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Tax Forum
The Treasury
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Dear Tax Forum,

SUBMISSION TO THE TAX FORUM BY THE AUSTRALIAN SECURITISATION FORUM

The Australian Securitisation Forum (**ASF**) is pleased to provide this submission to the Tax Forum. The ASF is a broadly based industry association through which participants in the Australian securitisation markets can advocate their common interests on important legal, regulatory, accounting, tax and market practice issues.

The ASF promotes the development of securitisation in Australia. It is the peak industry body representing participants in the securitisation market which include major banks, smaller Authorised Deposit-taking Institutions, non-bank issuers, fixed income investors and service providers to the sector. The ASF's role in Australia mirrors that of the American Securitization Forum in New York and the European Securitisation Forum in London.

The ASF performs a pivotal role in promoting and representing the industry to 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 ASF welcomes the opportunity to contribute to the Tax Forum and would welcome any discussions on this submission.

Yours sincerely,

Chris Dalton

Executive Summary

Securitisation plays a vital role in the financial markets by ensuring that low cost funding is available for providers of consumer finance in particular mortgage finance). This funding source is critical to the global competitiveness of Australia financial institutions. The importance of securitisation has been recognised by the Government through its instruction to the Australian Office of Financial Management to invest up to $20 billion in residential mortgage-backed securities (RMBS). It is submitted that the Australian taxation system should recognise the important role that securitisation plays in a competitive global market.

To recognise this role in the market, it is submitted that the taxation of interest income on debt instruments (including those issued by securitisation vehicles) should be taxed on a level playing field with other investments available to investors. The current taxation system provides incentives to invest in certain investments over others, based on their taxation treatment. In particular, the capital gains tax discount provides an incentive to invest in items taxed as capital (e.g. investment properties or shares) while the concessional tax rate applied to earning on superannuation investments provides an incentive for investors to contribute additional funds to their superannuation plans.

It is submitted that the interest on debt instruments issued by Australian based securitisation vehicles should be concessionaly taxed to ensure that securitisation vehicles are not at a competitive disadvantage relative to other investment opportunities available to institutional and other wholesale investors.

In addition, interest withholding tax on debt instruments issued by securitisation vehicles to non-resident investors should be automatically exempt from interest withholding tax to ensure that Australian based securitisation vehicles have access to global debt markets and access to funding at competitive rates.

To ensure the current momentum in the tax reform space is not lost, it is submitted that a taskforce should be established to monitor the implementation of current and future tax reform measures and be available to review the operation of Australia's taxation system in the future to recommend areas of reform to the Government, as a result of market and economic developments.

The role of securitisation in the market

The process of securitisation provides major banks, smaller Authorised Deposit-taking Institutions and non-bank issuer access to wholesale debt markets for their funding needs on competitive terms.

Securitisation is the process of converting a pool of cash flows into tradable securities. An originator transfers a portfolio of assets to a special purpose vehicle (**SPV**), such as a pool of loans or other receivables. The SPV then issues debt securities to investors to fund the purchase of the assets. The debt securities are secured by the assets transferred to the SPV. The cash flows on the underlying pool of assets are then used to fund the payment of interest and principal in relation to the debt securities issued by the SPV.

The separation of the securitised assets from the general assets of the originator provides risk separation for investors in the debt securities and, therefore, generally results in a higher credit rating on the debt securities which allows for lower interest margins.

The importance of securitisation has been recognised by the Australian Office of Financial Management, which has invested over $12 billion in debt instruments issued by securitisation in the last three years to ensure that competitive wholesale funding remained available to smaller financial institutions during the global financial crisis.

Tax policy considerations

In general, the ASF believes that the Australian taxation system should provide neutrality or a more balanced playing field for investors in choosing between different investment options. In particular, the taxation treatment of different investment options should not disadvantage investment products due to more advantageous taxation concessions being provided on certain investment options.

Australia's current taxation system creates a disincentive for investments in debt instruments, such as those issued by financial institutions and securitisation vehicles. There are two factors that give rise to this disincentive. Firstly, interest returns on debt instruments are taxed at higher rates than other investment options. Secondly, interest on debt instruments is subject to interest withholding tax when paid to a non-resident, unless they qualify for certain withholding tax exemptions.

Taxation treatment of debt instruments versus other investment options

Interest on debt instruments is currently taxed in the hands of investors at their applicable tax rate, without any tax concessions. This results in the interest income on the debt instruments being significantly disadvantaged when compared to other investment options, such as:

- Direct share investment – which may attract significant tax concessions in the form of the capital gains tax discount and dividend imputation credits
- Superannuation contributions – which results in the income on the contributions being taxed at the concessional tax rate of 15%
- Property investment – negatively geared investments provide a more tax effective investment as well as the capital gains discount.

The relative disadvantage faced by interest earning investments has been recognised in a number of reports and reviews, including:

- Federal Treasury's report entitled *Architecture of Australia's tax and transfer system* dated August 2008. In this report, it was noted that although Australia's top personal income tax rate was comparable to others within the OECD-10, Australia had a relatively high rate of tax on interest income.
- The Henry Review in its *Report on Australia's future tax system* dated December 2009 found that the tax outcomes for different types of savings vary considerably and results in tax being a factor in the investment decisions of Australians. As a result, the Henry review recommended that interest income (and certain other investment income) should attract a 40% tax discount.

The Federal Government has accepted the recommendation of the Henry Review in part, and has announced that a 50% tax discount will be introduced for interest income of up to $1000 from 1 July 2012. However, the announced discount is limited in its application and as yet, no legislation has been released.

It is submitted that the tax treatment of all interest income, including that earned on debt instruments such as those issued by securitisation vehicles, should be reviewed to ensure that the tax outcomes result in debt instruments are aligned to the tax outcomes on other investment options. In the context of securitisation vehicles, one approach may be for the introduction of a specific tax discount rate (and income cap) to apply to interest income earned by investors in debt instruments issued by securitisation vehicles. The discount rate (and cap) should reflect the nature of securitisation vehicles and investors.

Interest withholding tax on debt instruments

Interest paid on debt instruments to non-residents of Australia is currently subject to interest withholding tax at a rate of 10%, unless an exemption applies. An exemption is available where an Australian resident issues debentures that satisfy the public offer test in section 128F of the *Income Tax Assessment Act 1936* (**ITAA 1936**). In most cases, Australian financial institutions and securitisation vehicles are able to structure their funding programs to qualify for the exemption in section 128F of the TIAA 1936. However, this requires the issuing entity to meet certain conditions which increases the compliance costs for such entities. In the absence of the exemption, such entities would be required to compensate investors for the withholding tax cost which would place such entities at a competitive disadvantage relative to their global peers.

It is submitted that debt instruments issued by financial institutions and securitisation vehicles should be subject to an interest withholding tax exemption, without the additional requirements imposed by section 128F of the ITAA 1936 (or a substantially reduced withholding tax rate). This would provide for lower compliance costs and allow financial institutions and securitisation entities to issue debt to non-resident investors on more competitive terms. This should facilitate easier access by such entities to global capital markets.

Process for tax reform

The ASF recognises that in recent times a substantial amount of effort has been invested by the Federal Government in reviewing Australia's tax system, including the *Australian Financial Centre Forum* led by Mr Mark Johnson (the Johnson Report), the Henry Review and now the Tax Forum. The ASF welcomes and supports the Federal Government's tax reform initiatives. It is submitted that the focus on the implementation of recommendations which have been accepted by the Federal Government and the ongoing consultation on other recommendations is an important part of ensuring that there is continuous commitment and momentum on tax reform measures. It is also submitted that the ongoing review of Australia's tax system in response to market, economic and regulatory developments is an important element in enabling Australia's tax system to continue to be internationally competitive.

Establish a tax reform taskforce

It is submitted that the Federal Government should establish an independent taskforce with a mandate to review the implementation of specific announced tax reform measures and consider areas of the tax law that require review due to changing market and economic conditions. The taskforce should include government, industry and taxation advisers with appropriate qualifications and skills. The taskforce should ensure that the momentum gained during the recent tax consultation process is maintained and that reforms made as a result of the process are effectively implemented on a timely basis. The taskforce should also be used as an intermediary between the Government and external stakeholders, to enable ongoing consultation between interested parties.

While the Board of Taxation already has a role in this, a key difference between the Board of Taxation and the proposed tax reform taskforce is that the taskforce would have a mandate to review the progress of implementing announced tax reform measures and areas of the tax law based on consultation with relevant stakeholders taking into account market and economic developments. The Board of Taxation is responsible for undertaking reviews of specific areas of tax law as requested by the Government and developing a program of post-implementation reviews of recently introduced tax reform measures.

An alternative to the creation of a new taskforce would be to consider a broader mandate for the Board of Taxation to conduct reviews of areas of the tax system as necessary rather than as requested by the Government and also to monitor the progress of the implementation of announced tax reform measures.

We note that a similar taskforce was recommended (and accepted by the Government) for the financial services sector as part of the Johnson Report with a mandate to monitor the implementation of reform measures in the financial services sector and review existing tax policies which are relevant to financial services in light of market developments and tax related changes in other countries.

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