RESEARCH PAPERS OF WROCŁAW UNIVERSITY OF ECONOMICS No. 138
Financial Sciences 5 2010

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TAXATION OF ASSET SECURITIZATION IN POLAND

Summary: Taxation of securitization in Poland mirrors the existing tax barriers related to the implementation of new financial services. Amendment of tax regulations with respect to one group of initiators – banks in Poland, shows how far-reaching the final influence of tax-related changes on profitability of the transaction may be. As a result of limiting that instrument exclusively to bank assets, the securitization market based on other assets or on transactions concluded with an SPV being an entity other than investment funds is, as a matter of fact, marginalized. Concluding, it should be pointed out that the final model of securitization in Poland has been shaped exclusively by the tax regulations. Such a situation may be perceived as a breach of competition rules, whereas it hinders the development of new securitization market segments.

Key words: securitization, taxation, bank assets.

1. Introduction

Securitization of assets is a solution with an over 10 year history record in Poland. The first transaction of this kind on the domestic financial market was concluded in 1997. Since that time the total volume of assets subject to securitization has reached the value over 1 thousand million PLN, and the legislator has implemented special regulations to govern the manner and form of securitization. Despite the fact that from the global perspective, securitization involves an extensive range of assets [Kidacka 2006, p. 124 *et seq.*], in Poland such transactions relate only to overdue bank assets, in particular those under credits granted to consumers. It may be assumed that homogeneity of assets covered with securitization in Poland is the consequence of tax rules, as taxation does not only materially affect the costs of the overall undertaking (profitability), but also significantly hinders securitization of other assets.

This article presents an analysis of the influence of domestic tax regulations on the development of the securitization market in Poland. Therefore, this paper has been split into three key parts. The first one describes the structure of transactions within the context of their taxation. The second part focuses on an in-depth analysis of tax consequences arising from individual securitization stages, as varying for the entities that participate therein. And finally, the third part addresses the issue of taxation of the risk related to transfer of the securitized assets by way of sub-participation.

2. The structure of the transaction

Following the English etymology of the term "securitization", which has been derived from the final result of that transaction, namely the issue of securities, such a transaction should be recognised as a method of transforming non-liquid assets into financial instruments subject to unrestricted trading on the capital market [Feeney 1995, p. 1]. The first such a transaction was concluded in the United States in the 70s' of the last century, and involved debt receivables due to long-term mortgage credits, which were singled out and dealt with as a collateral for issue of long-term debt securities. Payments to investors were made by way of credit repayments by debtors, whose credibility was additionally warranted with a collateral established by some governmental agency. As a result of an active development of methods for credit risk assessment, it was subsequently possible for that form of financing to grow significantly, and now its actual value has been, in global terms, estimated to be a few billions of US dollars.

The general structure of the transaction may be described as a two-stage activity which involves at least three distinctive groups of entities. A diagram of such a transaction is presented in Figure 1.

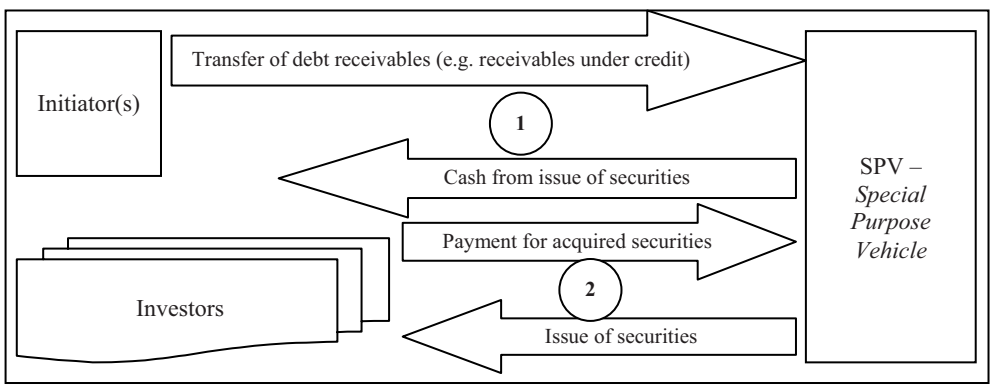

Fig. 1. The structure of securitisation

Source: own study based on J. M. Tavakoli, *Collateralized Debt Obligations & Structured Finance,* Jon Wiley & Sons, Inc, New Jersey 2003, p. 47-82; Ł. Reksa, *Sekurytyzacja wierzytelności na rynkach międzynarodowych,* "Bank i Kredyt" 2004, No. 2, p. 61-69.

The initiator, who holds non-liquid assets, transfers them to a special purpose vehicle (SPV), which has been established exclusively to conclude that transaction. The establishment of the SPV is substantiated with at least two reasons. Firstly, the acquisition of debt receivables contributes to improved financial ratios of the initiator, as those assets are formally excluded from his balance sheet (the so-called off-

-balance sheet securitization). Secondly, since the SPV is not entitled to conduct any other activity but to manage the debt receivables, the risk shouldered by the investors and involving potential bankruptcy of the initiator is limited (*bankruptcy remote control*). Finally, the SPV issues debt securities, which are acquired by investors, and repayment of which is collaterised with the transferred debt receivables. At the same time, the SPV manages the obtained debt receivables or commissions such management to external entities. Such activities provide, first of all, for the collection of debt receivables from debtors (collection) and transfer of the same to investors, taking into account the possible shift in time between the credit instalment payment and maturity of individual coupons of the issued securities.

The presented transaction model is of conventional type. In the course of practice pursued over the last several years, a number of innovations have been introduced involving both the object of the transaction as well as participation of other entities, which most frequently play the role of auxiliary underwriters for the entire issue or of entities that rate the credibility of the same. However, this model may be assumed to be the starting point for an analysis of securitization transactions as regards tax regulations.

Out of the two stages of the transaction, the first one may be, in the Polish civil law, regarded as a sale of debt receivables (1), whereas the second one, i.e. issue of debt securities, is perceived as standard in the capital market (2). As a result, also in the light of tax regulations, securitization is treated as a sequence of transactions, namely the sale of debt receivables and "issue" of debt in the form of debt securities. Assuming such an approach, taxation of securitization transactions involves still unresolved pragmatic issues related to taxation of the debt receivable assignment as well as, to some smaller extent, to tax consequences of issue of debt securities.

Till the end of June 2004, securitization was subject to general taxation rules. As from 1st July, its legal status changed as a result of the Investment Fund Act[1] that took effect. By virtue of that amendment, the legislator has introduced a special type of an investment fund, the so-called securitization fund (Art. 183 of the IFA), which, being another form of a closed-end investment fund, issues certificates to raise financial means in order to acquire debt receivables. At the same time, this Act, in the part that amends other statutes, has brought about a change in the Banking Law[2] (Art. 312 of the IFA) as well as in the Corporate Income Tax Act[3] (Art. 303 of the IFA) by way of determining the conditions binding for taxation of bank debt receivables under securitization.

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[1] Investment Fund Act of 27 May 2004, "Journal of Laws" No. 146, item 1546, as amended, hereinafter: the IFA.

[2] Banking Law Act of 29 August 1997, "Journal of Laws" No. 140, item 939, as amended, hereinafter: the Banking Law.

[3] Corporate Income Tax Act of 15 February 1992, Journal of Laws No. 21, item 86, as amended, hereinafter: the CIT Act.

At present, the tax regulations distinguish among at least three groups of securitization transactions, which bring about different tax consequences. The first group involves securitization of bank debt receivables with an investment fund. The second one includes securitization of other debt receivables with the fund, whereas the third group refers to securitization debt receivables, where the SPV's function is fulfilled by an entity other than an investment fund.

3. Bank asset securitization with the investment fund

A detailed tax regulation applicable to such a transaction brings in a relatively low risk, which cannot, however, be reduced to zero in the area of the tax system. The greatest concern has been still raised by the treatment of the sales with the sales tax. The concern arises from the general and mandatory exemption of the so-called financial services from this kind of taxation [Sobańska, Sieradzan 2001, p. 18, *et seq*]. Such an exemption covers many other activities, not only financial services. What more, it causes many negative, economic effects, such as revenue effects, distortion of input choices, incentive to self-supply, import bias and undermining of the destination principle, compliance costs and further distortion due to partially exempt selling [Bird, Gendron 2007, p. 121].

Reviewing the practice of tax authorities, it is possible to encounter different approaches to the scope of treating the sale of bank debt receivables with VAT and civil law transaction tax. On one hand, the prevailing opinion is that the transfer of bank debt receivables to a securitization fund is a sale of own debt receivables[4], which is not subject to the Goods and Services Tax Act[5]. In the meaning of the VAT Act, it is not a service, as services are, for the purpose of that legal Act, identified according to statistical classifications issued under public statistics regulations, except for e-services (Art. 8 item 3 of the VAT Act). Statistical authorities do not recognise the sale of own debt receivables as a service either[6]. Consequently, tax authorities claim that the sale of bank debt receivables to a securitization fund is

[4] Decision of the Second Mazovian Tax Office in Warsaw dated 13.06.2006, file no. 1472/RPP1/443-336/06/AW.

[5] Goods and Services Tax Act of 11 March 2004, Journal of Laws No. 54, item 535, as amended, hereinafter the VAT Act.

[6] See the letter by the Director of Co-ordination and Research Organisation Department of the Main Statistical Office in Warsaw dated 30 January 2006, file no. OB-02-22-5672/KU-732/2005/7865 from which it may be concluded that according to the Polish Classification of Goods and Services binding from 1 May 2004 and entered into force by the Regulation of the Council of Ministers on 6 April 2004 (Journal of Laws No. 89, item 844, as amended) as well as to the Polish Classification of Goods and Services applied for tax purposes and entered into force by a Regulation of the Council of Ministers on 18 March 1997 (Journal of Laws No. 42, item 264, as amended) a sale of own debt receivables is not a service according to the methodological rules of the Polish Classification of Goods and Services.

subject to a civil law transaction tax[7]. At the same time, it is possible to encounter an opinion that the sale of bank debt receivables is exempt from VAT under Art. 43 item 1 sub-item 1 of the VAT Act[8]. In the given interpretation, the taxpayer substantiated his stance with the presented classification-related opinion of the Statistical Office in Łódź, according to which the sale of debt receivables is a financial agency activity (Polish Classification of Goods and Services, no. 65.23.10-00.00). This means that one of the reasons for the inconclusive standpoint of the tax authorities lies with the divergent interpretations of the Statistical Office, which is unable to definitely qualify the activities undertaken by the taxpayers. If assumed as being subject to a VAT exemption, such a transaction should not be treated with civil law transaction tax in the light of the definite meaning of Art. 2 item 4 of the TCLT Act[9]. This thesis may be as well supported with a precedent decision of the provincial administrative court, according to which the sale of own debt receivables is not subject to the tax on civil law transactions[10].

As a result of the said amendment, the regulations of the CIT Act legally exempt from taxation, first of all investment funds, which is also applicable to securitization funds (Art. 6 item 1 sub-item 10 of the CIT Act). Such a regulation covers the international standards applied to SPV vehicles, which should be exempted from the tax [Kendall, Fishman 1996, p. 3]. At the same time, the bank selling the debt receivables does not recognise as revenues the debt receivables due from credits (loans), transferred to a securitization fund or an investment fund association that established the same, up to their outstanding amount (Art. 12 item 4 sub-item 15 of the CIT Act) unless they have not been actually transferred upon the lapse of 5 working days of the transfer due date (Art. 12 item 9 of the CIT Act). At the same time, a loss from the sale of debt receivables due from credits (loans) to a securitization fund or an investment fund association that established the same, the loss being a difference between the amount earned from that sale and the value of the debt receivables due from credits (loans) and matching the value of a provision already made for that part of debt receivables, as recognised under tax-deductible (revenue earning) costs, is the tax-deductible cost for the bank (Art. 15 item 1h sub-item 2 of the CIT Act). This solution develops, as a matter of fact, on the general rule that the loss from the sale of debt receivables is a tax-deductible cost if, at the moment of its incurrence, it was recognised as taxable revenue (*a contrario* Art. 16 item 1 sub-item 39 of the CIT Act), although the credits granted by banks are not classified as revenues. Moreover,

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[7] Decision of Second Mazovian Tax Office in Warsaw dated 22.06.2006, file no. 1472/SPC/436--11/06/PM.

[8] Decision of Second Mazovian Tax Office in Warsaw dated 25.07.2006, file no. 1471/NTR1/443--169/06/AM.

[9] Tax on Civil Law Transaction Act of 9 September 2000, "Journal of Laws" No. 86, item 959, as amended, hereinafter: the TCLT Act.

[10] Judgement of the Provincial Administrative Court of 14 February 2006, file no. I SA/Gd 1301/2003.

pursuant to Art. 16 item 1 sub-item 10 paragraph e of the CIT Act, expenses attributable to transfer, by a bank to a securitization fund or an investment fund association that established the same, of financial assets from repayment of credits (loans) subject to debt receivable securitization are not considered tax-deductible costs. Summarizing, it may be concluded that from the income tax perspective, bank asset securitization with a securitization fund is not only neutral, but it also brings about additional benefits such as possibility to recognise as tax-deductible costs the loss from the sale of debt receivables, which have not been earlier disclosed as revenues.

4. Other asset securitization with the investment fund

Tax regulations do not provide for any specific tax and legal solutions with respect to securitization of other debt receivables, except for the aforementioned legal exemption of the securitization fund from the income tax obligation. This means that already in this case it is possible to find the described discrepancies in the treatment of the sale of debt receivables with sales taxes. Moreover, such a transaction is not so favourable when it comes to the income tax. A loss from the disposal of debt receivables other than bank assets is, as a matter of fact, a tax-deductible cost provided, however, that the already accrued receivables were previously classified as taxable revenues (Art. 16 item 1 sub-item 39 of the CIT Act). In practice, if the total costs of a transaction are increased by a tax on civil law transactions and added to the high cost of establishing and running a securitization fund, any potential participant may feel effectively deterred from concluding such a transaction.

5. Securitization without investment fund

The first securitization of debt receivables without a securitization fund in Poland was carried out at the end of the nineties. The scarcity of such transactions until these days is a result of *i.a.* an imminent tax risk, which is posed by both an increase in the transaction cost as well as unclearness of tax treatment of individual parts of that transaction. The already mentioned obligation to tax assignment of bank debt receivables with the civil law transaction tax applies as well if other debt receivables are sold. As a consequence, the tax at the rate of 1% of the assignment value affects significantly the final profitability of such a transaction.

In the income tax area, the greatest difficulty is posed by coordination over time of the receipts and expenses on both the initiator's as well as the SPV's sides, in a way so as to have the transactions that generate the taxable revenues and tax-deductible costs concluded in the same settlement period. Moreover, in such securitization transactions, the SPV is most frequently a limited liability company, which is treated as a taxpayer subject to all the duties to keep records and make settlements. Although the costs of establishing such a company are smaller than those of an investment fund, the poor interest in this form of securitization may be evidenced by the fact that

securitization of bank debt receivables does not account for such a form. Regulations of the Banking Law provide for the possibility to sale bank debt receivables by an issuing entity (incorporated company) other than a securitization fund (Art. 92a item 3 of the Banking Act).

6. Sub-participation

Additional tax burdens, which occur with innovative financial services and materially affect the final financial result of those services, are not exclusively a characteristic feature of the Polish tax system. The same may be commonly encountered in other tax jurisdictions, which has made the capital market players search for new solutions that limit taxation and at the same time still provide the transaction participants with financial benefits. An example of such a solution related to securitization is the so-called sub-participation (or participation), which is defined as a transfer of a risk related to securitized debt receivables to the SPV [Jobst 2010, p. 8-9]. It does not involve any formal or legal transfer of ownership title to the securitized debt receivables, which in turn does not result in a tax obligation to arise due to their sale.

In Poland, however, the legislator took one step further and, from the income tax perspective, sub-participation has been approached in the way similar to the sale of debt receivables. Exercising such a treatment under regulations of the IFA, the legislator applied that solution exclusively to sub-participation in bank debt receivables with a securitization fund. Pursuant to Art. 15 item 1h sub-item 3 of the CIT Act, as tax-deductible (revenue earning) costs of a bank there may be recognised the amounts transferred to a securitization fund or an investment fund association that established such a fund, which are covered with a sub-participation agreement and include the following:

- benefits from securitized debt receivables,
- principal amounts of the securitized debt receivables,
- amounts earned due to the realisation of collaterals for securitized debt receivables.

At the same time, the loss from transfer of debt receivables under a sub-participation agreement to a securitization fund is not a tax-deductible cost[11]. As a consequence, a special treatment is applied only to performances transferred by the bank under execution of credit agreements being subject to sub-participation.

[11] Decision of the Tax Office of Małopolska Province dated 18.10.2005, file no. DP1/423-42/05/75047.

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OPODATKOWANIE SEKURYTYZACJI AKTYWÓW W POLSCE

Streszczenie: Opodatkowanie sekurytyzacji aktywów w Polsce odzwierciedla wpływ systemu podatkowego na rozwój określonych segmentów rynku kapitałowego. Wprowadzone szczególne regulacje podatkowe doprowadziły obecnie do sytuacji, że wyłącznie jedna grupa inicjatorów całego procesu, tj. instytucje bankowe, podejmują takie transakcje. Istniejące regulacje prawno-podatkowe prowadzą do marginalizacji innych uczestników, a tym samym mogą być traktowane jako negatywny przykład ingerencji w funkcjonowanie mechanizmu rynkowego. Podsumowując, obecny stan i perspektywy rozwoju rynku sekurytyzacji aktywów w Polsce uzależnione są przede wszystkim od kształtu regulacji podatkowych.