SELL DOWNS OR PARTICIPATIONS AS ALTERNATIVES TO SYNDICATIONS: CURRENT TECHNIQUES AND PROBLEMS

Comment by

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I would like to, if I may, address some of the revenue aspects of sell downs and participations. I would like to consider a situation where an Australian resident bank has made a loan or a fully drawn advance out of a branch in Australia. In that situation interest withholding tax will not be payable. If, however it then sells either all or part of its interest in that loan or fully drawn advance to a non resident bank, depending on the method of sale used, a liability for withholding tax could arise.

If the sale is by way of assignment, the borrower would be required to deduct interest withholding tax at the rate of 10% from interest payable.

While an assignment - whether legal or equitable - gives rise to direct contractual relationships between the assignee and the borrower (although he may not be able to sue in his own name) an assignment will operate only to transfer the rights and benefits of the assignor. It cannot itself impose any greater obligation on the borrower and consequently if there is any grossing up provision in the underlying loan agreement, it would not be possible to enforce that grossing up provision, against the borrower, unless the borrower had agreed that it could be done so in the assignment document. Even if the assignment is effective, to pass on the benefit of any grossing up provision in the underlying agreement, the borrower is unlikely to be very enthusiastic if the sale results in the borrower incurring additional costs because it is required to gross up interest payments.

If there is no grossing up provision in the underlying loan agreement, the sale could give rise to a real problem if the sale is done by way of assignment because the requirement to deduct withholding tax from the interest payment will, in effect, arise for the first time when the assignment becomes effective. This may effectively cause the asset to become unmarketable.

If the sale is completed by way of novation, as has been said, it effectively involves a new contractual arrangement between the borrower and the bank, and accordingly then it is a matter for negotiation whether the borrower will agree to pay withholding tax. I expect that would be unlikely.

Where the sale is done by way of a sub-participation, then the withholding tax problems don't really arise, because sub-participation represents merely a way in which the lending bank is funding its obligations under the loan agreement.

As the relationship between the lending bank and the borrower is not changed and the funding bank acquires no directly enforceable rights against the borrower, the borrower should not be subject to any obligation to gross up for withholding tax.

I mentioned earlier, the difficulty of selling an interest in a loan, if the interest payments would be received by the buying bank nett of withholding tax. If the sale, whether by way of assignment or novation, would result in interest withholding tax being payable, and if the borrower's obligations under the loan agreement are secured by a mortgage debenture over its assets, it would be very difficult to effectively impose an obligation on the borrower to gross up interest payments.

This is because section 261 of the Income Tax Assessment Act provides that a covenant or stipulation in a mortgage, which has or purports to have the effect of imposing an obligation of paying income tax on the interest to be paid under the mortgage, shall be absolutely void.

"Mortgage", for the purpose of that section, is very widely defined, and includes any agreement that is "collateral or supplemental to" a mortgage. I think in all probability, that would include the underlying loan agreement and possibly a deed of assignment or novation.

I turn now to stamp duty, very quickly. If the sale is done by way of a legal assignment, then in New South Wales, Queensland, Western Australia and Tasmania, ad valorem stamp duty would be payable, because the head of duty that covers conveyance of property, does not distinguish between real property and other forms of property.

I am pleased to say that in Victoria, that distinction is made, and our relevant head of duty only applies to a conveyance of real property and the transfer of land. The message is clear to the bankers amongst you, that these things should be done in Victoria!

There is, however, one remaining requirement in Victoria. That is that by section 84 of the Instruments Act of Victoria an assignment or transfer of book debts, whether absolute or conditional is invalid until it is registered with the Registrar General. Now that the Companies Codes no longer require

instruments creating or evidencing absolute transfers or assignments of book debts to be registered it is to be hoped that this anachronistic impediment to doing business in Victoria can be removed in the near future.