Attached is the draft brochure relating to the tax treatment of securitisation.

You are invited to send your comments on the attached draft brochure
on** or **before 31 October 2004 to:

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Due to time constraints it will not be possible to respond individually on comments received.

INVITATION FOR COMMENTS ON THE TAX TREATMENT OF SECURITISATION

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GUIDELINES

THE TAX TREATMENT OF SECURITISATION

SARS
At Your Service

This Guideline is a general guide dealing with the tax treatment of securitisation.

Although fairly comprehensive, it does not deal with all the legal detail associated with securitisation arrangements. It, therefore, serves the purposes of a guide only and should not be used as a legal reference.

The brochure is based on legislation as at 4 June 2004.

Should you require additional information you may:

- Contact your own advisors
- Contact the SARS Tax Avoidance Unit
- Visit the SARS website http://www.sars.gov.za

Prepared by
Law Administration
SOUTH AFRICAN REVENUE SERVICE
30 September 2004

GUIDELINES IN RESPECT OF THE TAX TREATMENT OF SECURITISATION

CONTENTS

1 Introduction

The South African Securitisation market developed in a short period to a level that took the United States and Europe years to reach. The market is currently characterised by a broad variety of transactions that provide new and diverse investment opportunities to investors in the capital markets.

This brochure has been written to assist assessors and advisors to understand the tax implications affecting securitisations, with reference specifically to the risks involved in Income Tax, Value-Added Tax, RSC Levies and Stamp Duty. It also addresses the risks for SARS and other creditors at liquidation of the originator.

2 Glossary

2.1 General

Credit derivative instrument

Any contract in terms of which the credit risk associated with a financial asset is isolated from the other risks associated with that financial asset and which credit risk is transferred from one counterparty, i.e. the protection buyer to another counterparty, i.e. the protection seller.

Credit Enhancement

A facility or arrangement in terms of which the provider of such facility or responsible entity under the arrangement is obliged to absorb losses associated with the pool of assets transferred in terms of a securitisation scheme.

Credit Rating

A rating assigned by a credit-rating agency to the commercial paper or other investment issued by a SPV in respect of a securitisation scheme.

Factoring

Transactions in which debts are sold at a discount to their face value, generally without recourse to the seller of the debts.

Issuer

The entity issuing commercial paper, usually the special purpose vehicle in a securitisation scheme, see special purpose vehicle.

Off-balance Sheet

Where a transaction and its financial effect are not in terms of generally accepted accounting practice required to be recorded as a liability on the relevant entity's balance sheet.

Originator

Institution or corporate transferring the assets in terms of the securitisation scheme into the special purpose vehicle.

Preference Share

A class of equity capital that ranks ahead of common shares in respect of dividends and the distribution of assets upon the dissolution or winding up of a company.

Receivables
A pool of trade debtors, loans, instalment sale agreements, lease agreements, bond payments and like cash flows packaged together and sold to a special purpose vehicle.

Servicer or Administrator
The entity that collects the income on the underlying assets on behalf of the SPV.

Special Purpose Vehicle* *(in the context of securitisation)*
A company incorporated or a trust created, insolvency-remote from the originator transferring the assets, and solely for the purpose of implementing and operating a securitisation scheme.

**SPV: Abbreviation for special purpose vehicle*

Subordinated Loan
A loan which usually carries a higher rate of interest due to it being subordinated in terms of risk (repayment) to other loans made to the special purpose vehicle in a securitisation scheme.

Synthetic Securitisation
A securitisation transaction in which the originator transfers to the Special Purpose Vehicle (SPV) credit risk in receivables by way of a credit derivatives contract, instead of transferring the receivables. For the transfer of credit risk, the originator pays to the SPV a risk premium. In essence, the SPV acquires credit risk on the assets by virtue of the credit derivative contract, and earns a risk premium for carrying the credit risk. Leaving aside the funding of the credit risk, the SPV acquires the risk/rewards of the credit assets of the originator: hence, these assets are supposed to have been "synthetically" transferred to the SPV. Such "synthetic transfer" is neither a transfer of the assets legally, nor in the accounting sense – it merely implies a risk-transfer transaction.

Trade debtors
Debtors created through the normal trading activities of an entity.

Traditional Securitisation
The packaging of individual loans and other debt instruments, converting the package into a security, enhancing its credit for the further sale to a third party, i.e. securitisation other than synthetic securitisation. Traditional securitisation is also referred to as "cash securitisation".

2.2 VAT Glossary

Exempt supplies

Those supplies that are not subject to VAT. Where a supplier makes an exempt supply, he may not claim any input tax in respect of goods and services acquired by him for the purpose of making exempt supplies.

Input tax
Any tax charged on goods and services purchased or acquired by a registered vendor wholly or partly for the purpose of making taxable supplies, including

- Any tax paid on goods imported by that person
- An amount of tax calculated by applying the tax fraction to a non-taxable supply of second-hand goods made to a registered vendor or to a repossession of goods.

Output tax

The tax charged by a registered vendor on any supply of goods and services made by that vendor (i.e. a supply made in the course or furtherance of carrying on an enterprise)

Taxable supplies

Any supply of goods or services made by a registered person in the course of any enterprise carried on by him. VAT can either be levied at the standard or zero rate.

Vendor

A person who is or is required to be registered under the Value-Added Tax Act 89 of 1991.

3 Background

3.1 What is Securitisation?

3.1.1 Traditional securitisation occurs when owners of periodical receivables, such as trade debtors, instalment sale agreements, lease agreements, bond payments and consumer loans, pool such receivables together in a package to sell to an entity established for the specific purpose of acquiring the receivables. The owner who sells the income streams is also known as the 'originator' and for purposes of this document the entity acquiring the right to the income will be referred to as the special purpose vehicle (`SPV').

3.1.2 The SPV raises the funds for the purchase of the receivables by issuing bonds or notes to third party investors. The SPV uses the income from the receivables to service the principal and interest payable on its bonds. The SPV's payment obligations are secured by the underlying receivables.

3.1.3 The originator and the SPV normally enter into an agreement in terms of which the originator will continue to administer and collect the receivables as agent or servicer for the SPV.

3.1.4 Certain mechanisms are implemented to ensure that the bonds or notes issued by the SPV acquire a credit rating suitable to investors' requirements. These are referred to as credit enhancement. The credit enhancement is quantified so as to satisfy the requirement of ratings agencies/investors for a target rating of the securities. The following paragraphs provide a brief background of such quantification or sizing of credit enhancement:

3.1.4.1 As the pool of assets of the originator has been isolated by way of legal transfer of the receivables, the assets in question do not suffer from the generic entity-wide risks of the originator's business. As such, the risks that the assets are subjected to are merely assets specific risks. These risks are analysed, based on the nature of the assets, either statistically, that is, based on past performance, or by reference to default probability of each individual component of the pool. Having thus established the "expected loss" of the pool, the credit enhancement is set to certain multiples of such expected loss to meet a particular rating objective.

3.1.4.2 Most securitisation transactions have various classes of securities with different ratings and therefore, these classes have different levels of credit enhancement. The various forms of credit enhancement could be broadly classified into (a) originator support; (b) third parties' support; (c) structural support. Originator support is credit enhancement provided by the originator, in various ways such as over-collateralisation (transfer of more receivables than paid for by the SPV), cash reserve (retention of cash by the SPV out of the moneys payable to the originator, either upfront or over a period of time), partial recourse, holding of a subordinated loan or any other subordinated security in the SPV, holding of preference shares in the SPV, etc. Third party support implies the buying of some form of guarantee, insurance or risk cover from external parties, such as banks, insurance companies, bond guarantors, etc. The ranking of various classes of securities among themselves provides credit enhancement. Each junior security, being subordinated to all its seniors, credit enhances the seniors. The junior-most provides credit support to all the securities, and is called the first-loss class.

3.1.5 The creation of a preference share structure as a credit enhancement structure is one in which the SPV issues preference shares to the originator. If the SPV has not performed as expected, the redemption of these preference shares equals the residual in the SPV after bondholders' claims have been met (might be less that than the purchase price). If the SPV has over performed, and there is excess residual it is paid as a dividend to the originator.

3.1.6 A synthetic securitisation transaction substantially differs from a traditional securitisation, primarily because the SPV does not buy the assets of the originator for cash as in a cash or traditional securitisation, but simply acquires credit exposure to the assets by way of a credit derivatives transaction. Therefore, its assets are primarily "synthetic assets", meaning the assets of the originator on which the SPV merely acquires credit risk. Hence, it does not need cash equal to the size of the assets on which it acquires the risk. Its funding needs are limited, usually, to the extent of credit enhancement required to raise the rating of the senior-most security to AAA. Therefore, the value of securities offered by the SPV in a synthetic transaction is much less than the size of the relevant asset pool. The funds raised by such security issuance are not paid off to the originator, but invested in safe external securities by the SPV, usually with an AAA rating, and these investments are collateralised in favour of the originator as a security interest to back up the credit derivative transaction.

3.2 Examples

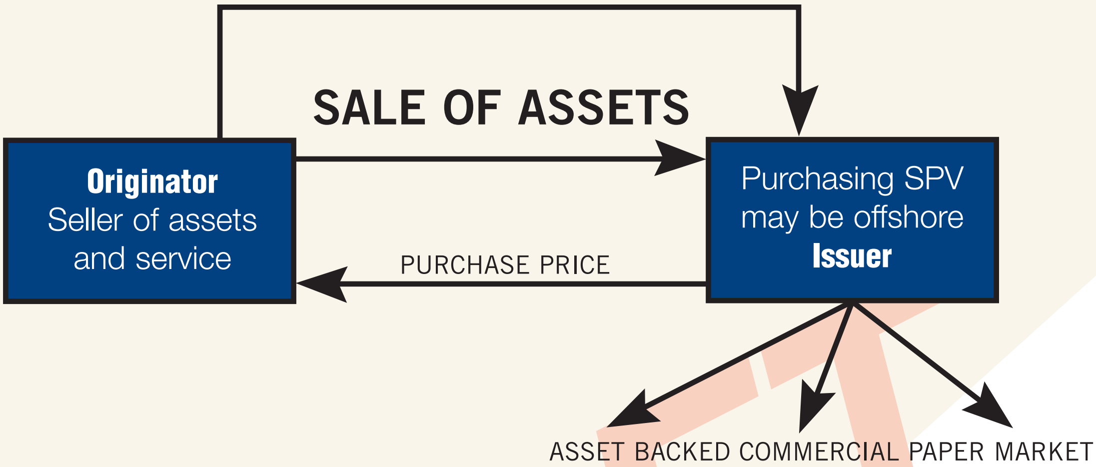
3.2.1 An example of a traditional securitisation of trade debts is e.g. where a company, (the originator) that carries on business in retail clothing, pools together all outstanding debtors that are e.g. older than six months and which will mature in, say, 18 months' time, and sell such debtors as a package to an unconnected company (the SPV) at a discount (calculated with reference to historical bad debts and the time value of money). The SPV raises the funds for the acquisition of the trade debts by taking up funds from investors by way of promissory notes or other commercial paper. The interest on these investments is serviced by the trade debts as and when they are paid. The investment is attractive to the investors as it is removed from the insolvency risks in the originator and because it is "enhanced" through loans from outside parties, risk insurance and subordinated loans from the originator and other parties. The investors mostly rely on the credit rating allocated to the investment by a reputable credit risk agency, such as Fitch, Standard and Poor, etc, to determine the soundness of the investment. The credit risk agencies take the factors listed above into consideration when allocating a risk rating to an investment in a securitisation vehicle such as the SPV in this example.

3.2.2 A simple example of a traditional securitisation of mortgage bonds is where a bank transfers a pool of identified and qualifying bonds to a SPV. Unlike the securitisation of trade debts which normally occurs at a discount, the securitisation of a bond book will usually be at a premium based on the fact that the future interest earnings on the book are also effectively included in the sale.

3.2.3 An example of a synthetic securitisation is where an originator holds a bond book of say, R100 million and enter into a credit derivative transaction transferring risk in the pool to the SPV. Let us suppose, given the loss history of the pool, a credit enhancement of 8% is sufficient to raise the rating of the securities of the SPV to AAA. We may then expect the SPV to issue securities of approximately 10% of the pool size, such that the top 2% is rated AAA based on the subordination of the remaining 8%. At this level, since the securities of the SPV are already rated AAA, the originator has achieved sufficient risk transfer to virtually remove the risk of the pool. Hence, here, the SPV will raise a funding of R10 million and invest the same, say, in government treasuries. These investments will be pledged with the originator as collateral for the credit derivative transaction. In this case, the income of the SPV will be (a) income from the investment in government treasuries; and (b) risk premium received from the originator. The expenses of the SPV will be the coupon paid to the various classes of securities.

3.2.3 Diagram

CREDIT ENHANCEMENT: GUARANTEE OR SUBORDINATED LOAN



3.3 South African Laws Governing Securitisation

3.3.1The Securitisation Regulations

3.3.1.1 There has been significant progress in regulating capital markets worldwide, i.e. the Basel Accord of 1988 drafted by a Committee consisting of members from the G10 countries. In the wake of the Basel II Accord the new Securitisation Regulations ("the regulations) promulgated in terms of the Banks Act,1990, bring South Africa's securitisation market up to speed with worldwide trends. The new regulations cater for a synthetic form of securitisation in addition to the traditional vanilla type of securitisation. The Regulations has been published in Government Gazette No 7975 of 4 June 2004.

3.3.1.2 A bank may accept deposits from the public, but may not partake in activities designated by the Registrar of Banks as falling outside the ambit of the business of a bank. Therefore if the SPV in a securitisation transaction conducts the business of a bank it will require a banking licence to do so. As a SPV raises funds from the public through note issues its activities may fall within the business of a bank. However, in terms of regulations issued in terms of the Banks Act, certain specific types of transactions are excluded from the business of a bank, i.e. the securitisation regulations of 13 December 2001(of which the said Regulations are the new version) and the Commercial Paper regulations of 14 December 1994. As long as a transaction complies with these regulations the SPV will not be deemed to be conducting the "business of a bank" and no banking licence will be required. When a banking licence is required the SPV will be subjected to banking regulation such as capital reservation, etc.

3.3.1.3 The effect of non-compliance with the regulations will be that the securitised assets will be reflected on the balance sheet of the bank concerned and chapter VIII of the Banks Act (dealing with capital adequacy requirements) will be applicable. In the case of non-compliance the regulations make, in addition to the above, also provision that the bank may be precluded from participating in future securitisation schemes and that potential additional capital reserving requirements be imposed. The regulations limit the activities of the SPV to transactions relating to a traditional or a synthetic securitisation scheme.

3.3.1.4 The new regulations deal specifically with synthetic securitisations, i.e. the transfer of credit risk. There are separate definitions for traditional securitisation schemes and synthetic securitisation schemes:

1 A traditional securitisation scheme is defined as a scheme whereby a SPV:

- issues commercial paper to investors; and
- uses the proceeds of such issue primarily to obtain assets; and
- makes payments primarily in respect of the commercial paper so issued or to an institution acting in a secondary role from the cash flows arising; or proceeds derived from the assets; or from facilities granted to the SPV by an institution in accordance with the provisions of the regulations.

2 A synthetic securitisation scheme is defined as a scheme whereby a SPV:

- issues commercial paper to investors; and
- uses the proceeds of such issuance primarily to obtain credit-risk exposure and assets that serve as collateral; and
- makes payments primarily in respect of the commercial paper issued or to an institution acting in a secondary role from the cash flows arising from the assets that serve as collateral and from the fees and/or premium paid to the SPV by an institution acting as an originator, remote originator or repackager.

3.3.1.5 The regulations introduce new transfer requirements in respect of both traditional securitisations and synthetic securitisations which include:

Traditional securitisations:

- The transfer of assets shall totally divest the transferring institution and all its associated companies;
- The SPV shall have no right of recourse against an institution acting in a primary role or any of its associated companies;
- No transferred allowed if the transfer will result in a breach of any of the terms of the relevant underlying transaction;
- A bank acting in a primary role may repurchase assets from a SPV only when such repurchase is conducted on market-related terms and conditions and there is no prior obligation to repurchase;
- Legal certainty relating to limiting of association of assets obtained through a legal opinion.

Synthetic securitisations:

- A bank may replace at its own discretion, the risk relating to any asset transferred in terms of a synthetic securitisation scheme, excluding the risk relating to a non-performing asset, with the risk relating to an asset of equivalent credit quality;
- Provisions relating to total divesture, no recourse against transferor and no transfer in breach of underlying transaction and limitations on substitution of reference asset, set out for traditional securitisation schemes apply mutatis mutandis;
- Regulates investment by banks as originator in notes issued by SPV to create market discipline.

3.3.2 Accountancy statements 133 and 412

3.3.2.1 Accounting standard AC 133 deals with accounting for financial instruments, including recognition and de-recognition thereof. Financial instruments include "financial assets" and "financial liabilities". If the assets transferred by an originator in a securitisation transaction are "financial assets", then the accounting standard is applicable to determine whether the transaction of securitisation will lead to de-recognition of the asset in question. In general, if the assets in question is a "financial asset" (for example, physical assets are not financial assets, neither are future receivables not currently on the balance sheet), and there is a "transfer" thereof (for example, there is no transfer in case of a synthetic securitisation), an off-balance sheet treatment is granted by permitting de-recognition of the asset. In order to de-recognise, the standard adopts a components approach, that is, it looks at the various components of a financial asset and de-recognises those that have been transferred, even if the asset has not been transferred in totality. If there is a transfer of the asset or its components, the next obvious question is whether there is a gain or a loss on such transfer. There are detailed rules as to fair valuation of the transferred components, retained components, estimation of the carrying value (book value) of the transferred components, and hence, computation of the gain/loss on sale. A gain/loss on sale is booked as a regular revenue income.

3.3.2.2 In terms of AC 412 SPVs are to be consolidated by an enterprise that controls the vehicle in substance with the objective of obtaining benefits from its activities. Consolidation of the SPV relies on the extent that a participant has provided the majority of the assets and/or credit enhancement, and enjoys the majority of risks or rewards. Application of AC 412 will require the consolidation of the SPV by one of the parties in almost all structures, with the possible exception of multi seller conduits.

3.3.3 The Companies Act 61, 1973

If the SPV is a company, this act will be applicable in respect of the incorporation of a SPV in South Africa and the issuing by the SPV of asset backed securities such as debentures.

3.3.4 Trust Property Control Act 57, 1988

This act will be applicable to the SPV if it is a trust.

3.3.5 Institutional Investors

The following legislation may be applicable to institutional investors in the SPV:

3.3.5.1 Collective Investment Schemes Control Act, 2002
3.3.5.2 Pension Funds Act 24, 1956;
3.3.5.3 Long-term Insurance Act, 1998;
3.3.5.4 Short term Insurance Act, 1998;
3.3.5.5 Financial Markets Control Act, 1989.

4 Commercial reasons for/benefits of securitisation

4.1 Securitisation is motivated by the following economic merits usually unrelated to tax benefits:

4.1.1 reduced financing costs – by creating tradable securities out of financial claims, securitisation helps to create markets in claims which would, in its absence, have remained bilateral deals, in the process securitisation makes financial markets more efficient;

4.1.2 diversifies funding resources – securitisation creates an alternative to borrowing;

4.1.3 assists with effective risk management – it allows originators a way of disposing of credit, interest rate and country risk by way of selling certain assets (cash flow streams).

4.1.4 Possible off-balance sheet treatment. If the transaction is afforded off-balance sheet treatment for accounting purposes, the originator is able to raise cash without the proceeds appearing as secured financing on its balance sheet. However, AC 133 (Recognition and measurement of financial instruments) and 412 (Consolidation of special purpose entities) make it difficult to obtain the off-balance sheet treatment. Securitisation can also be a means to boost corporate earnings, such as where a gain on sale can be recorded pursuant to a transfer of an asset or its components.

4.2 On the other hand investors regard the benefits and low risk created by the insolvency remote SPV's, indicated by a favourable credit rating from rating agencies as attractive investments. The pool of receivable assets is segregated in a manner that is intended to insulate them from any future bankruptcy of the originator.

5 Income Tax Risk of Securitisation

5.1 The income tax risk in securitisation lies in the situation where a originator claims that a true sale has been effected, but effectively retains the control in respect of the stream so as to:

(i) enable him to manipulate the securitisation arrangement to his advantage by claiming deductions in respect of the assets; or

(ii) allowing the income to revert back to itself should it be in its interest, e.g. could be structured in a non-taxable way such as dividends on preference shares;

(iii) protect and benefit certain creditors (who are party to the securitisation scheme) at the cost of SARS as a creditor, by divorcing the originator-taxpayer from its assets to which claim could be made in the liquidation process, should the originator be liquidated subsequent to the securitisation.

5.2 The following situations may be also be contemplated where securitisation transactions may be used as devices of tax planning/avoidance:

(a) Where there is an Offshore SPV: The impact of a securitisation is to transfer an income from the hands of the originator to the hands of the SPV – leaving the Revenue tax-neutral. However, if the SPV is an offshore (usually tax haven jurisdiction) entity, there is a potential loss of tax revenue.

(b) Where the SPV is taxed at a lower effective rate of tax than the originator: Any possibility of lower effective rate could encourage transfers of income.

(c) Where there is a change in the nature of the income, that is, from revenue to capital income: Normally, securitisation relates to financial assets which are trade assets, on sale of which a revenue income will arise. However, if there is a contention that the resulting income is a capital receipt or a capital gain, there is a potential loss of tax revenue.

5.3 There is no specific provision in the Income Tax Act ("the Act") that regulates the treatment of securitisation issues and general principles in respect of accrual, deductions, losses, bad debts, wear and tear, etc are to be applied to securitisation.

5.4 The following are the aspects that need to be focussed on to determine the tax risks in a traditional securitisation:

5.4.1 The nature of the selling price in the originator's hands, i.e. revenue or capital and if revenue the time of the incurral/accrual of loss/profit and the calculation of the quantum of such amount;

5.4.2 The nature of the debts in the hands of the SPV, i.e. revenue or capital, and the time of the incurral of the discount in respect of the purchase price;

5.4.3 Are the receivables trading stock in the hands of the SPV?

5.4.4 Whether the SPV is entitled to a bad debt allowance in terms of section 11(i) of the Act;

5.4.5 Whether the SPV is entitled to a doubtful debt allowance in terms of section 11(j) of the Act.

5.3.6 Whether a loss suffered by an originator in respect of a subordinated loan to the SPV will qualify as deductible.

6 Tax Treatment of a True Sale: Originator

6.1 Nature of Selling Price of Receivables in Originator's Hands

6.1.1 The principles emanating from the body of jurisprudence that has built up as the courts have interpreted the distinction between revenue and capital are applicable. The starting point is usually taken to be the intention of the taxpayer. If the taxpayer is intent on conducting a scheme of profit-making the receipt will be of a revenue nature. In this regard it can be stated that usually if the cash flows sold form part of the originator's on-going business, the gain or loss on sale will be of a revenue nature. Refer *ITC 317*, 8 SATC 171.

6.1.2 However, where a taxpayer sells its cash flows at face value this may be a factor indicating that that the taxpayer had no intention of making a profit and that factors such as separating the taxpayer from its assets to protect it or certain creditors in case of liquidation may have played a role in the securitisation.

6.1.3 However, if the cash flows sold form part of a transaction in respect of which the originator has substantially sold his "business" through a securitisation, capital treatment may be attainable. Refer *ITC 223, 6* SATC 150; *ITC 466*, 11 SATC 251. Where promissory notes are capital in the hands of the person receiving the discount, the loss upon sale was held to be of a capital nature. Refer *ITC 968* 24 SATC 726.

6.1.4 Also, where the discount on the purchase price is effectively a guarantee by the originator for bad debts, e.g. by taking back unremunerative contracts after a specified time, the court held that it effectively amounts to the reduction of the purchase price to the purchaser company and where the purchase price is of a capital nature this "discount" will also be of a capital nature and not deductible. In circumstances however, where the purchase price is of a revenue nature such a "discount" will be an allowable deduction incurred in the production of income. Refer *ITC 466* 11 SATC 251.

6.1.5 While there are no tax court cases on securitisation or factoring, case law dealing with discounting of promissory notes supports the position that discounts pursuant to factoring transactions are revenue in nature – irrespective if the intent is to raise capital. Refer *ITC 1628*, 60 SATC 33, *CSAR v Creative Productions (Pty) Ltd*, 61 SATC 106, 1999 2 All SA 14 (N).

6.2 Time and Amount of Incurral of Loss/Discount and Time of Accrual of Gain/Premium in respect of the Purchase Price

6.2.1 If the transaction qualifies as a sale for tax purposes, any revenue gain (premium) on the sale of the income stream will form part of gross income and be recognized on the date of transfer by the originator, in terms of the definition of gross income in Section 1 of the Act.

6.2.2 Likewise any loss (discount) on the purchase price will effectively be a deductible expense incurred in the production of income in terms of section 11(a) of the Act.

6.2.3 Subject to section 24J (4) providing for an adjusted gain or loss, section 24J does not find application in respect of either a gain/premium or loss/discount as there is no continuing relationship between the originator and the SPV in a true sale that, considers the time value of money over a future period of time. Stated differently there is no "instrument" between the originator and the SPV as defined in section 24J to which the provisions of the section can be made applicable. Even if the discount qualifies as interest which may have the effect that the originator may be an "issuer" as defined, the arrangement between the originator and the SPV does not meet the definition of an instrument in section 24J: "Instrument" means any form of interest-bearing arrangement, whether in writing or not, including (d) any … disposal of any right to receive interest …, in terms of any other interest-bearing arrangement.

6.2.4 The agreement in a true sale in terms of which the originator disposes of his right to receive interest from the borrower is an out and out sale of the originator's future income from interest and can therefore not be regarded as an interest-bearing arrangement from the perspective of the originator.

6.2.5 One needs to evaluate the premium/discount to determine that it has been fairly calculated. The premium/discount could include adjustments for impairment (receivables considered not to be recoverable over the term of the structure) and present value (discounting of amount that would have been received by the originator over the period). A like calculation will be completed for accounting purposes. However, the accounting gain/loss may differ from the tax gain/loss where the opportunity of earning income from servicing the receivables is regarded as a "servicing asset" for accounting purposes.

6.2.6 As tax rules do not have a concept where one can recognise the intangible servicing asset, the entire value is allocated to the receivable asset at transfer date resulting in an amount of the premium or the discount that differs from the accounting value. Servicing income is recognised for tax purposes as gross income received or accrued. Tax Officials should be alerted to the fact that when they do their calculation from the financial statements of the taxpayer and use the accounting gain/loss as starting point a tax calculation will have to be done.

6.2.7 This will entail that in the instance of a premium paid by the SPV to the originator, the taxable accrual will be reduced with the amount allocated to the servicing asset and in the instance of a discount the deduction will be increased with the amount allocated to the servicing asset for accounting purposes. Currently it is common for a nil value to be allocated to the servicing asset and the above issue will not ensue, however allocation between the receivable asset and the servicing asset is required by GAAP and future tax calculations may be affected.

6.3 Bad Debt Deductions

6.3.1 Bad debts are only deductible if the criteria set out in section 11(i) have been met, i.e. it must have become bad during the year of assessment in which it is sought to be deducted and it must have been included in the taxpayer's income during that year of assessment or any previous year of assessment.

6.3.2 Where the originator sold the receivables he will have to claim bad debts up to that date, as future bad debts will have to be claimed by the SPV. The SPV will not be able to claim bad debts in respect of the amounts of the receivables transferred. The discount usually accounts for any built-in bad debts, therefore no further bad debts can be claimed by the originator. Interest accrued to the SPV which becomes bad may be claimed as a bad debt deduction.

6.3.3 If the originator retains the risk of bad debts, it cast doubts as to whether a true sale was intended. In ITC 466, 11 SATC 251 it was held that a loss suffered by the Seller (originator) in respect of a guarantee was in effect a capital loss as the Seller had entirely given up its business in such contracts, and what it was doing by taking back bad debts under the guarantee was to reduce the purchase price to the purchaser company which was in this instance of a capital nature.

6.4 Service and Administration Fees

Any servicing and administration fees received will be for services rendered, and therefore subject to income tax in terms of definition of gross income in section 1 of the Act.

7 Tax Treatment of a true sale: Special Purpose Vehicle

7.1 Nature of Purchase Price of Receivables in SPV's Hands

The fact that the purchase price is capital or revenue in the hands of the originator does not dictate that it will have the same nature in the hands of the SPV. The standard tests have to be applied to determine whether the acquisition of the right to the income streams is of a revenue or a capital nature and deductible or not in the SPV's hands.

7.2 Time and Amount of Incurral of Premium and Time of Accrual of Discount in respect of the Purchase Price in the hands of the SPV.

7.2.1 Will the SPV have to recognize a discount (where the maturity value exceeds the purchase price) or premium (where the purchase price exceeds the maturity value) at the time of the acquisition or will section 24J apply enabling the SPV to spread the gain over the period of the instruments? Although the arrangement between the originator and the SPV cannot be regarded as an interest-bearing arrangement the SPV does in a true sale step into the shoes of the originator and became the "holder" of the instrument in respect of the original borrower.

7.2.2 Prior to the sale by the originator to the SPV, the originator was the "holder " in respect of the instruments and the original borrowers were the "issuers" and therefore section 24J was applicable. The originator was entitled to interest in terms of such income instrument.

7.2.3 After the sale by the originator to the SPV, the borrower is still the "issuer" of the original instrument and his accounting under section 24J should not be impacted by the securitisation. The SPV steps into the shoes of the originator and becomes the "holder" and a newly calculated discount/premium should be accounted for pursuant to section 24J by the SPV. The new calculation takes into account the premium/discount paid by the SPV and will not equal the amount calculated by the originator in terms of section 24J.

7.2.4 This creates a mis-match between the originator and the SPV. If it is a discount, the mis-match is negative as the originator will deduct the discount at the time of the sale agreement whilst accruals to the SPV will only be over the term. On the other hand if it a premium, the mis-match is positive as the income is included in the taxable income of the originator at the date of the sale and is only allowed as a deduction to the SPV over the term.

7.3 May the Receivables be treated as Trading Stock in the Hands of the SPV?

7.3.1 Officials should be alerted to the possibility that SPV's may attempt to treat the receivables as trading stock with the benefits of accompanying such treatment.

7.3.2 "Trading stock" is defined in section 22(1) to include:

(a) anything –

(i) produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purpose of manufacture, sale or exchange by him or on his behalf; or

(ii) the proceeds from the disposal of which forms or will form part of his gross income;

7.3.3 In *De Beers (Pty) Ltd v CIR* 1986 (1) SA 8 (A) it was held that the definition of "trading stock" as it then stood should be divided into two parts, (an additional part has now been added, but has no relevance to the present debate, as it deals with goods acquired for use/consumption in a taxpayer's trade). The first part being anything produced, manufactured, purchased or in any other manner acquired by a taxpayer for the manufacture, sale or exchange; and the second part being anything the proceeds form the disposal of which will form part of gross income.

7.3.4 Securitisations should not fall within the first part of the definition, as generally, the receivables are not acquired for use in manufacture, or to be sold or exchanged. In order for securitisations to fall within the second part, it must be shown that:

- there are proceeds
- from a disposal
- and that these proceeds form part of gross income.

7.3.5 It could be argued that there are "proceeds" each time a payment from the underlying receivables are collected, and that these "proceeds" would form part of gross income. However, these receipts cannot be terms as "disposals" as the disposal took place at the time the SPV acquired the pool of receivables.

7.3.6 The SPV will not be able to contend that the debts which it holds are held to be sold or exchanged or, if they are not, that a "disposal" of them takes place "the proceeds" will form part of its gross income. Refer *Syfrets Participation Bond Managers Ltd v CSARS*, 63 SATC 1 SCA.

7.4 Bad debt Deduction/Losses

7.4.1 Section 11(i) provides for a deduction in respect of bad debts due which have become bad, provided the debt has previously been included in the taxpayer's income. This provision will not be afforded the SPV, as debts have not previously been included in the SPV's income.

7.4.2 However, if the SPV qualifies as a moneylender, the SPV may qualify for an allowance in respect of doubtful debts in terms of the provisions of section 11(j) of the Act. This allowance, based on the discounted value if any, is subject to the Commissioners discretion and must be added back to income in the following year and a fresh allowance will be considered annually.

7.4.3 Should the amounts prove to be unrecoverable it will be allowed as deductions in terms of section 11(a) of the Act if the SPV qualifies as a moneylender – refer to the guidelines laid down in the minority judgment in *Solaglass Finance Co Ltd v* CIR 1991 (2) SA 257 (A).

7.4.4 Specific issues to consider in the context of securitisation are:

- Was the originator a "moneylender", and if so, has the SPV stepped into the originator's shoes;
- Who owns the receivables;
- Has there been discrimination in the original lending policies, or were funds lent to all who were eligible;
- Does the originator have the ability to substitute or repurchase the "bad" assets?
- Are there policies and procedures in place to regulate future lending and collection activities – even if the originator's are utilised;
- Is this a major portion of the SPV's activities;
- Is there a frequent turnover of the capital – are the assets short-term.

7.4.5 The mere fact that the SPV stepped into the shoes of a moneylender originator does not necessary mean that the SPV qualifies as a moneylender as the SPV itself must pass all the requirements for qualification as a moneylender.

7.5 Servicing and Administration Fees

The fees will be deductible by the SPV in terms of section 11 provided that they are market related. Excessive fees should be disallowed on one of the following usual grounds:

- that it is not incurred in the production of income;
- that is not in substance payment for services rendered.

7.6 Interest on the Commercial Paper and Senior Loans

This interest will be deductible in the normal course of events in terms of section 11(a) and the time of incurral will be in accordance with the provisions of section 24J.

7.7 SPV in foreign location

If the SPV is a non-resident, it will be subject to the income tax law of its country of residence and possibly to the provisions of section 9D of the Income Tax Act apply. This will be the case if a South African resident, i.e. the originator holds more than 50% of the participation rights in the capital, profits or reserves of the entity.

8 Income Tax Treatment if Securitisation a Loan

8.1 Originator

8.1.1 Nature of amount received from SPV

If the transaction does not qualify for sale treatment for tax purposes, gains or losses premium or discount) will not be recognised on the date of transfer by the originator as it will be treated as financing and the originator should be allowed an interest rate deduction on the loan from the SPV. The interest rate should be calculated with reference to the cost of funds which will be related to the external interest rate.

8.1.2 Bad Debt Deductions

If the transaction does not qualify for sale treatment, the originator will be allowed to continue to claim the bad debt deductions. These deductions will only be available to the originator as only the originator will comply with the requirement of section 11(i), i.e. the debt must have been included in the taxpayer's income.

8.1.3 Interest on the Commercial Paper and Senior Loans

Section 11(a) read with section 24J will be applicable.

8.2 SPV

8.2.1 Nature of amount paid over to Originator

The SPV will not recognize an unrealised gain or loss on the "acquisition" of the receivables. The definition of income and section 24J will be applicable to the SPV as holder of the financial instrument. Section 11(a) and section 24J will be applicable to the SPV as issuer in respect of the bondholders/investors.

8.2.2 Bad debt deductions

No bad debt allowance will be allowed to the SPV as the debt is not owned by the SPV.

9 VAT Risk in Securitisation

9.1 The claiming of an input deduction on bad debts transferred by the vendor (the originator) without recourse;

9.2 The claiming of an input deduction on bad debts acquired by a vendor (SPV) at face value and without recourse that exceeds the amount paid by the vendor (SPV) in respect of the face value) in contravention of section 22(1A) of the VAT Act.

9.3 The claiming of an input deduction on bad debts acquired by a vendor (SPV) at face value and without recourse that exceeds the amount paid by the vendor (SPV) in respect of such face value)

9.4 The claiming of input tax in respect of supplies that are exempt, i.e. the sale of book debts, granting of loans and the issuing of preference shares (all deemed to be financial services and exempt).

10 Value Added Tax Treatment

10.1 Overview of VAT cycle

A short and general synopsis of a cycle of VAT transactions entered into by a registered vendor is set out below.

Vendor A purchases goods for cash from vendor B to enable vendor A to manufacture a product. Vendor A would be entitled to an input tax deduction based on the fact that he has purchased goods for the purpose of making a taxable supply. Vendor A must however be in possession of a valid tax invoice in order to claim the input tax. Vendor B would account for output tax on the supply. When vendor A supplies his product, he must account for output tax irrespective of whether he supplies the product to a vendor or non vendor. In the event that vendor A supplies his goods on credit, output tax must still be accounted for. Where vendor A decides to sell his book debts to an SPV (i.e. a securitisation), the supply of the book debts would be exempt for VAT purposes.

10.2 Tax Treatment of Originator

10.2.1 Disposal of the Loan Book without Recourse
Section 2(1) of the Value-Added Tax Act 89 of 1991 ("the VAT Act") provides as follows:

"For the purposes of this Act, the following activities shall be deemed to be financial services -
"the issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security…"

Furthermore, a debt security is defined as
"an interest in or right to be paid money; or
an obligation or liability to pay money that is, or is to be, owing by any person, but does not include a cheque;…"

It is apparent from the above that the disposal of the loan book falls within the ambit of the section 2(1)(c) of the VAT Act. In terms of section 12(a) as read with section 2(1)(c) of the VAT Act, the supply is accordingly exempt.

Bad Debt Deduction
In addition, in terms of section 22(1)(iv)(aa) of the VAT Act -

"a vendor who has transferred an account receivable at face value on a –
(aa) non recourse basis to any person, shall not make a deduction in respect of such transfer in terms of this subsection.."

The originator is therefore not entitled to any input tax deduction in respect of any loss suffered in the transfer of the accounts receivable to the Issuer.

10.2.2 Disposal of the Loan Book with Recourse
The VAT implications of the disposal of the loan book as discussed above, are applicable in this scenario.

Bad Debt Deduction

However, where the loan book is transferred on a recourse basis, section 22(1)(iv)(bb) of the VAT Act provides that-

"a vendor who has transferred an account receivable at face value on a (aa)...

(bb)recourse basis to any person, may make a deduction in terms of this subsection only when such account receivable is transferred back to him and he has written off so much of the consideration as has become irrecoverable..."

Accordingly, the originator is only entitled to the input tax deduction when the debts revert to him and not anytime prior.

10.2.3 Disposal of loan book at face value

In terms of section 22(iv) of the VAT Act, the originator can only claim a bad debt deduction when the debts are written off if sold on a recourse basis. The originator is not entitled to a bad debt deduction if the accounts receivable are sold on a non-recourse basis. It must be borne in mind that a vendor is not entitled to claim input tax twice in respect of the same bad debts that are transferred to a recipient on a recourse basis.

10.3SPV conducting an enterprise

10.3.1 In order for the SPV to be regarded as conducting an enterprise for VAT purposes, it has to carry on an activity, continuously or regularly either in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit.

10.3.2 Once it has been determined that the SPV is carrying on an enterprise, the next issue to consider is whether the SPV's taxable supplies exceed R300 000 per annum. Should this be the case, the SPV would be liable to register as a VAT vendor. However, the SPV may register voluntarily should its taxable supplies exceed R20 000 per annum.

10.3.3 Bad Debts

Recourse Basis

Should the SPV be registered as a vendor, and it purchases book debts on a recourse basis, it will not be entitled, in terms of section 22(iv) of the VAT Act, to an input tax deduction in respect of that portion of the debt that has gone bad as the debt will be transferred back to the originator. The originator in this case will be entitled to the input tax claim in respect of the bad debt.

Non-Recourse Basis

- Where the SPV (a VAT vendor) purchases debts at face value on a non-recourse basis and the face value (i.e amount paid by the SPV) or a portion thereof is written of as bad (excluding any amount of finance charges or collection costs), section 22(1A) of the VAT Act is applicable. In this instance, the SPV may claim input tax based on the face value of the debt (limited to the amount paid by the SPV in respect of such face value) written off.

In other words, in the event that the SPV purchased the accounts receivable at a premium, it will, in most instances, be entitled to the bad debt deduction based on the value paid for the book debts in terms of section 22(1A) of the VAT Act.

- Where the SPV purchases debts at a discount on a non-recourse basis and the amount or a portion thereof is written off as bad, section 22(1A) of the VAT Act is applicable. In this instance, the SPV may claim input tax based on the discounted value of the debt written off. In other words, would the debts have been purchased at 90% of its value, the bad debt deduction will be calculated by applying the tax fraction to the value paid for the debts, i.e. 14/114 X 90.

10.4Supplies falling outside the ambit of financial services

In certain instances, the "transfer" of a financial service in terms of section 2 of the VAT Act, will not fall within the ambit of exempt supply. These exceptions are set out in section 2(4) of the VAT Act which provides as follows:

"....the term "financial services" does not include –

(a) the cession, assignment, transfer or other supply of any right to receive payment in relation to any taxable supply where, as a result of any such cession, assignment, transfer or supply, output tax in relation to that taxable supply would not be or become attributable to any tax period...

(b) the transfer of any interest in or right to be paid money that is, or is to be, owing by any person under a rental agreement; or

(c) the transfer of any interest or right to be paid money that is, or is to be, owing by a share block company under its loan obligation....to any person who is or will be a shareholder of such share block company..."

The aforementioned supplies would be subject to VAT and output tax must be accounted for in respect thereof.

10.5Granting of Loans

The granting of a loan falls within the ambit of section 2(1)(f) of the VAT Act which provides as follows –

"2(1) For the purposes.........

....

(f) the provision by any person of credit under an agreement by which money or money's worth is provided by that person to another person who agrees to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money's worth..."

Again, section 2(1)(f) must be read in conjunction with section 12(a) of the VAT Act. Accordingly, the supply is exempt for VAT purposes.

10.6 Issuing of preference shares

Section 2(1)(d) of the VAT Act provides as follows:

"(1) For the purposes.........

(d) the issue, allotment or transfer of ownership of an equity security..."

An equity security is defined as

"...any interest in or right to a share in the capital of a juristic person..."

The issue to be considered is whether the preference share falls within the ambit of an equity security.

It is apparent that the preference shares that may be issued by the Issuer falls within the ambit of section 2 (1)(d) of the VAT Act. Accordingly, the issue of the preference shares would be exempt in terms of section 12(a) as read with section 2(1)(d) of the VAT Act.

10.7 Administration fee

10.7.1 The issue to be considered is whether the absence of an administration fee or a fee that is charged that is less than the open market value in respect of the services rendered by the originator to the Issuer would attract any VAT implications.

10.7.2 If a fee is not charged or if it is charged at less than the open market value, one needs to determine if the Issuer and the originator are connected persons in terms of section 1 of the VAT Act. Should the parties fall within the ambit of "connected persons", it must be determined whether the recipient of the supply is entitled to a full input tax deduction.

10.7.3 In short, should the recipient not be entitled to a full input tax deduction, and it has been determined that the parties are connected, the supplier must account for output tax on the open market value of the supply.

10.7.4 "Connected persons" is defined as

"…..

(d) any company (other than a close corporation) and-

(i)…

(ii) any other company the shareholders in which…..are substantially the same persons as the shareholders in the first-mentioned company, or which is controlled by the same persons who control the fist-mentioned company.."

To determine if the originator and the Issuer are "connected persons", all dealing must be evaluated including preference share and ordinary share holdings.

10.7.5 Should the number of preference or ordinary shares issued by the Issuer to the originator result in the 2 entities falling within the ambit of "connected persons", the supply by the originator of administration services at no fee, or at a fee which is less than the open market value, will be regarded for VAT purposes as being made at the open market value in terms of section 10(4) of the VAT Act. The Originator would therefore have to account for output tax on the open market value of the supply.

Alternatively, should the two entities not fall within the ambit of "connected persons", the supply of the administration services (excluding the recovery of costs) will be regarded as being supplied for no consideration. Where an administration fee is not charged, , the value of the supply will be deemed to be nil in terms of section 10(23) of the VAT Act.

10.7.6 The proviso to section 2(1) of the VAT Act provides as follows:

"Provided that the activities contemplated in paragraphs (a), (b), (c), (d) and (f) shall not be deemed to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant's discount or similar charge, excluding any discounting cost."

It is therefore essential to determine whether any fee, commission etc has been disguised as a financial service or whether such fee etc is in fact a discounting cost. As stated in the proviso to section 2 of the VAT Act, such disguised fee (excluding the discounting cost) will in fact be taxable.

10.8Recovery of costs

If the originator is entitled to recover from the Issuer any out-of-pocket expenses reasonably incurred by it in rendering the collection services, the recovery of funds by the originator will be subject to VAT at the standard rate as the originator will be regarded as supplying a service to the Issuer when rendering the collection service. The originator would therefore have to account for output tax on the supply.

11 RSC Levies

11.1RSC Levies Risk: Establishment Levy

11.1.1 Where originators trade in the pooling and selling of debt books they are subject to RSC Levy;

11.1.2 Offshore SPV's that is managed and controlled in South Africa should be identified as they are subject to RSC Levies in South Africa.

11.2General

The Regional Service Councils Act 109 of 1985 makes provision for the levying of two separate levies. These are the regional services levy (the `payroll tax') and the regional establishment levy (the `turnover tax'). The ways in which these levies are to be calculated and paid were promulgated by the Minister of Finance in GN R 340 in *Government Gazette* 10613 of 17 February 1987.

11.3The Originator: Establishment Levy

11.3.1 The establishment levy is payable by every person carrying on or deemed to be carrying on an enterprise. An enterprise includes any trade, business, profession or other activity of a continuing nature, whether or not it is carried on for the purpose of deriving a profit.

11.3.2 The establishment levy must be calculated and paid on the leviable amount in relation to the leviable transactions in respect of each month. Leviable transactions are:

- in the case of an enterprise in the course of which goods are normally sold, any sale of goods under an agreement of sale concluded in the ordinary course of the enterprise;
- in the case of an enterprise in the course of which fixed property is normally sold, any sale of fixed property situated within the region under an agreement of sale concluded in the ordinary course of the enterprise;
- in the case of an enterprise in the course of which goods are normally let, the letting of goods;
- in the case of an enterprise in the course of which fixed goods are normally let, the letting of fixed property in the region;
- in the case of an enterprise in the course of which any trade, business, professional or other service is rendered, any such service rendered.

11.3.3 Applied to the facts of a typical securitisation, it appears unlikely that the sale of the income stream by the originator in a securitisation will attract Regional Establishment Levies in terms of the above list of leviable transactions. This is because of the fact that the originator, although it may derive income from the sale (e.g. on suspensive sale agreements/instalment sale agreements) of assets, does not normally trade in the pooling and selling of its debt book. The sale of its debt book is therefore not normally concluded as a sale in the ordinary course of an enterprise in the course of which goods are normally sold.

11.4The Special Purpose Vehicle: Establishment Levy

11.4.1 Certain financial transactions carried out by financial enterprises are regarded as leviable transactions. Falling within the definition of a 'financial enterprise' are the following institutions: Banking institutions, Unit Trusts, Long-term insurers, Short-term insurers, Pension and Provident funds, Retirement annuity funds, Benefit funds,, Medical Benefit Funds, Financiers, Buying associations and similar institutions, or any enterprise in the course of which financial assets are traded in or any company which carries on business as an investor of money.

11.4.2 The leviable transactions performed by financial enterprises are the following:

- the granting of any loan, advance, or credit, including the granting of credit under a credit agreement as defined in section 1 of the Credit Agreements Act;
- the investment in funds;
- the letting of goods or fixed property (excluding the letting of goods under "financial leases' as defined in
- the Credit Agreements Act);
- the rendering of any banking, financial or other investment services;
- The purchase, sale or discounting of or otherwise dealing in financial assets;

11.4.3 From the above is clear that the SPV will normally be subjected to RSC Levies.

11.4.4 Occasional financial transactions carried out by enterprises that are not 'financial enterprises' as defined are not leviable. The definition of a 'leviable transaction' makes no mention of financial transactions, such as borrowing or lending, that are carried out by an enterprise which is not a financial enterprise.

11.4.5 As only enterprises within a region or enterprises deemed to be carried on within a region in South Africa are subject to RSC levies an offshore SPV will not be subject to RSC levies. The "deeming" provision will have the effect that an offshore enterprise (constitutes a financial enterprise) that is managed and controlled from a region within South Africa, shall be subjected to Regional Establishment Levies in South Africa.

12 Stamp Duty

12.1 Stamp Duty Risk in Securitisation

Banks that securitise its credit card book, but retain the obligation to collect the payments on behalf of the SPV correctly treat the stamp duty in respect of the debit entries on the credit card account as stamp duty when accounting is done in respect of the fee payable for the collection service.

12.2 General

12.2.1 Stamp Duty is applicable on every instrument listed in Schedule 1 to the Act which is not covered by an exemption and which is executed in South Africa or executed outside South Africa and relates to the hypothecation or transfer of property in South Africa or to any matter or thing to be done in South Africa.

12.2.2 Save for "debit entries" through which the legislation acknowledges the force of electronic banking and taxes certain transactions, an instrument includes any written document or writing.

12.2.3 Schedule 1 imposes a charge on specified classes of instruments. From the deletions of items subjected to stamp duty in the recent past (especially since 1991) it appears that there has been a scaling down of liable instruments.

12.2.4 The types of instruments dealt with are debit entries, lease agreements and marketable securities.

12.3 Instalment Credit Agreements

No specific provision for stamp duty on the cession of an instalment credit agreement is made in the Stamp Duty Act. Therefore no stamp duty would be payable by the originator in respect cessions of instalment sale agreements.

12.5 Debit Entries

12.5.1 To overcome the difficulty created by the fact that an electronic entry in an account, the record of which is maintained on a magnetic tape or disc, cannot be regarded as a written document in its ordinary connotation, the Stamp Duties Act extends the definition of the term "instrument" to include a debit entry to bank and credit card accounts. All these debits are taxed at 20cents each.

12.5.2 The following limitations to the descriptions of the various types of accounts should be noted:
(a) a bank account must be a cheque account.
(b) Credit card schemes are included in the charge.
(c) the transmission accounts must have been computerized.
(d) credit entries to an account are not dutiable.

12.5.3 The person liable for the duty is the institution making the debit entry, but it has the right to recover it from its customers.

12.5.4 Thus where banks securitise its credit card book, but retains the obligation to collect the payments on behalf of the SPV it will be necessary to determine that the stamp duty in respect of the debit entries on the credit card accounts is treated correctly as stamp duty when accounting is done in respect of the fee payable for the collection service.

12.6Agreement of Lease

12.6.1 Stamp duty is payable on lease agreements and the charge is also applicable to sub-lease agreements, provided transfer duty is not chargeable in respect of such lease agreement (transfer duty will only be applicable to leases of ten years and longer).

12.6.2 In the instance of leases specific provision is made for stamp duty to be leviable in respect of the cession or assignment by a lessee of any of his rights under a lease. However, no similar provision is made for cession or assignment by the lessor of any of his rights under a lease. Furthermore, since the catch-all provision has been deleted, no provision is made in the Stamp Duties Act for imposing stamp duty on the lessor who cedes its rights in respect of a lease agreement.

12.7 Stamp Duty: Conclusion

From the above it can be seen that there is not a substantial stamp duty issue in respect of securitisations. It is important however to view each every securitisation individually to determine whether there may be a stamp duty risk, e.g. in respect of debit entries where credit card debtors are involved.

13 Tax Risk at Liquidation of the Originator: Sale versus Finance treatment

13.1 Though the motivation for securitisation is the raising of funds, it is not "financing" in the technical meaning of the word, since the entity securitising its assets is not borrowing money, but selling a stream of cash flows that were otherwise to accrue to it.

13.2 Because securitisation generally requires the segregation of assets in a separate legal entity in order to obtain the necessary bankruptcy protection, a potential exists for the creation of tax liabilities associated with the separate legal entity that would not exist if the originator issued debt directly. Neither the sale treatment nor the finance treatment is inherently prejudicial to the fiscus, but where the transaction is treated as a hybrid of the two, i.e. by divorcing the originator from its income accruals but retaining deductions and allowances in the originator whilst creating additional liabilities in the SPV, prejudice to SARS will ensue.

13.3 As the tax treatment of a sale differs from that of a finance transaction it is necessary to determine whether the taxpayer in substance agreed to truly sell its income stream (also referred to as a "true sale") or whether the taxpayer intended a secured borrowing involving a pledge as a collateral or a loan granted against collateral assignment of the receivables.

13.4 There is no specific provision in the Income Tax Act ("the Act") that regulates the treatment of securitisation issues and general principles in respect of accrual, deductions, losses, bad debts, wear and tear, etc are to be applied to securitisation.

13.5 It is only where there is sufficient external evidence to apply the doctrine of substance over form that a securitisation structure may be treated as a finance arrangement rather than a true sale. For these purposes a short summary of the applicable law is set out. From the Court Cases dealing with the common law doctrine of substance over form it appears that there are two relevant circumstances:

13.5.1 One can disregard the form of a contract between contracting parties if the form that the parties used for the contract is a disguise or a simulation – *plus valet quod agitur quam quod simulate concipitur. Refer Zandberg v Van Zyl* 1910 AD 303; *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue,* 58 SATC 229 SCA; *Relier (Pty) Ltd v Commissioner for Inland Revenue, 60 SATC 1 SCA.*

13.5.2 If on analysis of the contract between the parties it appears that a transaction has a specific character, that character indicates the nature of the transaction and not the label the parties attached to the contract. In this instance no disguise, simulation or fraud needs to be determined. Refer *Lawson and Kirk v S.A. Discount and Acceptance Corporation (Pty) Ltd 1937 CPD 273 at 292.*

13.6 In the Lawson and Kirk case referred to above, reference was made to the English case of In re George Inglefield Ltd (1933, 1 Ch.1) where Romer, L.J. at 27 proposed three tests to distinguish a true sale from a loan. They are:

13.6.1 Can the debtor pay off the debts and get his alleged security back or not;

13.6.2 Who gets any profit on a sale of the article purported to be sold; and

13.6.3 Who suffers any loss?

13.7 The following are indicators to determine what a true sale would include, (whereas the absence of these attributes might indicate that a loan against security was entered into):

13.7.1 If there is minimal recourse by the SPV to the originator;

13.7.2 If the SPV (and not only the originator) is concerned with the credit risk of the underlying receivables;

13.7.3 If there is minimal credit enhancing (i.e. sub-ordinary loans, preference shares investments, etc) by the originator;

13.7.4 If a minimal amount of residual interest in the receivables is retained by the originator;

13.7.5 If the originator does not have the right to substitute the receivables or to re-acquire them or to exercise a call option against the SPV

13.7.6 The SPV does not have a right to put bad debts back to the originator;

13.7.7 If the SPV can subsequently dispose of the receivables;

13.7.8 If the SPV's future rights in the receivables are not restricted in any way;

13.7.9 If the originator continues to service/administer the collection of the receivables on behalf of the SPV, he must be compensated with a market-related fee;

13.7.10If the SPV is adequately capitalised;

13.7.11If the SPV is derecognised for accounting purposes pursuant to AC133;

13.7.12If no rating agency is involved, the structure has to be scrutinized closely as "true" investors would require a rating from such an agency;

13.7. 13 If the originator is still deducting bad debts after the transfer, it is an indication that the parties do not regard it as a sale between themselves, but rather as a financing method;

13.7. 14If the credit enhancement of the SPV does not exceed acceptable levels so as to in substance amount to an assumption of all risk/rewards in the securitisation (refer paragraph 9 below).

13.8 If credit enhancing, such as subordinated debt, preference shares, guarantees, recourse, etc is provided by the originator, the level of such credit enhancement should be evaluated. For example, if the historical risk (default) of the underlying receivables is 4%, and the originator has credit enhanced the first 10%, the originator has not transferred the risks to the SPV, as 100% of the expected risk (4%) will be born by the originator. Therefore, the transaction might be considered a financing structure. Conversely, if the historical risk is 6% and the originator has credit enhanced the first 2% percent, risks have been transferred. In this instance it needs to be determined whether the retaining of one third of the risk negates against a true sale or not.

13.9 A taxpayer does not have to meet all the above requirements, and some of them hold more weight than others. Each structure needs to be evaluated on a case by case basis.

Annexure A: The International Position*

1.1 Income Tax

1.1.1 Germany

1.1.1.1 In Germany, after corporate income tax, trade tax is the most important tax levied on companies, and unlike corporate income tax, trade tax can occur even without profit. Tax obstacles to securitisation were abolished but true sale transactions still require careful structuring. Until January 2003 it was unclear whether SPV's that purchase receivables originating from bank loans in securitisation transactions should be subject to trade tax but at that date plans were announced to clarify that tax issue. Trade tax is a local tax, the rates of which depend on the municipality in which the business is located. Effective rates generally range from 11% to 19%. Trade tax is based on the taxable income computed for corporate income tax purposes but adjusted by certain add-backs and deductions. The most important add-back in the context of securitisations is the add-back of 50% of the interest payable on long-term debt, that is, debt with a term of more than one year. Interest payable on the financing raised by the SPV would often qualify as interest on long-term debt with the result that 50% of the interest would be added back when calculating the basis for trade tax of the SPV. This means that a debt-financed SPV might have a significant trade tax base even without having generated any profit.

1.1.1.2 In January 2003 a plan was announced to amend the relevant German trade tax legislation so that SPV's buying loan receivables from banks in securitisation transactions will be treated like the originator banks, that is, will be exempt from the add-back. Credit institutions licensed under the German Banking Act are already exempt from the above-mentioned add-back of interest under long-term debts if certain criteria are met. According to the Federal Ministry of Finance this move aims to expand the range of financial instruments available to the German banking sector, in particular to facilitate the financing of mid-cap companies, to strengthen further the appeal of obtaining corporate financing via the capital markets compared to traditional financing through loans and to broaden the spectrum of financing facilities available in Germany.

1.1.1.3 The above only applies to bank loan securitisations. As a consequence, uncertainty remains as to whether SPV's purchasing receivables from German corporates, which then service those receivables, will be subject to German trade tax.

** This is based on information provided in a comparative study of the International Bureau of Fiscal Documentation that appeared in the IBFD publication "Derivatives and Financial Instruments" vol 4 and 5 of 2002 and 2003 respectively*

1.1.2 Italy

1.1.2.1 Law No 130 published in the Official Gazette of Italy of 14 May 1999 governs securitisation transactions implemented in Italy using an Italian vehicle. Before enactment of this law it was necessary to have a non-Italian SPV issue the securities for reasons which relate to the economics of the transaction, i.e. a restriction on Italian companies to issue debt instruments exceeding their share capital and the existence of withholding tax on any interest payments made by an Italian entity to investors outside Italy. Law No 130 was therefore conceived to simply the process and to facilitate the increased use of securitisation as a financing technique in Italy.

1.1.2.2 Taxation of Originator: Losses on bad debts only deductible to the extent that they are supported by precise evidence. The same applies to losses resulting from the transfer of receivables executed without recourse, however a different conclusion may be reached if the transfer occurs with recourse.

1.1.2.3 Taxation of SPV: Despite Law No 130, the tax regime of the SPV is still unclear and subject to debate. Such uncertainty is due to the complete absence of any official guidelines, interpretation or judicial precedents governing the issue. In principle, the SPV, being an Italian corporate entity should be subject to Italian corporation tax and a regional tax on its annual profits subject to any such adjustments as are specifically provided for by the rules and regulations. However, pursuant to the regulations issued by the bank of Italy on the accounting regime to be followed by the SPV, assets and liabilities and any other values attributed directly to the securitisation of the receivables will be treated as off-balance sheet assets and liabilities and values. As a consequence of the off-balance sheet treatment for accounting purposes of the receivables, of the obligations arising from the issuance of the notes and of all the related cash-flows, Italian doctrine takes the position that income from interest and other revenues accrued to the SPV in the context of a securitisation transaction implemented under Law 130/99 as well as any interest on the notes is not included in the calculation of the taxable income of the SPV. However, the Italian authorities have not expressed their opinion on the issue, and therefore they may opt for a conservative view, according to which the income realized by the SPV is subject to taxation, irrespective of the accounting technique followed. For this reason SPV's are structured in Italy to be tax neutral (matching of taxable income with deductible costs for each year).

1.1.2.4 Taxation of Servicing Activities: According to Law 130/99, collection and other activities related to the management of the assigned receivables have to be performed by a separate entity and not by the SPV. Due to regulatory issues, the services must be an Italian financial entity, enrolled in a special register kept by the Bank of Italy. The service payable by the SPV to the servicer will not be subject to any Italian withholding tax or substitute tax, but will be included in the taxable income of the servicer and subject to Italian corporation tax and regional tax.

1.1.2.5 Taxation of Note holders: Pursuant to Law 130/99 notes issued by an SPV incorporated under that law are subject to the Italian income tax regime that ordinarily applies to debentures issued by public limited companies whose shares are traded in regulated Italian markets and, in particular, to the provisions of a legislative decree of 1996 that levies a substitute tax depending upon the maturity date of the notes, with certain exemptions, such as Italian resident corporate entities, investment funds, pensions funds and institutional investors and non-Italian resident persons meeting certain prescribed criteria. Early redemption trigger a tax equal to 20% of the interest accrued on the pre-paid principal of the notes up to the time of the early redemption.

1.1.2.6 Capital Gains Tax in respect of Securitisation: In respect of Italian resident individuals the difference between the consideration received and the cost incurred in the acquisition of the shareholding are subject to capital gains tax at a rate of 12.5%. Italian corporations, partnerships and permanent establishments of non-Italian entities are not subject to any final withholding tax or substitute tax but it will be included in the aggregate income of the relevant person according to ordinary rules.

1.1.2.7 The possible application of anti-abuse provisions to securitisation transactions: The Italian tax authorities may disallow tax benefits that may arise from certain transactions which fall within the list provided by Art 37bis of Decree No 600 of 19 September 1973 (such as disposals of receivables and operations involving securities) and which:

(i) are not based on valid economic reasons;

(ii) are aimed at circumventing obligations or prohibitions set forth by the tax laws;

(iii) are aimed at obtaining a tax reduction or a tax refund that would not otherwise be due.

1.1.3 Brazil

1.1.3.1 Securitisation transactions must fit in a regulated framework with specific rules issued by the Central Bank and the Securities Commission. In 1998 the Central Bank issued regulations concerning the securitisation of receivables of banks and other financial institutions. The securitisation transactions of financial institutions, however, may be made only through another legal entity incorporated for this sole purpose.

1.1.3.2 Apart from income tax (withholding and final), companies performing securitisation transactions are also subject to social contributions, tax on movement of funds and a tax levied on some financial transactions, i.e. the income from the securities follows the taxation of fixed income (i.e. a withholding of 20% for residents and 15% for non-residents). If the investor is resident company, the withholding is offset against the final income tax liability. If the resident is tax exempt, e.g. pension funds, withholding tax is not applicable. The originator may be subject to income tax if the receivables are transferred to the SPV at a value that is different from the book value. In such a case if the market value is higher, the income is taxed to the originator. Usually when the market value is different from the book value, the actual value is lower (due to the risk attached to the receivable) and no gain is realised.

1.1.3.3 Social contributions (known as PIS and COFINS) are levied not on income, but on revenue. The combined rate is 3.65% - 0.65% for PIS and 3% for COFINS. Usually there are no credits or deductions that can decrease the taxable base, which is in most cases equal to gross revenue. In the case of securitisation transactions however, all expenses that the SPV incurs to acquire the receivables and to issue the securities decrease the taxable base. In the end, the SPV will pay the social contributions only on the spread, if any, in the transaction. This measure, despite being an exception of the social contributions rule, was regarded necessary by the Brazilian authorities, otherwise the cost of securitisations would be increased by 3.65% of the issuance price of the securities, which would cancel the benefit – if not making the transaction unfeasible. On the other hand, PIS and COFINS are levied on the revenue of the originator as a result of the transfer of the receivables to the SPV.

1.1.3.4 In Brazil tax is levied on every movement of funds. This tax, which is referred to as CPMF has been in force since 1996. The initial rate was 0.20% but is currently 0.38% until the end of 2003. During 2004 CPMF ill be levied at a rate of 0.08%, and from 2005 it will be abolished. Banks and other financial institutions are responsible for the collection of CPMF. IN order to equalise the treatment in the domestic market of Brazil with the markets abroad, many transactions on the stock exchange and securities market became exempt from CPMF. Thus, since July 2002 securitisation transactions are exempt of CPMF.

1.1.3.5 The IOF is a tax levied on some financial transactions, particularly those related to debt, insurance, currency exchange and the issuance of securities. In this context it is a tax that is used to influence the market, to restrict or stimulate specific transaction. In the case of securities, the IOF rate is nil, although it can be increased up to 1.5%.

1.1.4 Canada

1.1.4.1 The most common types of securitisations currently done in the Canadian marketplace are the issuance of asset-backed debt by a bankruptcy-remote trust and the issuance of certificates representing co-ownership interests in receivables. The following are the tax consequences typically associated with them.

1.1.4.2 In a typical asset-backed deal an originator of receivables sells the receivables on a fully serviced basis to a trust. For the originator the basic consideration will be, as in other jurisdictions, whether the transfer of receivables to the trust will be considered to be a sale or a secured loan for income tax purposes. Barring the application of the general anti-avoidance rule, if the receivables are considered to be sold for commercial law purposes, they should be considered to be sold for income tax purposes. In the past, the characterisation of the transfer of receivables to a trust as a sale or a loan was the subject of detailed analysis. However, recent case law from the Supreme Court of Canada indicates "absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationship must be respected in tax cases. Re-characterisation is only permissible if the label attached by the taxpayer to the particular transactions does not properly reflect is actual legal effect" (*Shell Canada Ltd v The Queen* [1999] 4 CTC 313 (SCC)). Accordingly, if the transaction is structured so as to effect a legal sale (as will typically be the case), the transfer of the receivables should be considered to be a sale unless the general anti-avoidance rule is successfully applied.

1.1.4.3 The proceeds of the receivables will initially be recorded as the initial lump-sum received by the originator from the trust; the proceeds will be adjusted upward as the deferred purchase price is received by the originator. Given that the amount, timing, and even existence of payments of deferred purchase price is uncertain, an originator should not be required to include in income an estimate of the deferred purchase price upon disposition of the receivables. Should an originator repurchase a receivable, the originator may which to claim a reserve to the extent that collection of the receivable is doubtful. Given that taxpayers in Canada are not entitled to deductions for contingent amounts unless the Canadian Income Tax Act specifically provides for a deduction, originator in these circumstances must rely on the specific reserve mechanisms available for doubtful and bad debts.

1.1.4.4 A securitisation transaction is typically designed so that any income earned by the trust will be offset by deductions (including the deduction of distributions to beneficiaries of the trust) so that the trust has no taxable income.

1.1.4.5 The income tax issues for the debt holders relate to the fact that the debt issued by a securitisation trust typically has straight-forward terms. Maturity is fixed, the interest rate may be fixed or floating, and the debt is not issued at a premium or discount. For a taxpayer that is a corporation, partnership, unit trust or any trust of which a corporation or partnership is a beneficiary, interest will be included in income on an accrual basis. For other taxpayers interest will typically be included in income on a received or receivable basis (depending on the method regularly followed by the taxpayer). Dispositions of the debt will ordinarily yield non-capital gains or losses where the debt is held on income account, and capital gains or losses where the debt is held on capital account. Financial institutions subject to the mark-to-market regime will be required to mark-to-market or accrue on a yield-to-maturity basis, depending on the circumstances, and will be subject to specific rules regarding the disposition of the debt.

1.1.4.6 In the co-ownership structure, the public (co-owners) holds certificates representing co-ownership interests in the receivables. These certificates typically have terms similar to debt instruments, such as a stipulated rate of return equal to a percentage of the issuance price and a return of the issuance price on maturity. E.g. holder of a co-ownership certificate might have a co-ownership interest in a pool of receivables that entitle the co-owner to a portion of the collections on the receivables equal to 6% per year of the issuance price of the co-ownership certificate and, on maturity, a portion of the collections on the receivables equal to the issuance price of the co-ownership certificate. The proceeds of the issuance of the co-ownership certificates are used to purchase the corresponding co-ownership interests. The originator typically keeps a residual co-ownership interest in the receivables; this residual co-ownership interest allows the originator to retain any profits in excess of expenses and amounts payable on the co-ownership certificates but also places some of the risk of loss in respect of the receivables on the originator. The remainder of the co-ownership interest is typically sold to another entity, which could be a trust or a corporation which acts as an issue of the co-ownership certificates.

1.1.4.7 Tax consequences of co-ownership for the originator. If the originator does not retain a co-ownership interest for itself, the income tax issues relevant to the originator are similar to those set out in respect of the asset-backed debt structure referred to above. If he does retain a co-ownership interest, the income tax issues will be different. The originator will be considered to have disposed of one co-ownership interest to the issuer. The cost of the receivables will be allocated amongst the co-ownership interest retained and that sold. The originator will be entitled to maintain any doubtful or bad debts reserves in respect of the retained co-ownership interest.

1.1.4.8 Tax issues for Issuer:
If the issue does not retain a co-ownership for itself, it will generally not be subject to significant tax consequences. Income tax issues are associated with the purchase and sale of co-ownership interest, however, given that such purchase and sale take place virtually simultaneously, the issue will ordinarily not realize any gain or loss on the sale of the co-ownership interest, nor will the issuer receive or be required to accrue (without a corresponding deduction on sale) any periodic income in respect of the receivables.

1.1.4.9 Tax issues for co-owners: Income earned will generally be interest income, in which case it will be recognized by co-owners in accordance with the ordinary rules governing the recognition of interest income. Therefore a corporation, partnership, unit trust, or any trust of which a corporation or a partnership is a beneficiary will be required to recognize the interest income on an accrual basis. Other taxpayers will be required, generally to recognise the interest income on a received or receivable basis. Where the originator retains a co-ownership interest, as is typically the case, the originator will be considered to be entitled to a portion of the interest income on the receivables that is different than its entitlement to the principal of the receivables. Accordingly, a special interest accrual regime will be applicable. This regime will apply to the co-owners that are required to accrue the interest income, and will require each co-owner to recognise accrued interest.

1.1.5 Australia
1.1.5.1 Australia does not have laws specifically addressing securitisation. This compels one to examine various legal and regulatory provisions that may apply to each step in the securitisation process. The situation becomes even more complicated because the states have laws different to those of the Commonwealth. Guidelines issued by the Reserve Bank of Australia and the Australian Securities and Investments Commission are also relevant to securitisation. There are currently two major laws dealing with income tax, namely the Income Tax Assessment Act, 1936 (ITAA 1936) and Income Tax Assessment Act , 1997 (ITAA 1997). A rewrite of the 1936 Act is in progress.

1.1.5.2 Taxation of the assignment by the originator to the SPV
Section 25(1) of the ITAA 1936 states that in the case of a resident, assessable income is defined as gross income derived directly or indirectly from all sources within or without Australia. For a non-resident, assessable income is defined as gross income from sources in Australia. This is commonly referred to as “income according to ordinary concepts.” The Australian Tax Commissioner’s views on isolated transactions are found in a 1992

tax ruling. According to the ruling, the proceeds from an isolated transaction will be classified as assessable income if:

- the intention or purpose of the assignor was to make a profit or a gain; and
- the transaction was entered into in the course of carrying on a business.

Taxable income arrived at by reducing assessable income by allowable deductions. Basically allowable deductions are expenses incurred in deriving income. Expenses that are capital in nature are not deductible.

1.1.5.3 Taxation of the premium payments to the Originator

Reciprocal loans, interest rate swaps and management fees are employed to assist the originator to enjoy the benefits of the assets transferred to the SPV. In *Commissioner of Taxation v Broken Hill Pty Ltd* (2000) 45 ATR 507 it was held that so-called "interest" on the purchase price of shares was part of the purchase price and not allowable as a deduction. In securitisation transactions the originator may transfer the right to income at par plus deferred consideration. The purpose of the deferred consideration is to transfer any excess profit from the SPV to the originator. Therefore, this extra payment would run the risk of being made a part of the sale consideration and becoming assessable in the hands of the originator. There are instances when the originator makes a subordinated loan to the SPV in order to provide credit enhancement to the securitisation scheme. Interest payments by the SPV on the credit provided by the originator may not always be deductible to the SPV. In the above-mentioned *Broken Hill* case, the interest for the period up to the day of completion was held to be purchase price and not interest, thus disallowing the deduction. The distinction here is that, unlike in the *Broken Hill* case, the SPV would have had the use of the credit from the originator in its business and therefore had a better chance of deducting the interest from its income liable to tax.

1.1.5.4 Taxation of Management Fees

Management fees payable to the originator are generally deductible if it can be shown that he fees are incurred by the SPV in deriving assessable income. In Australia, deductibility is not dependent on the company being a trading or investment company; rather it is the connection between the expenditure and the production of assessable income. The general test for deductibility is found in sec 8-1 of the ITAA 1997 and has two prongs:

- incurred in gaining or producing assessable income; or
- necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

1.1.5.5 The tax issues to be considered will depend to a great degree on the type of structure set up to implement the securitisation scheme. This is so because of Sec 128F of the ITAA 1936, which provides a withholding tax exemption for interest paid and is very relevant when considering the tax position of non-resident bondholders. Resident taxpayers who are bondholders are not subject to withholding tax on interest income, whether the SPV is a company or a trust. Due to the effect of Sec 128F of the ITAA 1936, the position of non-resident bondholders will depend on whether the SPV is a trust or a company.

1.1.5.6 Capital gain or loss will arise only if a capital gains tax (CGT) event takes place. The CGT events are listed in the Act and, in general, arise only in the case of assets acquired or brought into existence after 20 September 1985. The potential for CGT liability may arise when the originator assigns to a SPV the right to income from the debtors. A CGT asset is any kind of property or legal or equitable right that is not property. The Act gives the following examples of CGT assets: land and buildings; shares in a company; units in a unit trust; options; debts owed; rights to enforce a contractual obligation; and foreign currency. CGT is residual tax and will only apply if an amount is not subject to tax under another provision of the Act.

1.2 Value Added Tax: International Position

1.2.1 Germany

1.2.1.1 The VAT position is uncertain in Germany following the trade tax analysis – refer Germany: Income Tax position in paragraph 4.1.1.1 above. The question here is whether or not the servicing is subject to (unrecoverable) German VAT at a rate of 16%. If one takes the position that the SPV does not have a German tax presence, then the originator in its capacity as the servicer renders services to a non-German entity that is exempt from VAT under the German VAT Act. If one take the position that the SPV has a German tax presence (its place of management or at least a permanent establishment), this means that the servicer renders services (administration and collection of receivables) to a German entity recipient, which is subject to VAT at the regular rate of 16%.

1.2.1.2 As the German tax authorities take the view that the mere purchase and holding of receivables does not qualify for entrepreneurship under the German VAT Act, the SPV is not entitled to input VAT recovery. As a result, the 16% VAT on the service fees would be lost. However, given that the servicing fees are moderate, the VAT risk was considered by the industry not to be significant and the rating agencies did not require a risk protection.

1.2.2 Italy

1.2.2.1 The transfer of receivables may alternatively be considered as a VAT-able transaction or a transaction that falls outside the scope of VAT, depending on the nature (i.e. as part of a financial transaction or a mere disposal of receivables) attributed to the transfer itself.

1.2.2.2 If the transfer qualifies as a financial service the supply of services is deemed to be a VAT-able transaction if made for consideration. Whit respect to assignments of receivables, it might be argued that the consideration payable would be equal to the difference between the book value of the portfolio and the relevant purchase price (i.e. the difference is equal to the discount).

1.2.2.3 Under Art.3(2)(3) of the VAT Law, the assignment of receivables qualifies as a supply of services and is therefore subject to VAT if part of a financial transaction. Pursuant to the ordinary rules, the transfer of receivables from an Italian originator to a non-resident vehicle under Law 51/91 would be considered as a VAT-exempt service supplied in Italy, provided of course, that consideration (i.e. the discount) is agreed in exchange for the services. As a consequence, originator would be obliged to self-invoice the discount, applying Italian VAT at a zero rate, in accordance with the domestic provisions governing the reverse mechanism.

1.2.2.4 In certain transactions, the receivables are assigned at their nominal value plus any VAT. It may therefore, be argued that the service is rendered without consideration, being therefore VAT-exempt (i.e. outside the VAT scope of application). In such a case, registration tax will apply on the transfer, which qualifies as a disposal of assets as discussed below.

1.2.2.5 If the assignment qualifies as a disposal of assets it will potentially be subject to registration tax (levied at a rate of 0.5%), although the payment of duty may be avoided by signing the sale and purchase agreement either outside of Italy or by way of exchange of correspondence.

1.2.3 Canada

1.2.3.1 Typically, no federal goods and sales tax (GST) or provincial sales tax arises in respect of the purchase of or receipt of payments on the debt or co-ownership interests. However, such taxes could be applicable if the receivables are leases or certain other types of property. The key concern with respect to GST arises in respect of the servicing fee that the trust, or in the case of a co-ownership interest, the co-owners, pay to the servicer of the receivables. A fee paid for servicing receivables would typically be subject to GST if paid on a stand-alone basis. However, in most cases a securitisation transaction will be structure so that the receivables are sold on a "fully serviced basis" (i.e. the consideration paid for the receivables include compensation for servicing).

1.2.3.2 Under the GST legislation, where a financial services (here, the sale of the receivable) is supplied together with a service that is not a financial service (here, the service of the receivable), and the financial service is related to the other service, it is the usual practice of the supplier to make these supplies together in the ordinary course of supplier's business and more than 50% of the consideration (measured as a total of the consideration for each supply if each supply were supplied separately) is for the financial service, then the supply of each service (financial and non-financial) will be considered to be a supply of a financial service.

1.2.4 Australia

1.2.4.1 Under the Australian goods and services tax (GST) regime, supplies may be classified as subject to GST, GST free, or input taxed. If a supply is input taxed, the supplier may not claim input tax credit in respect of acquisitions made in order to make the input-taxed supply. Financial supplies (as defined in the GST Act) are input taxed.

1.2.4.2 The Australian GST Act also contains a de minimus provision allowing entities making financial supplies below a prescribed threshold to claim input tax credits even though the financial supplies are input taxed and would therefore otherwise not be entitled to input tax credits. The conditions for the de minimus exception are that (i) the acquisitions must relate to making financial supplies and (ii) the entity must not exceed the financial acquisition threshold.

1.2.5 United Kingdom and European Union

1.2.5.1 VAT in Europe is based on the EC sixth Directive ("the Directive"). If the originator continues to service the receivables, one must first determine whether there is:

- a single supply of "serviced receivables"; or
- two separate supplies, one being a transfer of receivables and the other being the servicing of those receivables.

The servicing of receivables as a separate supply from the originator to the SPV as such may be subject to VAT, and VAT might be irrecoverable for the SPV. Furthermore, the SPV may be deemed to supply "factoring services" to the originator.

1.2.5.2 Only after one has determined whether there is a mixed/composite supply or multiple supplies the application of the exemptions can be considered. Under Art 13B (Other Exemptions), the Directive lists the following as exempt from VAT:

- the granting and the negotiation of credit, as well as the management of credit by the person granting it; and
- the negotiation of any dealing in credit guarantees or any other security for money, as well as the management of credit guarantees by the person granting the credit.

The role of the person granting the credit is critical for the exemption under the Directive. In Shed 9, Group 5 (Finance) of the UK Value Added Tax Act, the making of any advance or granting of any credit, as well as the making of any arrangement for any transaction comprising the making or granting of credit are exempt.

1.2.5.3 If the SPV's role is seen as factoring, no exemption will be available, as this has been explicitly carved out of the exemption.

1.2.5.4 Any exempt supply crates and issue for the supplier's right to deduct attributable input tax. One needs to distinguish for these purposes between:

- taxable supplies in the supplier's Member State;
- supplies outside the supplier's Member State;
- all other supplies;

The first two types of supply generate input tax recover. The last does not, unless the supply is of financial services and the recipient resides outside the European Union.

1.2.5.5 Because the supply of the receivables is an exempt supply, it will generally not give rise to a right to deduct any directly attributable input VAT.

1.2.5.6 If the originator makes both supplies generating recovery and supplies not generating recovery, the general rule is that the right to deduct VAT incurred is determined by Art 19, i.e. one applies a fraction to the "dual use" VAT, with the numerator being the value of outputs generating recovery and the denominator being the value of all outputs.

1.2.5.7 If the SPV is not engaged in economic activities, it is not entitled to any recovery of input VAT charged to it (e.g. on management fees and servicing fees). Even if the SPV does not qualify as a taxable person, it might still not be entitled to a refund/credit of input VAT, as all its supplies are exempt supplies. This may be different if and to the extent that the SPV's customers are outside the European Union. Different views prevail in different Member States: In most countries, it would be argued that the SPV's customers are the originators to which the SPV is supplying credit. In other countries, however, it is argued that the customers are the investors to which the SPV issues notes (the supply for VAT purposes is he issuance of the notes).

Annexure B:

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