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Dear Mr Challinor

**GSTR 2003/D6**  
**Assignment of Income Streams including under a**  
**Securitisation Arrangement**

I write on behalf of the tax committee of the Australian Securitisation Forum (*ASF*). The *ASF* is grateful for the opportunity to comment on the draft Ruling.

Since it is likely that you will have received submissions from other parties which address issues of concern to the *ASF*, it is likely that you will have already received detailed analysis of some of the issues identified below and we have therefore taken the approach in certain cases of stating the issue and providing limited discussion, in some cases. In other cases, such as the treatment of lease receivables and servicing fees we have provided more detailed comments.

**1. Legal transfers of underlying assets**

The primary concern of the *ASF* is the approach adopted by the ATO and reflected in the first sentence in paragraph 136 of the draft Ruling as follows:

The SPV makes only financial supplies

This flows from the conclusions reached by the ATO in relation to the nature of the method of acquisition of receivables by an SPV as reflected in paragraphs 39, 46 and 58 of the draft Ruling. The ATO has concluded that the assignment of lease receivables will always comprise an equitable assignment of the rights arising under the lease documents.

The *ASF* believes that the draft Ruling does not appropriately distinguish between an equitable assignment of rights under a lease and the associated legal transfer of the underlying leased property. The alternative argument referred to at paragraph 44 of the draft Ruling may be relevant to some transactions but does not contemplate the case where actual legal title in the leased property is transferred. Paragraph 40 of the draft ruling is in the following terms:

if there is an assignment of the income stream arising under an agreement then it is a financial supply. It does not matter that the assignment that is expressed in terms of all right, title and interest in the receivables agreement.

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It appears that the ATO may be confusing a reference to all right, title and interest under a receivables agreement with the circumstances where, in addition, the assignor transfers *all right, title and interest in the leased property*. In this instance, even though the assignment of rights under the lease may take effect only in equity, the transfer of the leased chattel will take effect at law.

Whilst paragraph 38 of the draft Ruling contemplates a legal transfer, the draft Ruling does not deal with the consequences that flow from such a transaction. For example, paragraph 39 and paragraph 58 refer to the underlying supplies under the lease continuing to be made by the assignor. If there has been a legal transfer of the leased property then this conclusion surely cannot follow. The Ruling should address all the consequences of a legal transfer of underlying assets. For example, the draft Ruling should address the ongoing supplies that are made by the transferee as opposed to the transferor and the fact that it is the transferee who has the GST liability and the entitlement to input tax credits for the taxable supplies which the transferee is now making.

## 2. Other difficulties with the ATO's approach

Paragraph 58 of the draft Ruling contains the following conclusion:

The assignor retains the obligation to make the underlying supply and any GST liability in respect of that supply.

Elsewhere in the draft Ruling, the ATO has concluded that the consideration paid, up front, by the assignee to the assignor for a pool of receivables is consideration for a financial supply. The payments from the debtor/lessee whilst remaining payable to the assignor, are received in trust for the beneficial owner of those payments being the assignee. In other words, the assignor has no beneficial interest at all in the ongoing payments. What consideration is the assignor receiving in respect of the underlying supplies referred to in paragraph 58 of the draft Ruling? In our view, there is no consideration being received and therefore there can be no taxable supply being made by the assignor and thus no GST liability.

## 3. Further consequences of the ATO's approach

The approach adopted by the ATO in the draft Ruling of treating the assignor as continuing to make underlying supplies, raises complications in relation to input tax credits for costs incurred by the assignor such as printing of offer documents, mortgage insurance and set up costs.

## 4. Servicing fees – relevant supply

It is submitted that the conclusion in paragraph 110 of the draft ruling that the payment of the servicing fees by the assignee is additional consideration for the original (financial) supply (of the receivables) by the assignor to the assignee is completely misconceived. The basis upon which the ATO has reached that conclusion is not clear. One possible analysis is that the ATO's approach is based on the misunderstanding that the servicing services are provided to the Originator's customer and not to the SPV or, put a different

way, that because the Originator has only equitably assigned the receivables it has not assigned its obligations and so charges a higher price for assigning the receivables to recognise that the assignee has obtained all of the benefit of the receivables without the associated obligation.

Alternatively, the ATO might be asserting that the servicing fees form part of a composite supply by the Originator to the SPV of the receivables, being a financial supply. The ASF does not agree with the ATO's conclusion and we have dealt with each of the possible bases for support of that conclusion below.

**(a) Servicing services are provided to the SPV**

The fundamental function of the servicer is to collect the repayments of principal and the payments of interest from the Originator's customers. That principal and interest is all beneficially owned by the SPV and therefore it is the SPV, alone, which has a vested interest in the servicing of the receivables. The suggestion that "servicing" the features of the loan and handling customer enquiries are obligations owed to the customer by the Originator and for which the Originator would normally receive consideration from the customer overlooks the fact that the commercial reality is that an Originator wants to maintain the relationship with its customer so as to enable it to develop that relationship and transact new business with the customer – that is, it has nothing to do with the real servicing of the receivables for which the SPV pays an arm's length fee to the servicer. The whole of the consideration given by the SPV to the Originator in respect of servicing relates to the management of the receivables and no consideration is provided in respect of those activities which the servicer also undertakes, in its own interests, in maintaining its relationship with the customer. In other words, the benefit that the Originator obtains or hopes to obtain from "servicing" the features of the loan in answering customer enquiries is future business from that customer and it seeks to recover the costs from that future business and not from the receivables that it has assigned.

**(b) Composite supply**

As indicated above, an alternative possible basis upon which the ATO might seek to support its conclusion is that the supply of the servicing services by the Originator to the SPV is part of a composite supply with the supply of the receivables. On the basis that the principal supply is that of the receivables and the supply of the services is incidental thereto, it might be suggested that there is a composite supply which would be treated as being solely a financial supply and thus wholly input taxed. The ASF does not agree with this conclusion or this basis of analysis for the reasons set out below.

The services mentioned in paragraph 108 are **not** a part of a composite/single supply with the equitable assignment of receivables. Although the services provided by the Originator to the SPV are essential for the overall set of transactions (ie the securitisation deal as a whole) and are obviously closely related to the equitable assignment, these facts are not determinative of the composite versus mixed supply question.

The critical issue is whether the services are ancillary or integral to the equitable assignment, rather than whether they are ancillary or integral to the securitisation deal as a whole. Following the principles established in the CPP case, this requires a consideration of whether in the objective eyes of the SPV, the services are a means in themselves or simply a means to better enjoying the equitable assignment.

It is the ASF's view that the services, although closely related to the equitable assignment and necessary to the operation of the securitisation structure as a whole, (ie for the SPV to receive an income stream under the equitable assignment), are not ancillary to the supply of the equitable assignment. That is, the services are not a necessary, integral or incidental part of the supply of the equitable assignment, as they do not form a better means of enjoying that supply. Rather, the services are essential to ensuring that the assets acquired under the equitable assignment are managed, but they are not essential to supply of the equitable assignment to the SPV, which occurs independently from the provision of the services.

The services are a means in themselves, because they represent the management of the asset portfolio acquired by the SPV which is a separate aim from the acquisition of the assets. The acquisition of the assets is not an essential or incidental part of the supply of the equitable assignment and therefore forms a separate supply as it is a distinct aim for the [customer].

An analogy can be drawn with a management fee charged by an investment manager to an investment fund. For example, where a manager sells equities to a fund as principal and then manages those same equities for the fund under one agreement, then the facts would be very similar to the securitisation structure. It is common ground that under these circumstances the management services would constitute a separate taxable supply from the sale of equities, which is input taxed.

In the UK case, *Wellington Private Hospital Ltd. v C&E Commrs CA* [1997] STC 445, it was held that the supply of drugs in a hospital was a separate supply from the medical treatment. In that case there was obviously a close relationship between the drugs and the medical treatment but they were separate supplies because each was a separate aim in itself. In that case Millett J stated:

The issue is not whether one element of a commercial transaction is ancillary or incidental to, or even a necessary or integral part of, the whole, but whether one element of the transaction is merely ancillary or incidental to, or a necessary or integral part of, any other element of the transaction. ... *The proper inquiry is whether one element of the transaction is so dominated by another dominant element as to lose any separate identity as a supply for fiscal purposes, leaving the latter, the dominant element of the transaction, as the only supply.* If the elements of the transaction are not in this relationship with each other, each remains a supply in its own right with its own separate fiscal consequences. {emphasis added}

In relating the above principle to the services provided, it is the ASF's view that the service fee is not so dominated by the equitable assignment (ie the dominant

element) that it loses its own identity, as it is one thing to sell an asset and another to service or manage it. Millett J also stated that:

What contracting parties have joined together, the commissioners may put asunder, but what contracting parties have themselves separated, I do not think that the commissioners can join together.

Adopting this principle, as all securitisation agreements quite clearly separate the equitable assignment from the servicer services, these supplies should not be artificially brought together for GST purposes alone. In any case it is questionable whether the ATO has a legal mandate to do so, if the Australian courts adopt the above principle.

## 5. Extent of creditable purpose

A direct consequence of the ATO's decision on the GST treatment of the various fees paid by the SPV is the need to address the extent of creditable purpose of the Originator in relation to the supplies it will be making. This will ensure that the ruling in its final form is comprehensive in its coverage of securitisation issues.

Using the servicing arrangement as an example, if the fees earned by the servicer are to be treated as is partly input taxed and partly taxable (as indicated under the existing draft ruling), then there is an issue as to whether an input tax credit is available to the Originator/servicer for costs incurred in relation to the taxable component of the service fee. If the underlying asset portfolio is input taxed (eg mortgages, loans, credit cards) then the issue is whether the costs incurred in managing the equitably assigned portfolio relate to the Originator's supply to the customer (input taxed) or the supply of services to the SPV (partly taxable).

It is the ASF's view that the costs are related to the supply to the SPV as this represents the most direct link between the acquisition and supply. Although the substance of securitisation is for an originator to sell a portfolio, once the sale (by means of equitable assignment) takes place, the managing of the portfolio is for the benefit of the SPV (as it is the beneficial owner of the portfolio). Accordingly, the costs will relate directly to the supply of services to the SPV because the principal reason why the Originator incurs the costs is to manage the loan in accordance with its contractual obligation to the SPV under the services agreement.

It is the ASF's view that the substance of the asset changes, once it has been equitably assigned, from a loan provided as principal to a loan managed as facilitator, in respect of which the Originator no longer derives a benefit from or has a profit interest in the receivables. This means that the principal reason why the Originator manages the facility is because of the service agreement with the SPV, under which the matching income stream (ie to the costs incurred) is received.

In the case of a leasing portfolio being securitised then in line with the principle above, there is a potential input tax credit denial for the Originator for the ongoing management costs that relate to the input taxed component of the servicing fee.

This would surely be an unintended consequence, as lessors would be denied credits in relation to managing a taxable portfolio for the SPV.

If the servicing fee is wholly taxable then the above principle would apply for all costs incurred in the management of the facility – ie a full credit should be available.

More generally, whilst the tables included with the draft ruling are helpful, they are restricted to a simple domestic issue of notes. To provide proper guidance to issuers, the tables should be expanded to specifically address the GST consequences of, for example, the offshore issue of notes, the characterisation of such an issue as a GST free supply and the consequent implications for the claiming of input tax credits and the impact that has when applying the financial acquisitions threshold.

## **6. RITC entitlement**

### **(a) Items 14 and 15**

We understand that shortly after the release of the draft Ruling, members of the ASF may have provided to the ATO some background material relevant to the original intention of Treasury that SPCs were to be entitled to claim RITCs under the Regulations. The essence of that material was that the ASF, the Australian Bankers Association and the Business Council of Australia had argued for changes to be made to the original GST Regulations to accommodate an RITC entitlement where an SPV acquired services under outsourcing arrangements. Accordingly, we believe that the changes made to items 14 and 15 as reflected in the final Regulations, were intended, in particular, to accommodate the arguments put forward by the securitisation industry.

### **(b) Item 23 – servicer fee**

It is the ASF's view that an entitlement to RITC for the servicing fee is also available for the SPV pursuant to item 23(a) of Reg 70-5.02. The equitable assignment is clearly an asset portfolio purchased by the SPV for investment purposes. The services rendered by the Originator are clearly that of the management of the SPV's asset portfolio and therefore fall squarely under item 23(a).

## **7. Financial acquisitions threshold**

It is submitted that the financial acquisitions threshold is not being interpreted as was originally intended by Parliament.

Paragraph 136 and paragraph 140 briefly discuss supplies that a SPV could make that may be GST-free but they do not draw out the matter. It would be useful if a new section were to be inserted after paragraph 141 containing a discussion on Debt Securities and GST free supplies.

This new section should elaborate on the consequences of the GST paid on the inputs to the SPV in respect to the assignment of a security stream purchased locally where the Debt Securities to support the purchase are issued to offshore note-holders.

An example should be included showing where a SPV arranges to purchase an income stream onshore (a financial acquisition) and funds the acquisition by way of issue of offshore securities (a GST free supply) resulting in the SPV in that case being fully creditable.

More generally, the ASF considers that the discussion in the draft ruling focuses too much on the acquisition supply issue. Furthermore, the table on page 28 should be amended because the "relates to" column does not correctly identify what certain supplies do actually relate to. The broad range of securitisation transactions needs to be better represented.

#### **Schedule 1**

Schedule 1 should be widened because it does not consider or allow for the possibility that a securitisation arrangement may be wholly under the FAT or that the debt issuance is GST free.

Should either situation occur:

- (i) there is no RITC (ie not applicable);
- (ii) or the arrangement has a direct causal link between a financial acquisition and a GST free supply and be partly or fully creditable.

Further at item 10 and 13 of that schedule no consideration has been given to the fact that these supplies may be GST free – this also should be amended.

### **8. Custodial Services**

We note that in the Table in Schedule 1 of the draft Ruling, the ATO has ruled that no entitlement to an RITC exists for custodial services. Custodial services described in paragraph 114 of the draft ruling are in our view covered by Item 15(c) of the RITC table.

As indicated in section 6 above, the drafting of items 14 and 15 of the RITC table was modified by Treasury in order to ensure the inclusion of third party outsourcing done by Securitisation Special Purpose Vehicles (*SPV's*).

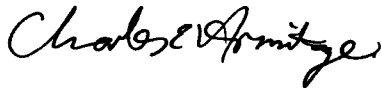
The original formulation of Items 14 and 15 would have precluded acquisitions made by Securitisation SPV's by virtue of a "to lenders" requirement. This requirement was removed subsequent to discussions between the ABA and Treasury. In actual fact, timing pressures and deadlines imposed by the Government allowed only very minor changes to the Regulations.

### **9. Classification Table in Schedule 1**

We note that the Classification Table in Schedule 1 to the draft Ruling confirms the various positions addressed in the remainder of the document. We believe the Table format should be retained in the final Ruling with appropriate changes being made to reflect any corresponding interpretational changes in the Ruling.

Should you have any queries please do not hesitate to contact, in the first instance, Charles Armitage.

Yours sincerely



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