15 September 2008

Review of Legal Framework for Administration of GST
Board of Taxation Secretariat
C/- The Treasury
Langton Crescent
PARKES ACT 2600

By email – taxboard@treasury.gov.au

Dear Sir / Madam

Review of Legal Framework for the Administration of the Goods and Services Tax

We refer to the paper entitled "Review of the Legal Framework for the Administration of the Goods and Services Tax", which was circulated by the Board of Taxation (**"Board"**) in July 2008.

We welcome the review by the Board and are grateful for the opportunity to make a written submission.

Background to the Australian Securitisation Forum

The ASF was formed in 1989 to promote the development of securitisation in Australia. As the peak industry body representing the securitisation market, the ASF performs a pivotal role in the education of government, regulators, the public, investors and others who have an interest or potential interest both in Australia and overseas, regarding the benefits of securitisation in Australia and aspects of the securitisation industry.

The Australian securitisation market enjoyed rapid growth over the last 10 - 12 years, until the global credit crunch struck in mid-2007. The size of the market, based on the values of securities outstanding by Australian securitisation vehicles, has increased from A$10 billion in March 1995 to nearly A$200 billion by the end of 2007.

Consistent with overseas securitisation markets, a large part of the growth of the Australian securitisation market has been the mortgage-backed securities market, which in turn has been driven by the banking and non-banking sectors.

In addition to residential mortgage loans, the types of assets that have been securitised to date in Australia include:

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- Vehicle and equipment loans and leases
- Credit and charge card receivables
- Trade receivables
- Collateralised loan obligations
- Net interest margin (income streams)
- Commercial mortgage loans and leases

Attached submission

Set out in the **Appendix** is our detailed submission to the Board. We request that the Board give serious consideration to our submission for the purpose of formulating its recommendations.

To summarise our submission, a key GST issue for the securitisation industry is that joint and several liability of GST group members needs to be restricted in order to facilitate securitisation trusts in becoming members of GST groups. This is because securitisation trusts rely on their debt being rated to fund specific pools of assets.

This submission highlights a fundamental deficiency in the GST grouping rules in the context of securitisation trusts. The existing inadequacies in the GST grouping rules have a particularly detrimental impact on the securitisation industry. However, it should be noted that the issues raised are equally applicable to all members of GST groups generally.

The issues raised have been addressed in the income tax arena (i.e. by way of tax sharing agreements), but have been ignored in the GST context without any apparent reason or justification (whether as a matter of policy or otherwise).

It is the strongly held view of the ASF that clarification is required as a matter of urgency. A failure to do so could have a significant adverse impact on the viability of certain securitisation structures, particularly in the current environment.

Should the Board wish to discuss this submission with a representative of the Australian Securitisation Forum, please do not hesitate to contact me on (02) 9463 4612.

Yours sincerely

Patrick Tuttle
Chairman
Taxation Committee
Australian Securitisation Forum

cc Attachment

Appendix

Detailed Submission by the Australian Securitisation Forum

Q2.4 Do the rules for:

• forming, operating, altering and dissolving a GST group, a GST religious group, a GST joint venture and a GST branch; and

• reporting their GST liabilities and entitlements achieve an appropriate balance between providing flexibility, minimising compliance costs and ensuring the integrity of the GST system? If not, how should they be modified?

ASF response

1. Joint and several liability - securitisation

The GST grouping rules are considered to raise one of the more significant issues affecting the securitisation industry and its participants. Revision of these rules should be viewed as having a high priority in any consideration of amendments or clarification to the existing GST law.

The need to reform the GST grouping rules, and in particular the application of the joint and several liability concept in relation to securitisation trusts, is especially important given the GST cost, potential problems, as well as broader tax administration issues, that are created if these entities *do not* group for GST purposes.

For example, many securitisation trusts are brought "on balance sheet" for accounting purposes, are consolidated for income tax purposes but are not grouped for GST purposes, primarily because of the joint and several liability that arises. This inability to GST group gives rise to the following consequences:

- An unnecessary increase in GST leakage under the arrangement (as servicer fees etc charged by an originator to a related, but ungrouped, securitisation trust would be subject to GST, but the securitisation trust would not be entitled to a full input tax credit). Such additional GST leakage could ultimately have an effect on pricing decisions.

- Significant GST complexity and uncertainty which could lead to unnecessary GST technical disputes with the ATO. Potential issues in this regard include classification of supplies, market valuation issues, reduced credit acquisition analysis etc – if the entities were GST grouped, certain transactions could be ignored for GST purposes and these issues would largely disappear.

- GST would become a factor in the method of raising funding as other forms of finance (such as direct debt funding) would have a different GST treatment. On the other hand, if securitisation trusts were able to be grouped for GST purposes, GST would be a relatively neutral factor (i.e. having a less distorting effect) in deciding what form any financing should take.

- Given the significant number of securitisation trusts that some entities have, having each trust separately registered for GST, being required to issue tax invoices, lodge separate GST returns and account for GST and input tax credits for transactions between entities that could otherwise be members of the same GST group, significantly increases the compliance burden and cost for businesses.

- A potential divergence of compliance practices and processes between income tax and GST that is confusing, inconsistent, unnecessary and seemingly unavoidable.

There have been ongoing disputes between the Commissioner and certain taxpayers in the securitisation industry in relation to the operation of the "associate" rules in Division 72 of the GST Act. This dispute has continued for a number of years (and is still ongoing), taking up much time and resources for participants in an industry that has been experiencing difficult market conditions.

However, such disputes would not arise if securitisation trusts were able to be grouped for GST purposes. This could be facilitated by relatively minor amendments to the GST law in circumstances that are entirely consistent with the policy of GST grouping while addressing commercial limitations that are peculiar to the securitisation industry.

Such issues have been caused by the inability of trusts to group due to the joint and several liability that arises. In particular, there is a lack of commercial appetite for external parties (e.g. rating agencies, investors) in accepting such liability. This is because securitisation trusts rely on their debt being rated to fund specific pools of assets, and potential exposure to liabilities of third parties would adversely affect debt ratings.

In the context of income tax consolidation, there is a carve-out for joint and several liability for members of a tax consolidated group. A similar restriction on joint and several liability in the GST grouping rules is required in order to:

- address and resolve the ongoing, unnecessary and adverse GST issues affecting the securitisation industry; and
- facilitate GST grouping arrangements in a way that is needed to align the GST grouping framework with the income tax consolidation rules.

Please note that this is considered to be a clear deficiency in the GST grouping framework (particularly in comparison with the income tax consolidation rules), and detracts from the ability for taxpayers in the securitisation industry to effectively apply and take advantage of GST grouping rules. To date, such a limitation creates unnecessary and inappropriate additional GST leakage (in addition to unnecessary ongoing disputes between the Commissioner and certain taxpayers in the industry).

In the income tax context, joint and several liability has been necessarily and appropriately curtailed by legislation, namely, tax sharing agreements (see sections 721-15 and 721-25 of the Income Tax Assessment Act 1997). In the Explanatory

Memorandum to the *New Business Tax System (Consolidation) Bill (No. 1) 2002*, the clear concerns that prompted the amendments were described as follows:

> "***Context of reform***
>
> *11.2 The Review of Business Taxation recommended that liability for group taxation debts be based on the common law concept of joint and several liability. This would mean that all members of the group would be liable at all times for the full amount of the income tax-related liability of the group (group liability) that arose during the period of membership.*
>
> *11.3 A number of concerns with this approach were highlighted during consultation, particularly in relation to the imposition of full joint and several liability. These included that:*
>
> *• a subsidiary member could become technically insolvent without the knowledge of that member - this is of particular concern for company directors, who are prohibited from permitting a company to trade while insolvent;*
>
> *• creditors of a subsidiary member could be swamped by the group liability - this could occur where a subsidiary member was insolvent and then incurred an additional debt, being a group liability; and*
>
> *• the due diligence activities of a purchaser of a subsidiary member would become necessarily excessive - because of the possibility that a subsidiary member might be liable for a group liability, a prospective purchaser would have to scrutinise the entire group to ensure that its due diligence obligations are satisfied.*
>
> *11.4 In foreign jurisdictions, similar concerns regarding the effect of an imposition of joint and several liability are mitigated via the application of an extensive regime of cross-guarantees and indemnities.*
>
> *11.5 However, in response to these concerns and to maintain legislative and administrative integrity, a modified model was proposed. This model differs from the Review of Business Taxation model in 3 key respects:*
>
> *• the head company of a consolidated group will be solely liable, in the first instance, for a group liability;*
>
> *• where that head company fails to meet the group liability by the time the liability becomes due and payable, the Commissioner may be able to recover a part or the whole of the unpaid amount directly from those entities (other than the head company) that were members of the group at any time during the period in which the group liability accrued (the contributing members); and*
>
> *• where a contributing member might be subject to recovery action by the Commissioner, it might nevertheless be able to exit a group free from a liability arising during a period in which it was a group member but which had not become due and payable at the time of exit, provided certain conditions are met."*

The arrangements introduced in relation to tax sharing agreements operated to restrict members from being jointly and severally liable to the extent allocated in accordance with the terms of the tax sharing agreement. This mechanism operated to alleviate commercial issues (as clearly stated in the extract) that would otherwise

arise from joint and several liability. However, unfortunately, such liability does not arise in the GST context.

There is precedent for implementing measures that address concerns that are peculiar to the securitisation industry. For example, the *Taxation Laws Amendment Act (No. 5)* 2003 introduced a specific exemption for certain special purpose entities in the securitisation industry in relation to the thin capitalisation rules. The explanatory memorandum included the following extract:

> "***Exemption of certain special purpose entities***
>
> ...
>
> *1.6 The securitisation industry is complex and dynamic. Many securitisation programs are not able to avail themselves of the benefits of the zero capital treatment provided under the current thin capitalisation legislation. In particular, the current definitions do not contemplate origination, warehousing, two-tiered securitisation or synthetic securitisation. Nor do the current rules allow any residual equity holding in a securitisation vehicle. As a consequence, many bona fide securitisation vehicles will inappropriately have a proportion of their interest deductions denied under the thin capitalisation rules.*
>
> *1.7 To address this, amendments will exclude special purpose entities from the thin capitalisation rules for all or part of the income year provided that the following conditions are met:*
>
> - *the entity is established for the purposes of managing some or all of the economic risk associated with assets, liabilities or investments (whether the entity assumes the risk from another entity or creates the risk itself);*
> - *At least 50% of the entity's assets are funded by debt interests; and*
> - *the entity is an insolvency remote special purpose entity according to the criteria of an internationally recognised rating agency applicable to the entity's circumstances.*"

The above extract refers to the complexity and dynamic nature of the securitisation industry, in addition to the commercial requirement for special purpose entities to be insolvency remote. However, such a commercial requirement can never be able to be satisfied in the context of an entity that is approved as a member of a GST group and subject to joint and several liability. This problem is clearly highlighted in the above extract from paragraph 11.3 of the Explanatory Memorandum to the *New Business Tax System (Consolidation) Bill (No. 1) 2002* in the context of the introduction of provisions dealing with tax sharing agreements.

The need for clarification is supported by the sheer complexity of securitisation arrangements, commercial limitations imposed on special purpose vehicles in that industry, the current inability for such entities to be added as members of any GST group and the (unnecessary) additional adverse GST consequences and disputes that have arisen for such entities.

The provisions dealing with tax sharing agreements arguably have some design features and limitations that are outside the scope of this submission and are specific to income tax. As such, a similar, but not the same, concept should be adopted.

At a high-level, the proposed solution would be to expand subsection 444-90(2) in Schedule 1 to the *Taxation Administration Act* 1953 (GST groups) by way of a simple amendment to refer to securitisation trusts as follows:

(2) Subsection (1) does not apply to a *member of a *GST group if:
(a) an *Australian law has the effect of prohibiting the member from entering into any *arrangement under which the member becomes subject to the liability referred to in that subsection; or
(b) the member satisfies the conditions in subsection 820-39(3) of the Income Tax Assessment Act 1997.

Subsection 444-90(3) would apply to restrict the joint and several liability to acts and omissions of the relevant trust.

The existing subsection 444-90(2) demonstrates that it is both possible and appropriate to implement an effective solution to address an anomalous or inappropriate outcome of GST grouping rules in a specific financial services context (i.e. life companies). It is submitted that such a solution should be extended to address the issues raised in this submission.

There may be other alternatives to achieve an outcome similar to GST grouping for securitisation trusts without joint and several liability, or without having to rely on revisions to the GST grouping rules. For example, a similar GST outcome could arise if supplies between associates could, at the election of the supplier or by agreement between the supplier and recipient, be treated by the parties as an input taxed financial supply to the extent of the relation between the supply to the associate and its input taxed activities. Such an alternative may instead require an amendment to Division 72 of the GST Act. Permitting a supplier to make an election to input tax a supply would not be a novel concept: see section 40-160 of the GST Act. Further details of such alternatives can be provided on request.

We would be happy to meet with representatives of the Board of Taxation to provide further background information and to discuss specific changes to the law and related issues.

2. Joint and several liability - general

The income tax concept of a tax sharing agreement applies to limit the joint and several liability of members of a tax consolidated group to an amount calculated in accordance with an allocation methodology described in the agreement.

In addition to the above proposal relating specifically to securitisation arrangements, an arrangement should be implemented in the GST law to limit the joint and several liability of all GST group members generally, as agreed between the representative member and that GST group member.

As mentioned above, it is submitted that the tax sharing agreement is arguably not appropriate for inclusion in the GST grouping rules. Instead, it is proposed that the representative member can specifically elect to make a valid declaration for the purpose of the GST law to restrict the joint and several liability of each GST group member from time to time to the acts and omissions of that GST group member.

Q2.14 Do the associate provisions that apply to transactions between associates for no consideration apply appropriately and interact effectively with other areas of the GST law? If not, what changes should be made to ensure that the GST law operates effectively?

ASF response

Market value is an extremely difficult and uncertain concept to apply. It relies on complex issues associated with valuation, leads to conflict and disputes with the Commissioner, is costly (by having to engage external valuers) and is ultimately based on assumptions and conditions that need to be tested.

Division 72 is a specific anti-avoidance provision and there are many circumstances in which there is no anti-avoidance element in transactions between related entities notwithstanding that the price charged for a supply may arguably be less than the GST inclusive market value (as determined in an open market and negotiated between a willing buyer and seller).

Such a potentially broad-ranging provision can operate to automatically alter GST outcomes and create uncertainty for taxpayers, particularly in the securitisation industry. It is submitted that Division 72, at the very least, creates significant uncertainty, extremely onerous compliance / administration / valuation costs for taxpayers and inevitable disputes with the Commissioner. At most, that Division is so uncertain in its operation that taxpayers cannot reasonably comply with its requirements.

Query whether such a provision is necessary or effective in the administration of GST in circumstances where a general anti-avoidance provision already exists in the form of Division 165 and may be relied by the Commissioner in appropriate circumstances.

It is suggested that Division 72 is too uncertain in its operation and should be deleted in its entirety for this reason. The Commissioner should rely on Division 165 in appropriate circumstances.