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Committee Secretariat
Finance and Expenditure Committee
Parliament Buildings
WELLINGTON

BY EMAIL

TAXATION (ANNUAL RATES FOR 2021-22, GST, AND REMEDIAL MATTERS) BILL

1. Summary

Overview

1.1 This letter sets out the Australian Securitisation Forum's submissions on the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill (Bill).

1.2 We wish to be heard in support of this submission.

1.3 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 The submission is set out as follows:

(a) In section 2, immediately below, we provide background to the submission, a summary of the relevant provisions in the Bill as introduced, and our submission as to the changes that should be made to the Bill.

(b) In section 3, we provide further background regarding the Australian Securitisation Forum and the securitisation industry and its importance to New Zealand.

(c) In the Appendix, we provide more detailed explanations of our submission points, including suggested amendments that could be made to give effect to each submission point.

2. Background to the submission

2.1 A securitisation is a transaction in which receivables (such as loans to consumers or businesses) are 'packaged' and sold to a special purpose vehicle (SPV) (typically a trust) which then issues debt securities to lenders, supported by the cash-flows from the

receivables that have been securitised. For lenders to be prepared to provide debt financing, it is critical that the SPV has no unanticipated liabilities, including tax liabilities.

2.2 Aspects of New Zealand's tax rules result in unnecessary complexity and uncertainty for securitisation transactions. There are broadly two sources of these current difficulties:

(a) First, certain rules and definitions applicable to trusts were designed mainly with a family trust or similar arrangement in mind, and not an SPV such as is used in a securitisation transaction. Parliament recognised this by enacting, and recently (in 2019) extending the scope of the debt-funding special purpose vehicle (DF SPV) regime which generally allows the SPV to be 'looked through', so a securitisation is treated more consistently with its substance (an SPV for the financing of receivables) than its form (an investment in a trust). This regime still contains some shortcomings, however, three of which are addressed in this submission.

(b) Second, in the past few years, a number of amendments to the Income Tax Act 2007 (Act) have been made, prompted by New Zealand's involvement in the OECD-led project to counter base erosion and profit-shifting (BEPS). Some such amendments have had a negative impact on some securitisations, even though securitisations were never within the scope of the OECD concerns that led to those amendments.

What is proposed in the Bill

2.3 The Bill includes:

(a) In clause 89, an amendment to address one of the limitations in the DF SPV regime.

(b) In clause 119, an amendment to provide that a lender is generally not deemed to be associated with a borrower for the purposes of the approved issuer levy rules due to being a beneficiary under a security trust arrangement. (By way of background, the approved issuer levy rules allow payment of a 2% levy on interest paid to a non-resident lender instead of deducting withholding tax at the rate of 10% or 15%, but only if the lender and borrower are not associated.)

Our submission in summary

2.4 We welcome and support both amendments as far as they go. Each amendment, however, is very prescriptive, and deals only with a particular instance of a wider issue.

2.5 This submission, therefore, calls for amendments that will address the issues in a principles-based way, rather than addressing only particular symptoms of those issues. That suggested approach should make for more coherent and certain tax laws, and should save the Government and Parliament time and resource having to make more detailed ad hoc amendments in future.

2.6 We therefore recommend that the following amendments be added to the Bill:

(a) DF SPV regime:

(i) The election to use the DF SPV regime should be able to be made at any time up till the originator's first tax return is filed (ie, it should not be necessary to wait until assets have been transferred to the DF SPV). (*See item 1 in the Appendix for more detail.*)

(ii) It should be clarified that the DF SPV regime can apply to transfers of receivables from one SPV (that is already a DF SPV) to another SPV. (*See item 2 in the Appendix for more detail.*)

(iii) It should be possible for the ELAECTION to use the DF SPV regime to extend to receivables transferred to the DF SPV directly by another entity that would be eligible to elect, but has not elected, into the regime. That outcome can be achieved under current law by way of a two stage transfer (ie, transferor transfers to the originator which then transfers to the DF SPV) but the correct policy outcome (that such receivables should be subject to the originator's section HR 9 election in respect of the ultimate transferee) should not require the insertion of this extra step. (*See item 3 in the Appendix for more detail.*)

(b) Association tests: A lender should not be treated as associated with the SPV as a result of some status or right that is an incident of it being a creditor to the SPV. Such creditor rights are not akin to an ownership relationship that the association tests (and various anti-avoidance rules that apply to transactions between associated persons) are intended to apply to. To give effect to this submission, the amendment proposed in clause 119 of the Bill (which would clarify that a lender is not deemed to be associated with a borrower for the purposes of the approved issuer levy rules as a result of being a beneficiary under a security trust arrangement) should be reframed and placed on a principled footing as follows:

(i) Instead of addressing only association due to a lender being a beneficiary under a security trust arrangement, the amendment should address other relevant association tests including by providing that a person is not associated with a securitisation SPV solely due to being a settlor of the SPV or having a power to appoint, as an incident of its role as a creditor to the SPV. (*See item 4 in the Appendix for more detail.*)

(ii) Instead of addressing only the consequences of being deemed to be associated for the purposes of the approved issuer levy rules, the amendment summarised in paragraph 2.6(b)(i) above should apply generally. This would be consistent with the fact that rights a person has that are incidental to being a creditor should not be equated with an ownership relationship, which is what the association tests (and the relevant rules that apply to transactions between associated persons) are intended to apply to. (See item 5 in the Appendix for more detail.)

(c) <u>Other instances of anti-avoidance rules over-reaching in relation to securitisations should be corrected:</u>

(i) It is common in securitisation transactions for the SPV to issue different classes of notes with differing levels of seniority. The more junior notes carry a higher interest rate to compensate for their junior ranking. A deeming provision recently added to the transfer pricing rules (section GC 18) has the effect that, for tax deductibility purposes, junior notes issued to the originator, or any other person deemed to be associated with the SPV, must (subject to an exception that is unworkable in securitisation transactions) be priced as if they ranked equally with the senior notes. This rule not only conflicts with the commercial reality that debt is priced differently according to its ranking, but also frustrates an important commercial driver for securitisations, which is to allow different investors with different risk profiles to hold different classes of notes. Notes issued by a securitisation SPV should therefore be excluded from section GC 18. (*See item 6 in the Appendix for more detail.*)

(ii) When the thin capitalisation rules were extended (in 2014) to apply to trusts, it was recognised that applying those rules to securitisation SPVs without modification would not be appropriate. Accordingly, the on-lending concession was expanded to ensure that a securitisation SPV that is a trust can 100% debt fund its assets, provided that the SPV's only assets are financial arrangements or property incidental to financial arrangements (section FE 13(1)(d)(ii)). This measure does not address the application of the thin capitalisation rules in all cases, however. We therefore submit that there should be a general exception from the thin capitalisation rules for securitisation SPVs. While this change may be seen as an extension of an existing rule (rather than a remedial amendment), it would address an anomalous distinction between different types of securitisation SPVs under current law, and would be consistent with the approach adopted in Australia. (*See item 7 in the Appendix for more detail.*)

3. Australian Securitisation Forum and the securitisation industry

About the Australian Securitisation Forum

3.1 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.

3.2 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 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

3.3 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, in particular by providing access to funding on competitive terms for lenders other than the large banks. This ultimately provides choice and benefits to consumers and supports economic growth.

3.4 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.
>
> 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.

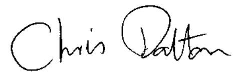
3.5 Internationally, tax authorities recognise the importance of providing certainty for securitisations. For example, the United Kingdom is undertaking a review of its tax rules for securitisations to ensure they are not an impediment to such transactions. And Australia has a specific exemption from its thin capitalisation rules for securitisation SPVs (section 820-39 of the Income Tax Assessment Act 1997).

3.6 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 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.

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

Yours sincerely,



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APPENDIX: EXPLANATION OF SUBMISSION POINTS

	Issue	Suggested Solution
Remedial amendments to ensure the DF SPV regime is workable in practice		
1.	<u>Timing of DF SPV election</u>: We support the amendment proposed (in new section HR 9BA(1)(a); clause 89 of the Bill) to permit an election under section HR 9 to be made before the originator's first return of income is filed. However, the requirement that the election be made "after the first transfer of assets to the debt funding special purpose vehicle" may be restrictive in practice. For example, the parties may wish for the section HR 9 election to be made as a condition precedent to financial close. This may be the case, for example, if the lenders require certainty that the section HR 9 election has been made before advancing funds to the SPV.	The proposed replacement of section HR 9BA, should be amended to read as follows (so that the election can be made before or after the first transfer of assets by the originator): *An originator makes an election referred to in section HR 9 by doing the following on or before making their first return of income filed after the originator transferred any of their assets to the debt funding special purpose vehicle:* *(a) returning income derived and expenditure incurred by the debt funding special purpose vehicle in that return:* *(b) notifying the Commissioner that the originator chooses to have the liabilities and obligations referred to in section HR 9 that the debt funding special purpose vehicle would have in the absence of the election.*
2.	<u>Transfers from warehouse trusts (where a section HR 9 election has been made for the transferor)</u>: It is sometimes necessary to transfer assets between securitisation SPVs. For example, an originator may establish a "warehouse trust" which holds assets before they are transferred to another trust. Assuming that both trusts are consolidated (for financial reporting purposes) with the originator of the warehouse trust, and that a section HR 9 election has been made in respect of the warehouse trust, the question may arise whether a DF SPV election can be made for the new trust.	Where there is a transfer of assets between two trusts, both of which are consolidated for financial reporting purposes with the originator of the transferor, and a section HR 9 election has been made in respect of the transferor, the transferee should also be eligible for DF SPV status (such that the transfer between the two trusts is ignored, and the assets continue to be treated as held by the originator). We consider this is already the position as a matter of interpretation of the relevant statutory provisions, but given the importance of this fundamental eligibility point, the point should be confirmed by Inland Revenue guidance or (if necessary) remedial amendment. One way to address the point by remedial amendment would be to insert, in section HR 9, after the words "of an originator" the words "which in this section may include another debt funding special purpose vehicle to which section HR 9 already applies in respect of that originator".

	Issue	Suggested Solution
3.	Transfers from warehouse trusts (where the transferor is consolidated with the originator and is a DF SPV, but no section HR 9 election was made): In some cases, a securitisation SPV meets the criteria for a section HR 9 election (ie, it is a DF SPV), but no such election was made by the originator. This scenario often arises where the SPV is a legacy structure created prior to the extension of the DF SPV regime to originators other than financial institutions in 2019. For an SPV in such a legacy structure to opt into the DF SPV regime, material amendments to the existing trust documentation are required (such as providing mechanisms for the trust to make payments to the originator to fund tax payments). Due to the number of parties involved in a securitisation transaction and the complexity of the documentation, making such amendments once a structure has been established may be costly and take some time. A commercially preferable alternative, therefore, is for the legacy SPV to transfer its assets to a new SPV (that can elect into the DF SPV regime) established by the same originator. But this alternative is not currently open due to a technical requirement in the rules that the originators in respect of the new SPV be companies within the same wholly-owned group of companies (whereas, in this case, the originator would be the legacy SPV trust). This issue arises even where the legacy SPV and the new SPV are both consolidated with the same sponsor group (which includes the underlying originator(s) of both trusts) for financial reporting purposes at all times. One way for the assets to be brought into the DF SPV regime upon transfer to a new securitisation SPV is for a "two stage" transfer to be undertaken. That is, the assets are first transferred back from the legacy SPV to a company within the originator group, and then transferred by that company to the new SPV that elects into the DF SPV regime. However, this "two stage" transfer may be undesirable for legal or commercial reasons. It imposes greater transaction costs on the parties. Further, the fact a two stage transfer (via the originator) would result in the assets being subject to the DF SPV regime while a direct transfer would not suggests the law as it stands is not coherent.	Where a company or trustee that meets the definition of "debt funding special purpose vehicle" but has not elected into the regime (Transferor DF SPV) transfers its assets to another company or trustee (Transferee DF SPV) that also meets the definition of "debt funding special purpose vehicle" and is consolidated for financial reporting purposes with the originator of the Transferor DF SPV, the transfer should be able to be treated (by election) for tax purposes as a transfer by the Transferor DF SPV to the originator(s), and in turn by the originator to the Transferee DF SPV. This election could be made by the originator in conjunction with a section HR 9 election in respect of the Transferee DF SPV. The result of the two elections, taken together, would be that the Transferor DF SPV is treated as disposing of the assets to the originator rather than to the Transferee DF SPV, and the transfer as between the originator and the Transferee DF SPV would be disregarded. This would put the parties in the same position (for tax purposes) as if the assets had been transferred back to the originator, and then to the Transferee DF SPV with a section HR 9 election being made, but avoid the need to in fact undertake a two stage transfer of the assets via the originator.

	Issue	Suggested Solution
A lender to the SPV should not be treated as associated with the SPV as a result of rights it holds as an incident of its role as creditor		
4.	Availability of AIL for senior creditors (or other third party noteholders): We support the clarification proposed in clause 119 of the Bill to ensure that a lender is not associated with a SPV (and therefore denied the benefit of the AIL regime) solely because it is the beneficiary of a security trust. We submit that the clarification needs to go further, to address other scenarios in which lenders may be treated as associated with the SPV because of rights or a status they hold as an incident of their role as creditors. In particular, association can arise where the SPV is a trust and: (i) the creditor is a settlor or has power to appoint or remove the SPV trustee (power to appoint); or (ii) the creditor is associated with another entity that is a settlor or has a power to appoint. Not extending the clarification in this way would increase the existing uncertainty; the narrow amendment addressing possible association due to being a beneficiary under a security trust might lead to an inference that other rights that are incidental to a person's position as creditor do result in association, which would be an incorrect policy outcome. The relevant association tests appear to have been drafted with a family trust or similar private arrangement in mind. For trusts of that type, a settlor, or a person with power to appoint, might be considered to have the necessary degree of control or influence to be treated as associated with the trust. For a securitisation SPV, on the other hand, the trust is a mechanism to hold receivables and allocate cash to noteholders. A settlor, and/or a person with a power to appoint, will often hold that status or that power as an incident of the person's role as a creditor to the trust, and not as a quasi-ownership right. While it is possible to structure around the over-reach in the existing association tests, this results in increased cost and complexity. The current tax settings may, for example, alter the types of creditor protection mechanisms that can be included in the trust documentation.	In addition to the exclusion for a lender that is a beneficiary of a security trust, a person should not be associated with a securitisation SPV or treated as holding related-party debt in respect of the SPV solely because it (or an associated person of it) is a settlor of the SPV or has power to appoint, in each case as an incident of its role as a creditor to the SPV. This change would be an extension of the change already proposed in the Bill. The change would recognise that a party that could technically be associated with a SPV (or be treated as holding related-party debt) should not be treated as associated (or as holding related party debt) by reason only of some status or right that is an incident of it being a creditor to the SPV. If it were thought necessary for these amendments to apply only to certain trusts (so officials could be certain that existing settings are preserved in relation to, for example, family trusts), the concept of "specified commercial trust" in Schedule 3 of the Trusts Act 2019 could be considered. We would expect securitisation SPVs and other trusts used for financing arrangements to be specified commercial trusts, while family trusts would not be.

	Issue	Suggested Solution
5.	Application of BEPS rules to senior creditors (or other third-party noteholders): Where a noteholder is associated with the SPV (see (4) above), various BEPS rules may affect the tax neutrality of the SPV. These include the NRFAI rules (which may require NRWT to be paid on an accrual basis), the restricted TP rules (which may require junior debt to be priced as if it ranked equally with senior debt), and the anti-hybrid mismatch rules. These rules apply to associated persons on the rationale that the associated persons have a control or ownership interest in the relevant entity. That is not the case where the association arises because of a status or a right the person has as an incident of their role as creditor.	As proposed at (4) above, a person should not be associated with a securitisation SPV (or treated as holding related-party debt) solely because it (or an associated person of it) is a settlor of the SPV, has power to appoint, or is a beneficiary of a security trust, as an incident of its role as a creditor to the SPV. If this principle were applied to the NRFAI, restricted TP and anti-hybrid mismatch rules (as well as to the AIL rules) it would go a considerable way to addressing the current over-reach of those three regimes. This could be achieved by having the exception in section RF 12(1)(a)(ii) addressed in the Bill (extended as proposed at (4) above to cover the settlor and power to appoint association tests) apply generally to the NRFAI, restricted TP rules and the anti-hybrid mismatch rules, and not only for the purposes of AIL. We emphasise that such a change would not exempt securitisation SPVs from the various restrictions for related party debt referred to above (namely, the NRFAI rules, restricted TP rules, anti-hybrid mismatch rules and non-availability of AIL). These restrictions would continue to apply where the lender is truly associated with the SPV (eg, if members of the originator group both hold junior notes, and are the beneficiary of the SPV). What would change is that a lender would not be deemed to be associated (and therefore subjected to those regimes) by reason of rights it holds or a status it has as an incident of its role as a creditor to the SPV. Further, the anti-hybrid mismatch rules would continue to apply to all debt (including debt issued to non-associated senior lenders) where there is a structured arrangement.

	Issue	Suggested Solution
Other instances of anti-avoidance rules over-reaching in relation to securitisations should be corrected		
6.	<u>Pricing of junior notes</u>: Where an originator (or other party which is associated with the SPV) holds junior notes, for deductibility purposes, those junior notes are assumed (subject to the exception noted below) to be priced as if they ranked equally with the senior notes. This is a result of section GC 18, which requires subordination to be disregarded on the basis that it is an "exotic" feature. Section GC 18(9) permits subordination to be taken into account where subordinated debt is held by third parties but only if: a) the portion of the SPV's related-party debt that is subordinated does not exceed the portion of the SPV's third-party debt that is subordinated (section GC 18(9)(b)(i)); and b) no more than 80% of the subordinated debt is held by related parties (sections GC 18(9)(b)(ii) and (iii)). In order to comply with (a) in practice, if an associated person of the SPV wished to hold (say) 15% of the most junior notes it would also need to hold 15% of each of the note classes ranking ahead of the junior notes. This conflicts with the usual operation of securitisation SPVs. Typically, the most senior notes are held exclusively by third parties, but at least some of the more junior classes of notes may be held by the originator group (to provide an element of risk retention by the originator) which is in many cases associated with the SPV (eg, as a result of being a beneficiary of the SPV). Accordingly: • The existing rules give rise to the perverse outcome that if some junior notes are held by an associate, and some by third parties, the junior notes held by related parties must be priced (for deductibility purposes) lower than the junior notes held by associates, despite having the same risk profile. • Further, the requirement to disregard subordination can impact the tax neutrality of the SPV and lead to double taxation, as the jurisdiction of the junior noteholder can be expected to require arm's length pricing without disregarding subordination (just as New Zealand would, if the noteholder were a New Zealand entity holding subordinated notes in a foreign securitisation SPV). Finally, risk retention achieved through the originator or sponsor holding junior notes is regarded internationally by regulators as desirable. It ensures an alignment as between the interests of the parties to the securitisation transaction (ie, the originator and its group of entities) and the investors.[1] Indeed, the United Kingdom government is consulting on changes to provide further clarity for "retained" securitisations.[2] In this context, it is incongruous that the New Zealand tax settings, far from facilitating risk retention by the originator holding junior notes, create impediments to them doing so.	Subordination is fundamental to the structure and purpose of a securitisation, to allow different investors with different risk profiles to hold different classes of notes, priced differently to reflect their seniority. Notes issued by a securitisation SPV should therefore be excluded from section GC 18 in much the same way (and on the same rationale) as regulatory capital instruments are excluded (section GC 18(10)).

[1] See Scott Heezen and Isabella Wong "Securitisations" in *The Tax Specialist* Volume 24(5) (June 2021) at page 243.

[2] See "Reform of taxation of securitization companies: consultation" HMRC, 23 March 2021.

	Issue	Suggested Solution
7.	Operating leases: When the thin capitalisation rules were extended (in 2014) to apply to trusts, it was recognised that applying the thin capitalisation rules to securitisation SPVs without modification would not be appropriate. Accordingly, the on-lending concession was expanded to ensure that a securitisation SPV that is a trust can 100% debt fund its assets, provided that the SPV's only assets are financial arrangements or property incidental to financial arrangements (section FE 13(1)(d)(ii)). However, issues have arisen due to the (narrower) on-lending concession in practice in relation to assets of a securitisation SPV, such as operating leases, that are not financial arrangements. In such cases, the on-lending concession is not available, and (because securitisation SPVs are, by their nature, entirely debt funded) the thin capitalisation rules may deny deductions to the SPV. The application of the thin capitalisation rules to such SPVs creates a structural mismatch between the net income for tax purposes and accounting income/cashflows, which compromises the tax neutrality of the SPV. In such cases, it is necessary to rely instead on the fact that a securitisation SPV (where it is a trust that is the sole member of its worldwide group) should not breach the worldwide group test provided that its "owner-linked debt" (ie, debt provided by a settlor or associate of the settlor) does not exceed 10% of its total debt.[3] However, this creates a material restriction on the amount of owner-linked debt that is permitted and is, as noted at row 6 above, is contrary to steps being taken internationally to encourage risk retention).	There should be a general exception from the thin capitalisation rules for securitisation SPVs. This would address the issues arising with the operation of the on-lending concession and the worldwide group test. It would also be consistent with the approach adopted in Australia (ITAA97, s 820-39). The exception should also apply to an originator of a DF SPV in respect of assets and debt that it is deemed to hold/be party to through operation of section HR 9. Alternatively, amendments should be made to address the specific issues noted. This could include an extension of the on-lending concession to operating leases for securitisation SPVs (or to an originator of a DF SPV in respect of assets and debt that it is deemed to hold/be party to through operation of section HR 9).

[3] Under the worldwide group test, there is no denial of deductions if the trust's New Zealand group debt does not exceed 110% of its worldwide group debt. For these purposes, worldwide group debt will be the trust's New Zealand group debt, less any owner-linked debt that is excluded under section FE 18(3B). For example, if the trust had $100m of assets, $90.91m of third-party debt and $9.09m of owner-linked debt, its New Zealand group debt percentage (100%) would be less than 110% of its worldwide group debt percentage (90.91%). In such case, there would be no denial of deductions under the thin capitalisation rules despite the fact the trust is 100% debt funded. (Section FE 5(1)(ab), which would not permit any owner-linked debt, does not apply to a trust.)