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New Zealand tax law changes will affect securitisation structures

Overview

Proposed and recently enacted changes in New Zealand tax law provide a mix of good and not so good news for securitisation structures. Amendments extending the existing financial institution special purpose vehicle (FI SPV) regime to non-financial institution originators will provide for flow-through treatment of the SPV in a broader range of circumstances, which should make it easier to achieve tax neutrality. On the other hand, securitisations with a cross-border dimension may be caught up in certain measures included in the reforms made to address base erosion and profit-shifting concerns (BEPS).

Extension of FI SPV regime to non-financial institutions

The FI SPV regime provides for an SPV to which receivables are transferred to be treated in certain circumstances as part of the originator transferring those receivables. The rationale for this regime is that it aligns the tax treatment of the arrangement with its financial reporting treatment and with its economic substance, which is that the transfer of the receivables to the SPV is to facilitate financing for the originator rather than to effect a sale to a third party.

The FI SPV regime currently applies only to residential mortgage-backed security and covered bond structures entered into by financial institutions. The Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill proposes to extend this flow-through tax treatment to corporate securitisation transactions.

Under the proposed extension of the FI SPV regime, where the assets of a securitisation SPV are included in consolidated financial statements prepared by an originator (ie, a person who transfers their assets to the SPV), or by a person in the same wholly-owned group as the originator, the originator may elect for the SPV to be treated as part of the originator for tax purposes. This would permit receivables to be transferred into the SPV without triggering a tax liability for the originator, and would mean that the SPV itself is not subject to tax (with any tax on its activities being paid by the originator instead). The regime is available only if the originator is a New Zealand tax resident.

The new rules will be available for existing corporate securitisations. A transitional rule provides for the originator to be deemed to reacquire the securitised assets, effectively "stepping into the shoes" of the SPV.

The extended FI SPV regime, which will be re-named as the debt funding special purpose vehicle SPV, is proposed to apply for income years starting on and after enactment. The Bill is expected to be enacted by 31 March 2019.

BEPS-related amendments: impact on cross-border borrowings

Over the past two years, New Zealand has enacted a raft of amendments intended to counter BEPS. A number of those amendments are directed at cross-border related-party financing, which has been high on the list of BEPS-related concerns for the New Zealand Government.

The Government's concerns about the tax consequences of certain related party borrowings arise largely from cases involving high priced intra-group debt, rather than securitisation structures. Nonetheless, the amendments made in response to the concerns may have adverse (and potentially unforeseen) consequences in relation to cross-border related-party borrowings in a securitisation context.

The rules for determining the related party borrowings that are subject to the new regimes are detailed, and depend on the particular regime being applied. However, at a minimum, each of the new regimes will apply to any lending between associated persons.

The definition of "associated person" can be surprisingly broad in the context of a securitisation structure. Where the SPV is a trust other than a unit trust, any settlor or beneficiary of the trust, or any person having the power to appoint or remove trustees, will be associated with the SPV. In practice, this may make it difficult to avoid an outcome in which the originator or the arranger is associated with the SPV.

Where an SPV has borrowed from a person subject to the rules as described above, the following new regimes have the potential to affect the deductibility of interest expenditure for the SPV, or the SPV's obligations to pay withholding tax on such interest:

- **Restricted transfer pricing rules:** These new rules may (with some exceptions) require subordinated notes held by a non-resident associate of the SPV to be priced (for transfer pricing purposes) as if they ranked equally with senior notes (and disregarding certain other so-called "exotic" terms). Failure to price in accordance with these rules could result in denial of deductions to the SPV for expenditure under notes held by an associated person, even if the notes are demonstrably on arm's length terms (eg, where notes on the same terms are held by an unrelated party). The rules also risk double taxation, given the inconsistency between this restricted transfer pricing methodology, and the standard transfer pricing methodology likely to be accepted in the holder's jurisdiction of residence.

- **Anti-hybrid mismatch rules:** These rules may deny deductions to the SPV, if interest expenditure recognised by the SPV in respect of notes held by non-NZ holders is not recognised as income by the holder within two years of the end of the SPV's income year (because the holder's jurisdiction either characterises the notes as equity, or characterises the SPV differently from its characterisation for New Zealand tax purposes), and either the holder is related to the SPV, or the notes are issued pursuant to a structured arrangement. In applying these rules, it is also necessary to consider whether the jurisdiction in which the holder is resident has its own anti-hybrid mismatch rules, and whether the rules of that jurisdiction apply in priority to the New Zealand rules to counteract the mismatch.

- **Accrual-based withholding tax rules:** These rules may require New Zealand non-resident withholding tax (NRWT) to be paid annually by reference to the amount of interest expenditure incurred by the SPV on notes held by its associates. This rule will apply if there is a significant timing mismatch between interest payments and interest deductions for the SPV (eg, where notes are issued to an associate at a discount, or where interest payments on notes held by associates are deferred under the cash flow waterfall). This rule can affect the tax neutrality of the SPV, in that the NRWT must be paid annually by the SPV, even if no interest payments are made. Under the cash waterfall in most SPV arrangements, the NRWT would be payable in priority over payments under any notes (including any notes ranking ahead of the notes held by the associate). Whether the SPV could deduct the NRWT from subsequent interest payments made to the associate would depend on the terms of any gross up (or no gross up) provision, and any change of law provisions.

Each of the above BEPS-related law changes will apply to existing arrangements. The first two changes (restricted transfer pricing rules, and anti-hybrid mismatch rules) will apply for income years of the SPV beginning on or after 1 July 2018. The third change (accrual-based withholding tax rules) will apply for income years of the SPV beginning on or after 31 March 2017, although the first NRWT payment (on an accrual basis) would not be due until after the end of the second income year to which the new rule applies.

Where securitisation structures are or may be affected by these rules, we recommend seeking advice promptly, since (depending on the entity's balance date) the new rules may already be in force. Consideration could be given to structural solutions or (where it appears that the relevant consequence may be unintended) to raising issues with Inland Revenue officials. While the relevant rules have already been enacted, there is the possibility of remedial amendments being made to address unintended consequences of the new rules.

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