of a securitisation trust.

[4] The requirement that the securitisation trust "has its assets included in financial statements that are prepared using IFRSs and are audited" (paragraph (f) of the DF SPV definition) has not been included. The financial reporting treatment is not relevant in this context (unlike under the DF SPV regime, which applies only where the securitisation trust is consolidated with the originator for financial reporting purposes). For smaller securitisation trusts, a requirement to prepare audited IFRS accounts could therefore introduce disproportionate cost and complexity.

3. Other remedial amendments required

Overview

3.1 The ASF and other submitters have previously raised before this Committee the need for a number of remedial amendments to the income tax treatment of securitisation trusts (see the *ASF submission to the Finance and Expenditure Committee on the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill* dated 29 October 2021 (**2021 ASF Submission**)).

3.2 Some of the submissions made in the 2021 ASF Submission were adopted in the earlier Bill.[5] The remainder were acknowledged by Inland Revenue officials (and officials did not disagree with the substance of them), but were not addressed on the basis that "further work is required" which would "require prioritising and resourcing as part of the Government's tax policy work programme".[6]

3.3 The ASF therefore repeats its submission dated 29 October 2021 and requests that such further work on the outstanding submission points is undertaken as a matter of priority for inclusion in the current Bill. The fact the proposals have not been addressed results in continuing cost, delay and complexity in the implementation of securitisation transactions in New Zealand, which are an important source of funding for the New Zealand economy as explained in the Appendix.

3.4 The outstanding submission points from the 2021 ASF Submission which continue to require consideration by officials are summarised below. In relation to one of these submissions (regarding the overreach of the association tests), we have provided additional detail and proposed drafting, given the particular importance of addressing this issue in the current Bill.

Addressing the overreach of the association rules for trusts *(2021 ASF Submission, Appendix, rows 4 and 5)*

Our submission

3.5 A person should not be associated with a securitisation trust (or treated as holding related-party debt) simply because the person (or an associate of the person):

(a) is a settlor of the securitisation trust or has the power to appoint or remove the trustee; or

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5 See rows 1 and 2 of the Appendix to the 2021 ASF Submission.

6 See rows 3 to 7 of the Appendix to the 2021 ASF Submission. See also the Officials Report to the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill at pages 252, 254, 255 and 256.

(b) is a beneficiary, settlor or person with a power of appointment or removal of a security trust,

in each case where the relevant relationship exists, or the relevant power is held, as in incident of the person providing third party debt funding to a securitisation trust.

Explanation

3.6 Currently, there is a specific exclusion in the approved issuer levy (**AIL**) rules for association arising due to a person being the beneficiary of a security trust. However, the exclusion does not address all instances of overreach of the association rules (for example, association arising as a result of a person being a settlor of a security trust), and does not address all of the consequences of such overreach (for example, the application of the transfer pricing rules). The exclusion is therefore inadequate and requires remedial amendment.

3.7 The existing exclusion should be buttressed by a general exclusion in subpart YB, extending to all regimes that refer to the concept of associated persons. Specifically, section YB 16 should be amended by inserting a new subsection (3) which states that:

> In this Act, a securitisation trust and a person that provides funds to the securitisation trust (**Person A**) are not treated as associated persons where, ignoring this subsection (3), Person A and the securitisation trust are associated persons by reason only of Person A being:
>
> (a) a beneficiary, settlor or holder of a power of appointment or removal of the trustee of a trust established to hold a security interest granted by the securitisation trust in connection with funds provided to the securitisation trust by persons that include Person A, and any property arising from, or incidental to, the enforcement or holding of that security interest:
>
> (b) a settlor or holder of a power of appointment or removal of the trustee of the securitisation trust where Person A's status as a settlor or as the holder of such power arises as an incident of Person A providing funds to the securitisation trust.

Comments

3.8 Paragraph (a) of the proposed new section YB 16(3) addresses third party noteholders who may be associated by virtue of the security trust arrangements. Paragraph (b) addresses third party noteholders who may be associated by virtue of being a settlor of, or having the power to appoint the trustee, of the securitisation trust itself as an incident of their lending to the trust. We consider both changes should be made, but at a minimum, paragraph (a) should be introduced as a matter of priority.

3.9 For clarity, the drafting of both paragraphs (a) and (b) is intended to ensure that only true third party lenders (who might become a settlor or have a power of appointment as an incident of lending) are not associated with the securitisation trust. The originator group should continue to be associated with the securitisation trust. Any settlement they make, or power of appointment they hold, would not be an incident of providing funds to the trust. Further, a member of the originator group would usually be the beneficiary of the securitisation trust (and so associated on that basis).

Other remedial amendments *(2021 ASF Submission, Appendix, rows 3, 6 and 7)*

3.10 In addition, we repeat the following from the 2021 ASF Submission:

(a) it should be possible to elect to use the DF SPV regime where receivables are transferred to a DF SPV by an entity (other than the originator) that would be eligible to elect, but has not elected, into the regime (2021 ASF Submission, Appendix, row 3);

(b) notes issued by a securitisation trust should be excluded from section GC 18 (Loan features disregarded by rules for transfer pricing arrangements) (2021 ASF Submission, Appendix, row 6); and

(c) securitisation trusts should be excluded from the thin capitalisation rules (2021 ASF Submission, Appendix, row 7).

Appendix: Australian Securitisation Forum and the securitisation industry

About the Australian Securitisation Forum

1. The Australian Securitisation Forum (**ASF**) is the leading industry body representing participants in the securitisation and covered bond markets in Australia and New Zealand. The ASF has representation from across the securitisation and structured finance industry including issuers, investors, banks and service providers such as lawyers and trustees.

2. While (as its name suggests) the ASF has a much larger presence in Australia (reflecting Australia's much larger financial markets and securitisation industry) the ASF also has a dedicated New Zealand Market subcommittee comprised of local market professionals. The ASF's aim is to promote, protect and strengthen the Australian and New Zealand securitisation market, to build investor confidence and to drive sustainable growth for its members.

Importance of securitisations to New Zealand

3. Securitisation provides an important source of funding for a range of financial institutions by allowing them access to wholesale debt markets for their funding needs on competitive terms. Securitisation also contributes to competition amongst lenders, which ultimately provides choice and benefits to consumers and supports economic growth.

4. The importance of securitisations, and of ensuring New Zealand's tax laws are not an impediment to them, was recognised in the reforms (enacted in 2019) to expand what is now the DF SPV regime in section HR 9 of the Act. The Regulatory Impact Assessment (**RIA**) to the Bill which introduced those reforms stated:

> A securitisation is a funding mechanism that involves issuing marketable securities that are backed by the expected cash flows from specific assets. New Zealand businesses with large books of trade credits or other receivables (Originators) may wish to raise funding by using those receivables as security. To do this, the Originator of the receivables transfers them to a special purpose vehicle (SPV), and the SPV then issues securities (typically debt instruments) to lenders. The SPV is structured to be bankruptcy remote from the Originator, so that the SPV's assets cannot be accessed by the Originator's creditors. In New Zealand (and internationally, in most cases) this means that the SPV is typically a trust.
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> A securitisation can have several commercial benefits compared with a regular loan, such as risk management, balance sheet

> improvement, credit enhancement, lower cost of funding, and access to a wider pool of lenders.
>
> An important commercial objective of a securitisation is maintaining tax neutrality while ensuring the SPV is bankruptcy remote from the Originator. It is particularly important to ensure that the SPV itself is not exposed to a tax liability, as this can affect its credit rating.

5. Internationally, tax authorities recognise the importance of providing certainty for securitisations. For example, Australia has a specific exemption from its thin capitalisation rules for securitisation SPVs (section 820-39 of the Income Tax Assessment Act 1997).

6. More generally, Australian regulators have a supportive policy position towards the role and benefits of securitisation in funding Australia's economic growth. This approach is reflected in the relative size of the Australian securitisation market. In 2022 the total volume of securitisation issuance in New Zealand was NZD1.825 billion.[7] In that same year, the total volume of securitisation issuance in Australia was AUD50 billion.[8] Although the Australian economy, measured by GDP, was over 6.7 times the size of the New Zealand economy in 2022, the Australian securitisation market was close to 29 times the size of New Zealand's.[9]

7. In addition to size, the make-up of the New Zealand securitisation market is an important differentiator. In Australia non-bank issuers account for around 80% of all Australian issuance, whereas non-bank issuers account for all New Zealand issuance.[10] Securitisation therefore is an essential funding source for smaller lenders and so is critical to increasing competition and reducing concentration. As such, supporting the growth of the securitisation market also supports a diversified and competitive financial system.

8. The 2019 amendments to the DF SPV regime were described in the RIA in the following terms (at page 2):

> In terms of equity and fairness, taxing securitisations in accordance with their economic substance, would ensure that tax does not penalise (or incentivise) securitisations compared with other forms of

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7 "Australian Securitisation 2022 Year in Review" Martin Jacques Westpac 20 December 2022

8 "Market Statistics" Australian Securitisation Forum https://www.securitisation.com.au/market-statistics

9 "GDP (current US$) - Australia, New Zealand The World Bank data.worldbank.org/indicator

10 Above n 7.

> fund raising. This would mean that the benefits of securitisations can be enjoyed more broadly.
>
> …
>
> The fiscal cost of the proposal for the Government is expected to be minor, as securitisations are typically structured to prevent tax arising where possible. There could be a fiscal cost from not recognising the transfer of assets to the SPV, although this would be the same as if the securitisation had not occurred.

9. The changes sought in our submission are consistent with this same general approach.

Yours sincerely,

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