

11 April 2005

Mr Tony Long  
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Australian Tax Office  
World Trade Centre  
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Melbourne VIC 3000

Mr John Challinor  
GST Financial Supplies  
Australian Taxation Office  
Chermside  
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Dear Mr Long and Mr Challinor

### **GSTR 2004/4 - Servicer Fees**

We refer to our meeting on Friday 27 August 2004 and the related draft Issues Paper forwarded by you under cover of your email dated 26 August 2004. We write on behalf of the Australian Securitisation Forum (**ASF**).

Following the abovementioned meeting, we requested the agreement of Tony Long to the circulation of the draft Issues Paper more broadly amongst the membership of the ASF. Mr Long responded that a revised draft Paper was being prepared in light of the discussions held on 27 August 2004 and he would prefer that we circulated the revised Paper rather than the original Paper. He also indicated that the revised Paper would be available in a week or so from that time (ie early September 2004). We have been waiting to provide a written response to the matters discussed on 27 August 2004 and canvassed in your draft discussion Paper until we received your revised Paper. We have still not received a revised Paper. Nevertheless, because the industry is very keen to have this matter resolved as soon as possible, we are writing in response to the original draft Paper recognising that the final Paper may be different from the draft and that our submissions may require subsequent amendment accordingly.

Given the time that has elapsed, we would be very grateful if you could please commit to responding to this letter by 29 April 2005.

We attach as Appendix 1 a list of the services typically provided by a Servicer.

### **Executive Summary**

The views of the ASF are as follows:

- (a) The ATO's characterisation of the supply by the Servicer as a supply of legal remedies is simply wrong. The characterisation of the supply by the Servicer is, at law, a supply of services in relation to managing the receivables for and on behalf of the securitisation vehicle which is the beneficial owner of the receivables.
- (b) The acquisition by the securitisation vehicle of the services provided by the Servicer clearly relates to the issue of securities to the capital markets investors rather than the acquisition of the beneficial interest in the receivables.

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- (c) Items 7, 14, 15, 17, 23 and 29 of GST Regulation 70-5.02 apply in appropriate circumstances to allow securitisation vehicles an RITC by reference to the full amount of the servicing fee.

The reasoning to support these conclusions is set out below.

We have addressed the issues set out in section A of your draft discussion Paper using the numbering and headings adopted by you. We also note that this submission is concerned solely with the servicing fee issue and the fact that we have not commented on the matters under heading B should not be taken as acceptance of the ATO's views on these matters. They will be dealt with separately.

#### **1. Characterising the supply made by the servicer for GST purposes**

To the best of the knowledge of the ASF tax sub-committee, all of the major banks and, we had understood, other participants in the securitisation industry have consistently treated the supply of services by the Servicer as a taxable supply.

We are not able to confirm whether, in all cases, there is a consistent approach adopted. You have indicated that you are aware of circumstances in which it might be the case that supplies by a Servicer are treated as input taxed supplies. On the basis of information available to us we are surprised by your assertion but we are unable to confirm whether this is correct or not.

It would be surprising if the ATO's views on the correct characterisation of an arrangement were to be influenced by one participant adopting a different approach to that adopted by the clear majority of participants.

#### **2. What constitutes the Servicer supply?**

Although not mentioned in GSTR 2004/4, it appears that the ATO is now taking the view that the main supply made by the Servicer to the securitisation vehicle is a supply of *the benefit of legal remedies in the event that the originator/servicer does not continue to service the receivables as required*.

This seems to be based upon a particular view taken by the ATO of the nature of the equitable assignment of receivables by a seller to a securitisation vehicle. The point is made by the ATO that under an equitable assignment, obligations cannot be assigned. Whilst this is correct, the conclusions apparently drawn from this are misguided.

Another respect in which the ATO has misconstrued the nature of the equitable assignment is that the ATO appears to believe that the effect of the equitable assignment is to transfer beneficial ownership of the *payment streams*. This is not correct. In fact, the assignment is of a legal chose in action (being the debt owed by the obligor to the originator) and which satisfies all of the requirements to be a legally enforceable assignment other than the requirement to give notice of the assignment to the obligor. It is only because notice is not given to the obligor that the assignment takes effect in equity rather than at law. In other words, since a Seller will typically assign "all of their right, title and interest to and under the receivable", there can be no doubt that this is an effective assignment of the debt. If notice of the assignment were given to the obligor, the assignment would be a legal assignment. As notice is not given the assignment is not enforceable at law but is recognised in equity as an effective transfer of ownership of the debt. Being an equitable assignment of the

debt, it has the effect that the assignee becomes the beneficial owner of the *debt* not merely the beneficial owner of payment streams. It is an assignment of the tree and not merely the fruit.

This conclusion is uncontroversial and, indeed, has previously been reached by Mr Long himself in the context of income tax and specifically the operation of section 102CA of the *Income Tax Assessment Act 1936* in relation to securitisation transactions, in a paper on Mortgage Backed Securities presented at a conference held on 4 & 5 December 1995 at the Parkroyal at Darling Harbour, Sydney:

When the underlying property is passed along with the right to income which attaches to the property then s 102CA should have no application.

As a securitisation will usually involve the assignment, whether equitable or legal, of the vendor's full beneficial interest in an asset this provision should have no application.

Some years later in a paper co-authored by Mr Long and published in *The Tax Specialist*, Volume 1 No.3 February 1998 the following statement was made:

When the underlying property passes with the right to income that attaches to the property, sec 102CA should have no application.

If it is accepted that a securitisation usually involves the assignment, whether equitable or legal, of the originator's full beneficial interest in an asset, it is submitted that sec. 102CA should have no application.

Importantly the basis for these statements is general law on the effect of assignments and not income tax law. We note that there is nothing in the GST Act which modifies the position at general law. There is, therefore, no basis for Mr Challinor's apparent view that an equitable assignment merely creates a right in the assignee to receive an income stream.

The focus of the ATO on the Servicer continuing to do what it would normally do in relation to servicing the receivables and discharging obligations which it retains in its capacity as originator is misplaced. The assertion by the ATO that there are obligations which continue to be owed by the originator to the obligors is unsubstantiated. In our meeting, it was apparent that the ATO considers that the activities involved in discharging these ongoing obligations are a significant part of the activity undertaken by the Servicer. In fact, there are minimal obligations to be discharged by the originator on an on-going basis. These obligations (which primarily relate to the requirements imposed by the Uniform Credit Code, where applicable) are met through standard systems which are highly automated and require very little effort and time commitment by the Servicer. In any event, if Party A has contracted to provide certain services to Party B there is nothing that prevents Party A subsequently contracting with Party C to provide the same services to Party C. Under the arrangement between Party A and Party C, Party C receives the services from Party A. It is not correct to analyse the arrangements as giving Party C merely the benefit of legal remedies if Party A breaches its obligations to Party B.

Relating that to servicing, if it were correct to say that the Servicer has obligations to the obligors under the receivables to carry out the servicing activities, that is not inconsistent with the Servicer contracting with the new beneficial owner of those receivables (and who thus has a separate motivation to have the receivables properly serviced) as well. The

Servicer is providing its services as a Servicer and is not merely giving the securitisation vehicle the benefit of legal remedies in relation to any separate ongoing relationship that the Servicer, in its capacity as originator, might have with the obligors.

The correct characterisation of the servicing arrangements is that the securitisation vehicle, as beneficial owner of the receivables (and not merely the payment streams) engages the Servicer, which is often the originator and assignor of the receivables but, in some cases, is a third party, to perform duties in managing the receivables on behalf of their beneficial owner. This is clearly not an obligation which has remained with the Servicer in its capacity as Seller but rather a duty which it has specifically contracted to perform as Servicer for the benefit of the securitisation vehicle as beneficial owner of the receivables.

There are circumstances where a third party servicer is engaged at the Commencement of a transaction and other cases where back-up servicers are contemplated to be appointed in the future. It is totally inconsistent with this to suggest that where the Servicer happens to be the originator that it is carrying out its existing duties —it is no different from a third party Servicer and shouldn't be treated any differently in this context.

For the sake of completeness, we note that during the meeting you indicated that if title were perfected such that the securitisation vehicle became the legal owner of the receivables then the position would be different because the securitisation vehicle would then be effectively treated as the lender and would thus have the obligations attaching to that role. This reasoning is flawed because the title perfection merely completes the equitable assignment so as to make it a legal assignment. Obligations cannot be transferred under a legal assignment any more than they can be under an equitable assignment. To transfer obligations, a novation would be required. We believe that the ATO is trying to draw too much from the nature of the assignment of the receivables as an equitable assignment.

We do not understand the distinction you draw between the services comprising *management of delinquent accounts* and the other services such as the regular processing of amounts, depositing amounts into a collections account, providing status reports etc. All of these services are equally directed towards management of the receivables on behalf of and for the benefit of their beneficial owner (ie the securitisation vehicle). Furthermore, we can find no statutory basis for such a distinction.

As pointed out in your discussion paper, the view was taken by the ATO in the draft ruling GSTR 2003/D6 that the Servicer supply was treated as an input taxed supply on the basis that the servicing fee constituted additional consideration for the assignment of the receivables. As indicated above, this is factually and legally incorrect. We note that in a recent decision of the Tax Court of Canada, *Canada Trust Co Mortgage Company v Her Majesty The Queen* [17 December 2004], it was concluded, on the facts in that case, that no part of the payments made by the securitisation vehicle to the seller was subject to GST. It was clear that part of the payments made by the securitisation vehicle did relate to the servicing provided by the seller. In our opinion, the decision in that case relates to both different legislation and different facts from the current situation. Importantly, at paragraph 5 of the decision, the judge observes as follows:

It is clear that CTM made a supply of services to the Trusts in conjunction with the sale of the mortgages. That however is not the issue.

The judge then went on to articulate what the issues to be considered in fact were. In the present circumstances we are concerned precisely with the question of whether the Servicer provides servicing services to the securitisation vehicle. As indicated above, that issue was not addressed at all in the Canadian case and therefore if the Canadian case has any bearing on the current issue it is only to provide confirmation that notwithstanding the fact that no separate fee was charged the Tax Court of Canada had no difficulty concluding that servicing services were, in fact, provided by the seller to the securitisation vehicle.

In conclusion, to describe the supply by the Servicer to the securitisation vehicle as a supply of the benefit of legal remedies is incorrect at law. The correct legal analysis is that the Servicer does supply to the securitisation vehicle the management of the receivables. The fact that the Servicer, if it is also the original originator, may have some residual obligations to the obligors, does not prevent it, either legally or commercially, from contracting to supply the debt management services to the securitisation vehicle. It is not correct to characterise this as an undertaking by the original originator/Servicer to continue to carry out its existing obligations.

### **3. Relating the acquisition of servicer services to a supply**

You state that the position adopted in GSTR 2004/4 is that the acquisition of Servicer services solely *relates to the acquisition supply ... and not to any other supply the SPV may also make*. The reason given for the acquisition of the servicer services relating to the acquisition supply does not actually deal with the words *relates to* at all and certainly there is no attempt made to justify the conclusion that the acquisition of Servicer services does not relate to any other supply.

As discussed in the meeting, the ATO's conclusion is not accepted by the securitisation industry and the ATO's justification for that conclusion is regarded as entirely unsatisfactory.

Obviously the term *relates to* can be interpreted very broadly but to give logical effect to its meaning in the context of allowing input tax credits for expenses incurred, it must be the case that sensible interpretation requires that there be some active connection between the incurrance of the expense and the making of the financial supply. At best, it could be said that the acquisition of the Servicer's services is related to the acquisition supply in the sense that they both arise out of the acquisition of the receivables. However, the real need for obtaining the Servicer's services and the real function performed over the life of the transaction relates to the issue by the securitisation vehicle of notes. As previously explained, the rating agencies pay very close attention to the servicing of the receivables in making their assessment of the ability of the securitisation vehicle to service the notes that it issues. Therefore the real connection is between the notes and the Servicer's services and the connection between the Servicer's services and the acquisition supply of the receivables is merely incidental.

#### 4. Entitlement to a reduced input tax credit in relation to the servicer fee

As will be apparent from the foregoing commentary we reject completely the suggestion that any part of the Servicer services comprises a right to legal remedies. That is neither factually nor legally correct. Therefore, the discussion below is concerned with the supplies actually made by the Servicer and thus acquired by the securitisation vehicle.

The ATO asserts that items 14 and 15 are limited in their application. In paragraph 407 of GSTR 2004/1, the ATO indicates that item 15 refers to services involved in the *ongoing management of existing loans*. That conclusion is clearly correct. However, the ATO then asserts in paragraph 409 of GSTR 2004/1 that the services must be undertaken on behalf of the lender. We can find no justification for drawing this conclusion. In the context of GSTR 2004/4, we can see no basis for limiting the scope of items 14 and 15 to services provided to the original lender. There is absolutely nothing to prevent a loan being acquired and no basis for drawing a distinction between the management of that loan for an assignee (being the beneficial owner of the loan) rather than for the original lender.

Furthermore, the deletion of the apparent restriction to services provided to the lender in the original draft regulations can be explained only on the basis that the legislature intended not to allow the availability of an RITC to be limited in that way. There is no other possible explanation for the change. Given that the reference to *the lender* in items 14 and 15 were deliberately removed by the government, it is patently absurd for the ATO to suggest that it is entitled to read those words back in. If the government had intended those words to be read in then they would not have been deleted.

We note that Treasury is considering the underlying policy both in terms of the history behind the drafting of items 14 and 15 (which may be immaterial having regard to the foregoing comments) but also more generally as to whether it is really government policy to discriminate against securitised transactions which is precisely what the ATO's artificial restriction on the scope of items 14 and 15 achieves.

Whilst items 14 and 15 may be concerned with loans, we believe that securitisation vehicles are entitled to RITC's in relation to other receivables under items 7, 23 and 29.

Item 7 applies to "Processing, settling, clearing and switching transactions of the following kinds:

...

- (b) other credit and debit transactions...

We can see no reason why this item is not directly applicable to securitisation transactions. Indeed, very close parallels can be drawn with the situation in example 33 in paragraphs 262 and 263 of GSTR 2004/1.

Item 23 also has clear application. In the ATO's Discussion Paper reliance is placed on a very selective and incomplete quotation from GSTR 2004/1. The list of services reproduced in the ATO's Discussion Paper is actually prefaced by the following words:

"For the purposes of paragraph 23(a), investment management services include, **but are not limited to ...**"

Therefore, a broad meaning of investment management services is intended. Clearly, in managing the receivables (being a portfolio of assets owned by the securitisation vehicle) the Servicer is engaged in the "ongoing implementation or execution of a given investment mandate ...". We consider that paragraph 23(a) is applicable to all securitisation vehicles and paragraph 23(b) is also applicable to a large number of securitisation vehicles.

Furthermore, it is well established law (*FC of T v Everett* 80 ATC 4076) that under an equitable assignment, the assignor, subsequent to the assignment, receives income in the capacity of trustee for the assignee. This falls within item 23(c).

This nature of the capacity of the assignor in many securitisation transactions is even more applicable in relation to item 29, particularly the *collection of income and other payments* in accordance with item 29(c).

We note that the ATO accepts that item 17 will operate to allow a reduced input tax credit for that portion of the fee paid to the servicer which relates to the *management of delinquent debts*. We are at a loss to understand the basis upon which the ATO restricts item 17 to the management of delinquent debts. Debt recovery can be given a broad meaning to cover the regular collection of non-delinquent debts – if it were intended that debt recovery were only to apply to delinquent debts then query why litigation should be separately identified as a course of action since it would be a normal part of a recovery process for delinquent debts, as would the lodgement of documents. Delinquency is not a black and white issue – how do you determine at what point a debt qualifies as "delinquent"? Furthermore, we note that item 17(d) has not been addressed by the ATO.

Therefore, the ASF strongly rejects the ATO's views that an RITC is available for the fee paid to the servicer only to the extent that the fee relates to the management of delinquent debts. We do not believe that such a restriction is authorised by the GST Act or the GST Regulations.

## 5. Conclusion

For the reasons set out above, the ATO's conclusion that the supply made by the Servicer to the securitisation vehicle is the supply of the benefit of legal remedies is wrong and cannot be supported. There is clearly a supply by the Servicer of loan management and debt collection services. As the ruling itself does not really attempt to characterise the nature of the taxable supply made by the Servicer, minimal if any amendment to the ruling should be required in this regard but confirmation to the industry of a retraction of the ATO's erroneous views would be required.

For the reasons set out above, there is no apparent justification for the ATO's artificial limitation on the scope of items 14, 15, 17 and 23 and the ASF considers that the ruling should be amended to make it clear that the supplies by the Servicer do fall within these items and items 7 and 29.

Yours sincerely

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Encl

Copy To Mr Neil Mann

**Appendix 1****Services supplied by Servicer in relation to loans**

<b>Item</b>	<b>Activity</b>
1	Credit analysis
2	Security valuations
3	Loan/finance lease/CHP settlements and discharge
4	Registration & stamping of loan/finance lease/CHP documentation
5	Property title searches
6	Loan/finance lease/CHP & security variations
7	Loan/finance lease/CHP maintenance & customer support
8	Debtor / guarantor discussions, correspondence & negotiations
9	Arrange repayments
10	Prepare, issue, execute statutory notices
11	Make decisions in relation to collections process
12	Maintain debtor file
13	Arrange / receive valuation on security
14	Arrange / obtain possession of security
15	Secure, preserve, maintain security in possession
16	Arrange sale / realisation of security in possession
17	Prepare documentation and attend to settlement of realised security
18	Collection of arrears
19	Prepare and collate performance statistics
20	Collect and enforce loans/finance lease/CHP's
21	Keep accurate accounts and records
22	Comply with all applicable laws, rules and regulations
23	Comply with all requirements of the relevant Servicing Agreement