

2 February, 2001.

Confidential communication

The Australian Taxation Office
Attention: Assistant Commissioner
Law Design and Development
(Consolidation)
P O Box 900
Civic Square ACT 2608

Dear Sir

**New Business Tax System (Consolidation) Bill 2000
Exposure Draft**

Thank you for the opportunity to comment on the Exposure Draft Legislation.

Please find attached a submission from the Australian Securitisation Form (“**ASF**”) regarding matters arising from the Exposure Draft Legislation affecting the securitisation industry. This submission follows, and should be read in the context of, the ASF’s previous submission (dated 3 November 2000) on the impact of the New Business Tax System (Entity Taxation) Bill 2000 Exposure Draft.

An executive summary of the submission is as follows:

- 1 ***Securitisation trusts which are 100% owned by a Corporate Group (eg where a member, or members, of the group are the sole beneficiary(ies) of the trust) should either be excluded from the application of the consolidation regime or, alternatively, be able to elect to be kept outside of the consolidation group.***

A major concern with the proposed consolidation regime is the way in which members of the consolidated group may be liable for the tax liabilities of other members of the group. Any potential exposure for a securitisation vehicle to outside liabilities will almost certainly lead to downgrading by the rating agencies or even the refusal to rate new issues. Further details in relation to these issues are incorporated in Appendix A attached.

- 2 ***Where a corporate securitisation vehicle is owned by a Charitable Trust (whose objects are all discretionary beneficiaries), the Charitable Trust and the corporate entity should not be required to consolidate under any legislation that will ultimately be introduced.***

Based on the current drafting in the Exposure Draft Legislation, a charitable trust and any wholly owned corporate securitisation vehicle may constitute a consolidatable group. The decision whether to consolidate would currently lie with the charitable trust (being the head entity). Should legislation (when finally introduced) require the charitable trust to consolidate with the corporate securitisation vehicle, such that it would be liable for (and economically bear the burden of) any tax liability of the corporate securitisation vehicle, adverse and anomalous consequences would arise to the charitable trust - to the detriment of the securitisation structure.

Further details in relation to this issue are incorporated in Appendix B attached.

We look forward to the opportunity of discussing the various alternatives contained in this submission (and our earlier submission in relation to Securitisation Trusts and the proposed Entity Tax rules) with you with a view to developing a mutually satisfactory solution which will provide certainty that securitisation vehicles (both trusts and companies) can continue to be taxed as stand alone entities.

When you are in a position to discuss the submission or if you have any queries in relation to it, please do not hesitate to contact, in the first instance, Ian Godfrey on (02) 9258 1425.

Yours faithfully

Ian Godfrey
Convenor
ASF Taxation Sub-Committee

APPENDIX A

Securitisation Trusts Wholly Owned By Corporate Groups

Issue

The ASF is concerned that the application of any joint and several liability rules in the proposed consolidation regime, if introduced, will adversely affect the ratings able to be assigned to securities issued by securitisation trusts.

This issue was flagged in the ASF's earlier submission dated 9 June 2000 on the general impact of the Ralph Report recommendations on securitisation vehicles (see further paragraph 3.0 of Part B of that submission).

Analysis

Under the Exposure Draft Legislation, a securitisation trust, all of whose members (ie beneficiaries, objects and/or unitholders) are part of a consolidatable group could itself be required to consolidate with that group (for example a securitisation trust that has as its sole beneficiary a subsidiary of a bank). Whilst such a trust would not be a head entity, it could (depending on whether it satisfies the test for an "Australian resident trust", when that test is developed and introduced¹) constitute a 100% Australian subsidiary of the group of which the beneficiary is a member. If the head entity of the group then decides to consolidate, on the current drafting of the Exposure Draft Legislation, the securitisation trust will be part of the consolidated group. Although it is currently optional whether a (head entity and) group elects to consolidate, we note that due to the benefits associated with consolidations (ie the ability to more easily manage a group's income tax affairs, the ability to group tax losses and the ignoring of intra group transactions, etc), most sponsor banking groups would elect to be consolidated.

There are to be specific rules introduced dealing with ability of the Commissioner to recover from subsidiaries income tax owing by the head entity of a consolidated group, where the head entity defaults on its primary obligation for the income tax debts of the consolidated group. These rules are presently missing in the Exposure Draft Legislation. We note that originally the Ralph Report recommended that under tax consolidation regime all member entities be jointly and severally liable for any income tax debt that has not been paid by the head entity. The Federal Government has departed from this recommendation following submissions relating to the *Corporations Law*, solvency issues and members' credit ratings. Thus the worst case scenario that a securitisation trust owned by a major bank could be potentially liable for the tax liabilities of the entire bank group no longer seems likely.

Nonetheless, any mechanism under the new rules whereby the trustee of a Securitisation Trust could be liable for the tax on the income of the trust (or worse the income of some other entity within the consolidated group of which the trust is a member) would effectively deny the "tax flow through" status of the Securitisation Trust and would have negative commercial consequences (as discussed in our previous submissions).

¹ Although the term "Australian resident trust" is not asterisked in the Exposure Draft Legislation, implying that it requires a corresponding definition, we note that paragraph 1.86 of the Explanatory Memorandum to the Exposure Draft Legislation states that "The test to determine whether a trust is an Australian resident is still being developed".

ASF recommendation

There would appear to be several possible solutions to the problem which could be implemented as alternatives. These are as follows:

- (a) *Provide a carve out in the test of what constitutes an “Australian resident trust” for securitisation vehicles.*

The Exposure Draft Legislation provides that an entity (other than a common Australian corporate entity) will be a 100% Australian subsidiary where (amongst other things) it is “an Australian resident trust”. The tests as to what constitutes an Australian resident trust are yet to be defined for these purposes (refer to paragraph 1.86 of the Explanatory Memorandum). Providing a carve out (in this test) for Securitisation Trusts (as we have previously proposed be excluded from the proposed entity taxation would be a simple solution. A copy of that suggested definition is attached in Appendix C.

- (b) *Provide an explicit exemption from the application of the consolidation rules to securitisation trusts (and securitisation companies).*

This alternative approach would treat Securitisation Trusts (as defined) as excluded trusts for the purposes of the consolidation regime thus preserving their stand-alone treatment.

This solution should also be relatively simple. It could take the form of one of the exemptions currently included in subsections 168-78(2) to (7), which provide a carve out to what is a common Australian corporate tax entity. However, this exemption would be applicable to the definition of “a 100% Australian subsidiary”, and not to “a common Australian corporate tax entity” (to which subsections 168-78(2) to (7) are directed).

Regardless of the approach taken to Securitisation Trusts, the ASF would also like to explore the possibility that “Securitisation Companies” might be excluded from the consolidation rules. For these purposes, a Securitisation Company is a special purpose company whose activities are essentially the same as those described in respect of Securitisation Trusts in Appendix C.

- (c) *Provide a mechanism by which a securitisation trust (or, alternatively, the sponsor group) can elect to have the securitisation trust excluded from the consolidated group.*

This third approach would be to incorporate, in the Exposure Draft Legislation, a provision entitling the Trustee (or Manager) of a Securitisation Trust, or the head entity of the sponsor group, to elect that the trust will not be required to consolidate with the sponsor group, but may rather be taxed on a stand alone basis. This would provide the sponsor group with the flexibility of whether to consolidate or not. For reasons given above, we presume that a securitisation trust (or sponsor group) will rarely elect for the trust to be consolidated. If the sponsor group does in fact elect to consolidate the trust, it may then be liable for other tax debts of members of the group.

A similar approach could also be adopted for “Securitisation Companies”

- (d) *Ensure that the liability for tax rules ultimately introduced for a consolidated group do not impose a liability on the trustee of a Securitisation Trust within the relevant group.*

Such an approach would seem generally necessary for any trusts (not just Securitisation Trusts) that are not taxed as separate entities under the proposed Entity Taxation rules (and which are to continue to be taxed at the “beneficiary level” under Division 6 of the 1936 Tax Act).

We submit that the efficacy of “flow through” taxation for such trusts will be denied if, upon a default by either the beneficiary in whose assessable income the net income of a Division 6 type trust is actually included or a default by the head entity of the group that includes the beneficiary to pay their tax liability, the relevant tax liability reverts to the trustee. Such a result would impose a “secondary” risk of entity taxation on trusts that are intended not to have a “primary” liability as entities for income tax purposes.

APPENDIX B

Corporate Securitisation Vehicles Owned by Charitable Trusts

Issue

The ASF is concerned that a corporate securitisation vehicle owned by a Charitable Trust (ie a discretionary trust whose objects are all charitable institutions) (“**Charitable Trust**” or “**Ownership Trust**”) will be required to consolidate with that entity under any consolidation regime when ultimately introduced (however, we note that if a general exemption from the consolidation rules for “Securitisation Companies” is available, as referred to in Recommendations (b) and (c) of Appendix A, then this issue falls away).

Analysis

Under the Exposure Draft Legislation a consolidatable group comprises of a head entity and all its 100% Australian subsidiaries.

An ownership trust would constitute a head entity if it is a “common Australian corporate tax entity”. An ownership trust will be deemed to be a common Australian tax entity if it is:

- (a) a “non-fixed trust”;
- (b) it is an entity of a kind all or some of whose taxable income for the income year is taxable at the ordinary corporate tax rate; and
- (c) it is not covered by any of the specific exemptions incorporated in section 168-78 of the Exposure Draft Legislation (ie those applying to mutual entities, co-operatives, PDFs, non-profit companies and some credit unions).

A discretionary trust (such as an Ownership Trust) will constitute a non-fixed trust unless it falls within the definition of “excluded trust”, when that term is defined for the purposes of the New Business Tax System (Entity Taxation) Bill 2000. Assuming that the Ownership Trust does not fall within the definition of an excluded trust, then it is an entity of a kind whose taxable income for the year will be taxable at the ordinary corporate tax rate.

The Ownership Trust would not fall within any of the exemptions contained in section 168-78.

As all of the shares in the corporate securitisation vehicle will be owned by the Ownership Trust, it will constitute a 100% Australian subsidiary of that entity.

Currently, the choice whether to consolidate is proposed to lie with the head entity (ie the Ownership Trust in this case). Accordingly an Ownership Trust ought to be able to avoid the application of the consolidation regime.

If, however, the Ownership Trust and the corporate securitisation vehicle were required to be consolidated, it would give rise to adverse and anomalous consequences. These would include the Ownership Trust having an unfunded tax liability (on behalf of the corporate securitisation vehicle), and no means to pay this liability.

ASF recommendation

There would appear to be several possible solutions to the problem that could be implemented as alternatives. These are as follows:

- (a) *Ensure that the current mechanism incorporated in section 168-95 is reflected in any legislation when introduced, such that an Ownership Trust will have the option whether to consolidate or not.*

This alternative is quite straightforward and will give rise to a satisfactory result.

- (b) *If for some reason the government decided to resile from the currently proposed option of head entities being able to elect to consolidate (and instead consolidation of consolidatable groups was intended to be mandatory) then the ASF would wish that an Ownership Trust comes within the definition of “excluded trust” when that definition is introduced for the purposes of the New Business Tax System (Entity Taxation) Bill 2000.*

By way of background, all the objects (beneficiaries) of the Ownership Trusts are charitable institutions. Over the life of the transaction, an Ownership Trust will rarely receive any income. Dividends from the corporate securitisation vehicle are typically prohibited from being paid until winding up of the structure. The purposes of the Ownership Trust is to own the shares in the corporate securitisation vehicle, so that company can be off-balance sheet (from the sponsor group) for accounting purposes. This off-balance sheet treatment allows the company to obtain funding at a lower cost in the future. There are no tax benefits associated with an Ownership Trust holding shares in the corporate securitisation vehicle.

Based on such a structure, we submit that providing for an exclusion to an Ownership Trust will not give rise to any tax advantages to that trust or to any of the entities in which the Ownership Trust holds interests. Furthermore, as the Ownership Trust is not part of a “corporate group” (ie its beneficiaries being charitable institutions), the exclusion of such an entity from the consolidation regime would be consistent with the underlying policy of the proposed regime.

APPENDIX C

Proposed Definition of a Securitisation Trust (*)

The following definition is for discussion purposes.

A “securitisation trust” is one that satisfies all of the following requirements:

- It is a trust that is established for the purposes of acquiring, originating or warehousing financial assets¹ funded or to be funded, either directly or indirectly², by the issue of marketable securities, and any related support facilities entered into by the trust.
- The marketable securities which fund the securitisation of the assets are either rated by a international ratings agency or issued into the market following a public offer of the type referred to in section 128F(3) of the Tax Act or acquired by a bank or financial institution.
- It is a fixed trust as to both income and capital and there are no more than five unitholders.
- It acquires or originates within 12 months of its establishment assets of at least \$10 million.

For the purposes of the definition of “Securitisation Trust”, a securitisation trust will be a fixed trust notwithstanding that trustee can issue and redeem units at a price other than one based on net tangible assets of the Trust and notwithstanding trustee has broad powers to amend trust deeds without the consent of the unitholder(s).

Each of the above suggested factors is somewhat arbitrary but they are intended, in aggregate, to describe a trust that accommodates most securitisation transactions.

(*) The ASF would like to explore the possibility that a “Securitisation Company” with similar features to those described above may be able to be excluded from the consolidation rules (and continue to be taxed on a stand alone basis).

¹ financial assets - As well as “eligible investment business assets” (per Section 102M of the 1936 Act), this definition should clearly include any other income or cash flow producing asset such as a lease/hire purchase, rights to management (and other) fees.

² indirectly - means that you look through chains of securitisation vehicles to find an issue of securities to the capital markets.