

The source of a debt defeasance receipt

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Abstract

A debt defeasance arrangement is an arrangement whereby a debtor's obligation to pay a creditor is nullified. The debtor and other parties perform a variety of legal and other actions in order to effect a valid debt defeasance arrangement. One of the actions that should be taken by the debtor is to pay an amount to a third party who takes over the obligation to pay the debt. The money received by the third party is referred to as a debt defeasance receipt.

Debt defeasance arrangements are used in countries such as the United States of America and Australia. The financial community in South Africa is becoming increasingly interested in the debt defeasance arrangement. As South Africa is becoming part of the global community, more foreign companies are doing business in South Africa. Because it is a relatively unfamiliar arrangement, that has not yet been addressed by the South African taxation authorities, there are probably a number of unanswered tax questions regarding the arrangement. One issue that is not yet clear is what the source of a debt defeasance receipt would be if it were to be received by a non-resident in South Africa.

A survey was done among South African banks, auditing firms and taxation senior counsel to determine the majority opinion of South African respondents regarding the source of a debt defeasance receipt. Although a variety of alternatives are identified as possible sources, the majority view is that the source is the debt defeasance business activities that are conducted by the recipient. It therefore follows that if the recipient of a debt defeasance receipt conducted his or her debt defeasance business activities in South Africa, the receipt will be of a South African source.

Key words

Debt defeasance arrangement

Source

Non-resident

South Africa

1 Introduction

In November 1983, the Financial Accounting Standards Board (FASB) of the United States of America issued an amendment to statement number 26 of the Accounting Principles Board to address the accounting for transactions that involve in-substance defeasance of debt (Peterson, Peterson and Ang 1985:59). In its statement number 76, the FASB identifies criteria in terms of which a firm may defease debt (that is, satisfy the debt obligation) through the establishment of a trust that contains United States of America government securities that have a maturity profile that match the cash flows of the defeased obligation. The debt is then considered defeased or satisfied by the trust arrangement (hence the “in-substance” that is associated with this transaction). The issuing of this statement by the FASB was in response to growing interest over several years by the financial community in the use of in-substance defeasance to remove debt from the balance sheet and to improve reported earnings (Peterson *et al* 1985:59).

In 1990, the Accounting Standards Review Board (ASRB) of Australia issued statement number 1014, which permits the use of in-substance debt defeasance (Wearing 1993:179). Wearing (1993:179) also confirms that listed companies in the United States of America and Australia have been making increasing use of in-substance debt defeasance since 1993.

1.1 Defining debt defeasance

A debt defeasance in its true form is a delegation of a debt by the borrower to the assumer, which results in the borrower no longer being contractually bound to the lender. Claassen (2001:§ D-36) defines a delegation as a transaction by means of which a creditor accepts one debtor in substitution for another. This definition is confirmed in the case of *Standard Bank v Union Boating Company* (1890(7):268).

The Afrikaans word for defeasance is “nietigverklaring” (Bosman, Van der Merwe and Heimstra 1984:805). Translated into English, this Afrikaans word also means annulment, nullification, invalidation, vacation, setting aside, declaration of nullity and rescission (Bosman *et al* 1984:342). According to Morris (1973:345), defeasance also means annulment or rendering void; the voiding of a contract, deed or a clause in a contract; or a deed that provides for annulment. It therefore follows that the term “debt defeasance” means to invalidate or nullify debt. Peterson *et al* (1985:60) agree with this interpretation by stating that the term refers to the release of a debtor from the legal liability that is associated with a debt.

When debt is defeased, it is no longer reported as a liability on the face of the balance sheet. Only new debt, if any, is recorded (The Governmental Accounting Standards Board 1987:200).

For the purposes of this paper, a payment made by a party who wants to defease his or her debt, and which is received by the party who assumes the debt, is called a debt defeasance receipt.

There are four types of debt defeasance arrangements, namely:

- Legal defeasance (The Governmental Accounting Standards Board 1987:200).
- In-substance defeasance (Gray and Seville 1985:101).
- Instantaneous legal defeasance (Nenna and Clough 1990:20).
- Instantaneous in-substance defeasance (Nenna and Clough 1990:20).

A legal defeasance occurs when a debt is legally satisfied, based on certain provisions contained in the debt instrument, even if the debt has not actually been paid (The Governmental Accounting Standards Board 1987:200). Nenna and Clough (1990:17) define a legal defeasance as an arrangement whereby the borrower is released from his or her obligation towards the lender when a third party, the assumer, accepts the obligation to pay the lender the principle loan liability on the maturity date of the loan concerned. The assumer receives a consideration for accepting this liability. The lender has no further right of action against the borrower and the assumer does not act for or on behalf of the borrower (Nenna and Clough 1990:17). The borrower is also released from the covenants contained in the agreement (Johnson, Pari and Rosenthal 1989:1051).

An in-substance defeasance occurs when debt is considered defeased for accounting purposes, as well as for financial reporting purposes, even though a legal defeasance has not taken place (The Governmental Accounting Standards Board 1987:200). Johnson *et al* (1989:1050) state that it is a procedure whereby a borrower can remove the debt from his or her books even though the borrower has not legally been released from being the primary obligor under the terms and conditions of the debt agreement. Debt is considered defeased in-substance for accounting and financial reporting purposes if the borrower irrevocably places cash and/or other assets in a trust (The Governmental Accounting Standards Board 1987:201; Gray and Seville 1985:101). The trust is restricted to owning monetary assets that are essentially risk free with regard to the amount, timing and collection of interest and capital. The monetary assets should be denominated in the same currency as the principal loan liability (The Governmental Accounting Standards Board 1987:201; Johnson *et al* 1989: 1049).

In both a legal and an in-substance defeasance arrangement, the arrangement is entered into in relation to an existing debt. An instantaneous defeasance is an arrangement entered into in relation to a new debt (Nenna and Clough 1990:20). An instantaneous legal defeasance arrangement usually involves a third party, the assumer, who assumes the capital obligations of the *new* loan liability (Nenna and Clough 1990:22). An instantaneous in-substance defeasance is an arrangement whereby the borrower places assets in trust at the same time as raising debt in order to defease the debt. This transaction amounts to a profit-making arrangement and is motivated by the ability of a party to raise debt at an interest rate that is lower than the rate of return on the investment (Johnson *et al* 1989:1049).

1.2 The problem

South Africa has lagged behind the rest of the world regarding the use of a debt defeasance arrangement. A debt defeasance arrangement has not been addressed in the South African Generally Accepted Accounting Standards, nor is it mentioned in the Income Tax Act.

The financial community in South Africa is becoming increasingly interested in debt defeasance arrangements. Both the Accounting Standards Board of South Africa and the income tax authorities should therefore address the treatment of this arrangement for both accounting and taxation purposes.

1.3 Objective of the study

Because the starting point in the calculation of taxable income is gross income, it is necessary to determine the amount to be included in the gross income of a non-resident. The requirements of all of the components of the definition of gross income should be fulfilled before an amount may constitute gross income. One of the components of the definition of gross income concerns the source of the income.

Non-residents are only taxed on receipts and accruals of income that derive from sources within, or that are deemed to be within, South Africa in terms of the definition of gross income (Income Tax Act 1962: section 1). There is no definition of the term “source” in the Income Tax Act. It appears that the reason for this lack is that it is virtually impossible to define satisfactorily in all circumstances the qualities that determine the source of income (De Koker 2002:§5.3). In *CIR v Lever Brothers and Unilever Ltd* (1946:13) it was found that it is probably an impossible task to formulate a definition that serves as a universal test for determining when an amount is received from a source within the Republic of South Africa. In *CIR v Epstein* (1954(3):231) an observation was made that the legislature is probably aware of how difficult it is to define the words “source within the Republic” and therefore no definition has been formulated.

As a consequence of the fact that there is no definition of “source” in the Income Tax Act, the courts have to decide, on the particular facts of each case, whether income is or was received from a source within the Republic (De Koker 2002:§5.3, Huxham and Haupt 2002:15).

Section 9 of the Income Tax Act deals with amounts that are deemed to have been received from a source within South Africa (Income Tax Act 1962: section 9). Section 9 was analysed to identify all the circumstances in which a receipt is deemed to be a receipt that has a South African source. None of the provisos refer to or concern a debt defeasance receipt (Biemans 2002:32).

The objective of this study is to determine the source of a debt defeasance receipt in cases in which it is received by a non-resident.

1.4 Hypothesis

It was hypothesised that there could be more than one source of a debt defeasance receipt.

1.5 Scope of the study

This study focuses on the source of a debt defeasance receipt if it is received

- in South Africa and
- by a non-resident.

The study was not limited to debt defeasance arrangements in which the original debt was provided in South Africa. Furthermore, for the purposes of this study, no limitations were placed on the place where the debt defeasance receipt is applied .

1.6 Importance of the study

The financial community in South Africa is becoming more interested in debt defeasance arrangements (Marais 2002). The South African financial markets are rapidly being integrated into the global community (Stals 1998) and as a result thereof more non-residents are doing business in South Africa.

The Income Tax Act states that gross income in relation to any person other than a resident is the total amount, in cash or otherwise, received by or accrued to or in favour of such person *from a source within, or deemed to be within, the Republic* (Income Tax Act 1962: section 1). It is therefore probable that non-residents will soon be faced with the issue of whether or not they should pay tax on a debt defeasance receipt as they are taxed on income that has its source within South Africa. This study addresses the question of whether there is certainty regarding the source of a debt defeasance. It also lays the groundwork for further investigations into the topic that may be necessary.

2 Research methodology

In order to determine which type of income could be considered to most closely mirror a debt defeasance receipt and to obtain general inputs regarding what South African respondents consider the possible source(s) of a debt defeasance receipt to be, a questionnaire was distributed to those persons in South Africa who are likely to be knowledgeable about a debt defeasance arrangement and South African income tax.

The questionnaires were distributed to all the South African entities that may have been involved with the implementation of, research into or structuring of debt defeasance transactions and may therefore be in a position to provide meaningful information that could lead to a logical conclusion. The questionnaire was a necessary instrument, because the debt defeasance arrangement is still in its infancy in South Africa. Therefore there is very little literature available on the topic in South Africa

The information obtained was collated and the majority opinion was determined of the South African respondents who are knowledgeable about debt defeasance arrangements and South African income tax.

2.1 Questionnaire

Section A of the questionnaire comprises general questions about the respondent. Section B comprises questions relating to the respondent's knowledge of and exposure to tax issues and debt defeasance arrangements. Section C comprises 24 statements that are divided into 5 subsections in accordance with the type of income that could be used as a guideline to determine the source of a debt defeasance receipt. These types of income were derived from a detailed study of sources of income and the questions were based on the results of that study (Biemans 2002).

The respondent were required to choose from five options, namely.:

- 1 Totally disagree.
- 2 Disagree.
- 3 Neutral.
- 4 Agree.
- 5 Totally agree.

The statements contained in section C of the questionnaire are all closed statements and the respondent could therefore only choose from one of five options. Section D, the last section of the questionnaire, comprises three open questions that specifically concern the source of a debt defeasance receipt and the respondent could provide his or her opinion on the issue concerned .

2.2 Population and sample

A debt defeasance arrangement is a very specialised arrangement that is not well known in South Africa. From discussions with various tax specialists in the corporate market in South Africa it became evident that the following entities may have had the greatest measure of exposure to, and have done the most research on, this arrangement:

- Banks.
- Auditing firms.
- Taxation senior counsel.

A list of the registered banks was obtained from the Banking Council of South Africa and a list of the largest registered auditing firms was obtained from the South African Institute of Chartered Accountants. These auditing firms are much larger than the other auditing firms in terms of turnover, staff numbers, client base and international representation. It was difficult to communicate with taxation senior counsel as a result of their status in the taxation arena as well as their workload.

All the banks on the list that was provided by the Banking Council of South Africa were included in the sample, with the exception of the banks that were under curatorship. All four of the auditing firms on the list provided by the South African Institute of Chartered Accountants were included in the sample. It was decided not to include taxation senior counsel in the population due to their inaccessibility but to invite two members of the senior council to take part in the study and form part of the sample. A total of 33 questionnaires were distributed to a person in each of the banks and auditing firms and to the two taxation senior counsel members. They were distributed to either

- a tax partner or a manager in the auditing firms or
- a structured financier, tax manager or accountant responsible for the tax affairs of the bank,

depending on who is most knowledgeable about the tax effects of the debt defeasance arrangement or, failing this, about the tax affairs of the bank.

A telephone call was made to each of the parties included in the sample to determine which person is most capable of completing the questionnaire. The identified respondent was telephoned and his or her telephone number, fax number, e-mail address and physical address obtained and noted. Each respondent was also asked how he or she would prefer to receive the questionnaire. In accordance with the response received, the questionnaire was either delivered by hand, faxed or e-mailed to the respondent.

2.3 Response rate

Each party who had not responded, was phoned each week for six weeks.

The response rates were as follows:

- Banks 80% (20 of 25 distributed);
- Auditing firms 100% (4 of 4 distributed);
- Taxation senior counsel 50% (1 of 2 distributed).

The respondents in banks who did not reply provided the following reasons for not responding:

- The confidentiality of their clients prohibit them from completing the questionnaire. Even after being assured of anonymity, they were still unwilling to complete the questionnaire.
- The topic is so complex that it can only be completed by a staff member who is not currently available.
- As a result of to the workload caused by the South African Revenue Services ("SARS") submitting arbitrary queries to his or her employer the respondent does not have the time to complete the questionnaire.

The one taxation senior counsel member who did not complete the questionnaire stated that he was too busy assisting clients who had received arbitrary queries from SARS.

All the respondents who completed the questionnaire had thoroughly considered the statements that they made. Seven respondents in banks completed only the first two sections of the questionnaire, because they had never been involved in the implementation of, research into or structuring of debt defeasance arrangements. Their reaction is in line with the instructions that are contained in the questionnaire.

The opinions stated in the fourth section of the questionnaire proved to be valuable for providing views regarding the research topic.

3 Findings of the study

The responses that were provided are summarised in terms of percentages below. The following abbreviations are used:

- B = Banks
- AF = Auditing firms
- TSC = Taxation senior counsel

3.1 Dividends

3.1.1 Results

- 1 To what extent do you agree that the originating debt of a debt defeasance receipt is comparable to shares that generate a dividend?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	54%	30%	8%	8%	0%
AF	25%	50%	25%	0%	0%
TSC	0%	100%	0%	0%	0%

Eighty-four percent of the bank respondents, 75% of the auditing firm respondents as well as the taxation senior counsel do not agree with the statement that the originating debt of a debt defeasance receipt is comparable to shares that generate a dividend.

- 2 To what extent do you agree that the originating cause of a debt defeasance receipt is the originating debt?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	8%	23%	15%	39%	15%
AF	0%	25%	0%	75%	0%
TSC	0%	100%	0%	0%	0%

Fifty-four percent of the bank respondents and 75% of the auditing firm respondents agree with the statement that the originating cause of a debt defeasance receipt is the originating debt. The taxation senior counsel does not agree with this statement.

- 3 *To what extent do you agree that the location of the originating debt is the place where the lender conducts his or her business activities?*

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	8%	15%	0%	54%	23%
AF	0%	50%	25%	25%	0%
TSC	0%	0%	0%	100%	0%

Seventy-seven percent of the bank respondents and the taxation senior counsel agree with the statement that the location of the originating debt is the place where the lender conducts his or her business activities. Fifty percent of the auditing firm respondents disagree with this statement, whereas 25% of the auditing firm respondents hold a neutral view.

- 4 *To what extent do you agree that the location of the originating debt is the place where the debt creation contract was entered into?*

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	15%	54%	8%	23%	0%
AF	25%	50%	0%	25%	0%
TSC	0%	0%	0%	100%	0%

Sixty-nine percent of the bank respondents and 75% of the auditing firm respondents do not agree with the statement that the location of the originating debt is the place where the debt creation contract was entered into. The taxation senior counsel agrees with the statement.

- 5 *To what extent do you agree that the same court cases could be used to determine the source of a debt defeasance receipt as are used to determine the source of a dividend receipt?*

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	15%	39%	23%	23%	0%
AF	25%	50%	25%	0%	0%
TSC	0%	100%	0%	0%	0%

Fifty-four percent of the bank respondents, 75% of the auditing firm respondents as well as the taxation senior counsel do not agree with the statement that “dividend” court cases could be used to determine the source of a debt defeasance receipt.

3.1.2 Conclusion

The respondents do not hold the opinion that a dividend receipt is comparable to a debt defeasance receipt. Therefore the same court cases cannot be used to determine the source of both types of receipt. The majority of respondents are of the opinion that the originating cause of a debt defeasance receipt is the originating debt and that the location thereof is where the lender conducts his or her business activities.

3.2 Services rendered

3.2.1 Results

- 1 To what extent do you agree that the person who accepts a debt defeasance receipt, and also the liability to repay the originating debt, renders a service in respect of repaying the originating debt?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	15%	15%	8%	39%	23%
AF	25%	25%	0%	50%	0%
TSC	0%	0%	0%	0%	100%

Sixty-two percent of the bank respondents, 50% of the auditing firm respondents as well as the taxation senior counsel agree with the statement that the debt defeasance recipient (the assumer or the trust) renders a service in respect of repaying the originating debt. Fifty percent of the auditing firm respondents do not agree with this statement.

- 2 To what extent do you agree that the originating cause of a debt defeasance receipt is the service that is rendered?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	15%	23%	15%	39%	8%
AF	25%	25%	0%	50%	0%
TSC	0%	0%	0%	0%	100%

Forty-seven percent of the bank respondents, 50% of the auditing firm respondents as well as the taxation senior counsel agree with the statement that the originating cause of a debt defeasance receipt is the service that is

rendered. Thirty-eight percent of the bank respondents and 50% of the auditing firm respondents do not agree with this statement.

- 3 *To what extent do you agree that the location of the service that is rendered is the place from which the originating debt is repaid?*

	Totally disagree		Neutral	Totally agree	
	1	2	3	4	5
B	23%	39%	23%	15%	0%
AF	25%	25%	50%	0%	0%
TSC	0%	0%	0%	100%	0%

Sixty-two percent of the bank respondents and 50% of the auditing firm respondents do not agree with the statement that the location of the service that is rendered is the place from which the originating debt is repaid. The taxation senior counsel disagrees with the majority view, whereas 50% of the auditing firm respondents hold a neutral view.

- 4 *To what extent do you agree that the same court cases could be used to determine the source of a debt defeasance receipt as those that are used to determine the source of a service rendered?*

	Totally disagree		Neutral	Totally agree	
	1	2	3	4	5
B	15%	23%	23%	23%	15%
AF	25%	25%	25%	25%	0%
TSC	0%	0%	0%	0%	100%

Thirty-eight percent of the bank respondents and 50% of the auditing firm respondents do not agree with the statement that the “services rendered” court cases could be used to determine the source of a debt defeasance receipt. Thirty-eight of the bank respondents, 25% of the auditing firm respondents and the taxation senior counsel agree that these court cases could be used as a reference.

3.2.2 Conclusion

The respondents are of the opinion that the trust or assumer renders a service. However, the respondents are divided about whether the same court cases could be used to determine the source of a debt defeasance receipt as are used for services rendered. A small majority of respondents hold the opinion that the originating cause of a debt defeasance receipt is the service that is rendered.

3.3 Royalties

3.3.1 Results

1 *To what extent do you agree that the invention of a debt defeasance arrangement and the utilisation of wits and intellectual capital to determine the feasibility of such an arrangement that generates a debt defeasance receipt is comparable to the generation of a royalty?*

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	39%	53%	8%	0%	0%
AF	75%	0%	25%	0%	0%
TSC	100%	0%	0%	0%	0%

Ninety-two percent of the bank respondents, 75% of the auditing firm respondents as well as the taxation senior counsel do not agree with the statement that a debt defeasance receipt is comparable to a royalty.

2 *To what extent do you agree that the originating cause of a debt defeasance receipt is the invention of the debt defeasance arrangement?*

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	30%	54%	8%	8%	0%
AF	75%	0%	25%	0%	0%
TSC	0%	100%	0%	0%	0%

Eighty-four percent of the bank respondents, 75% of the auditing firm respondents as well as the taxation senior counsel do not agree with the statement that the originating cause of a debt defeasance receipt is the invention of the debt defeasance arrangement.

3 *To what extent do you agree that the location of the innovation is the place where the innovators utilise their wits and intellectual capacity?*

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	39%	23%	0%	30%	8%
AF	75%	0%	0%	25%	0%
TSC	0%	100%	0%	0%	0%

Sixty-two percent of the bank respondents, 75% of the auditing firm respondents as well as the taxation senior counsel do not agree with the statement that the location of the innovation of the debt defeasance arrangement is the place where the innovators utilise their intellectual capacity.

- 4 *To what extent do you agree that the same court cases could be used to determine the source of a debt defeasance receipt as are used to determine the source of a royalty?*

	Totally disagree		Neutral	Totally agree	
	1	2	3	4	5
B	47%	30%	15%	8%	0%
AF	100%	0%	0%	0%	0%
TSC	100%	0%	0%	0%	0%

Seventy-seven percent of the bank respondents, 100% of the auditing firm respondents as well as the taxation senior counsel do not agree that court cases regarding “royalty” could be used to determine the source of a debt defeasance receipt.

3.3.2 Conclusion

The respondents do not hold the opinion that a royalty receipt is comparable to a debt defeasance receipt and therefore the same court cases cannot be used to determine the source of both types of receipt.

3.4 Trading commodities

3.4.1 Results

- 1 *To what extent do you agree that a debt defeasance arrangement, the sale of debt by the original debtor to another party, is comparable to the sale of a trading commodity?*

	Totally disagree		Neutral	Totally agree	
	1	2	3	4	5
B	15%	46%	0%	39%	0%
AF	0%	75%	0%	0%	25%
TSC	0%	0%	0%	100%	0%

Sixty-one percent of the bank respondents and 75% of the auditing firm respondents do not agree with the statement that the sale of a debt by the original debtor to another party is comparable to the sale of a trading commodity. However, taxation senior counsel does agree that it is comparable.

2 To what extent do you agree that the originating cause of a debt defeasance receipt is the sale of the debt?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	31%	15%	23%	31%	0%
AF	0%	50%	0%	25%	25%
TSC	0%	0%	0%	100%	0%

Forty-six percent of the bank respondents and 50% of the auditing firm respondents do not agree with the statement that the originating cause of a debt defeasance receipt is the sale of the debt. The taxation senior counsel and 50% of the auditing firm respondents do agree with the statement.

3 To what extent do you agree that the location of the “sales” activity is the place where the debt defeasance activities are performed?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	23%	15%	23%	39%	0%
AF	0%	50%	25%	0%	25%
TSC	0%	0%	0%	100%	0%

Respondents are very divided in respect of their views on the statement that the location of the “sales” activity is the place where the debt defeasance activities are performed. Thirty-eight percent of the bank respondents and 50% of the auditing firm respondents do not agree with the statement, whereas 39% of the bank respondents, 25% of the auditing firm respondents as well as the taxation senior counsel do agree with the statement.

4 To what extent do you agree that the location of the “sales” activity is the place where the debt defeasance contract is entered into?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	23%	31%	23%	23%	0%
AF	25%	50%	0%	25%	0%
TSC	0%	0%	0%	100%	0%

Fifty-four percent of the bank respondents and 75% of the auditing firm respondents do not agree that the location of the “sales” activity is the place where the debt defeasance contract is entered into.

- 5 To what extent do you agree that the same court cases could be used to determine the source of a debt defeasance receipt as are used to determine the source of the sale of a trading commodity?

	Totally disagree		Neutral	Totally agree	
	1	2	3	4	5
B	31%	31%	8%	31%	0%
AF	25%	25%	25%	25%	0%
TSC	0%	0%	0%	100%	0%

Sixty-two percent of the bank respondents and 50% of the auditing firm respondents do not agree that court cases regarding “trading commodity” could be used to determine the source of a debt defeasance receipt. The taxation senior counsel and 25% of the auditing firm respondents do agree with the statement.

3.4.2 Conclusion

The respondents do not hold the opinion that a receipt for the sale of a trading commodity is comparable to a debt defeasance receipt and therefore the same court cases cannot be used to determine the source of both types of receipt. Some respondents do agree that the location of the “sales” activity in a debt defeasance arrangement is the place where the debt defeasance activities occur.

3.5 Business income

3.5.1 Results

- 1 To what extent do you agree that a debt defeasance receipt is comparable to a receipt of business income?

	Totally disagree		Neutral	Totally agree	
	1	2	3	4	5
B	8%	23%	15%	46%	8%
AF	0%	0%	50%	25%	25%
TSC	0%	0%	0%	0%	100%

Fifty-four percent of the bank respondents, 50% of the auditing firm respondents as well as the taxation senior counsel agree with the statement that a debt defeasance receipt is comparable to the receipt of business income. Fifty percent of the auditing firm respondents hold a neutral view in this regard.

2 To what extent do you agree that the originating cause of a debt defeasance receipt is the debt defeasance activities that are performed by the recipient of the debt defeasance?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	0%	8%	23%	61%	8%
AF	0%	0%	50%	25%	25%
TSC	0%	0%	0%	100%	0%

Sixty-nine percent of the bank respondents, 50% of the auditing firm respondents as well as the taxation senior counsel agree with the statement that the originating cause of a debt defeasance receipt is the debt defeasance activities performed by the recipient of the debt defeasance.

3 To what extent do you agree that the location of the debt defeasance activities is the place where the debt defeasance receipt is received?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	8%	39%	0%	54%	0%
AF	25%	25%	50%	0%	0%
TSC	0%	0%	0%	100%	0%

Respondents are very divided regarding the statement that the location of debt defeasance activities is the place where the debt defeasance receipt is received. Fifty-four percent of the bank respondents and the taxation senior counsel agree with the statement, whereas 47% of the bank respondents and 50% of the auditing firm respondents do not agree with the statement. Fifty percent of the auditing firm respondents hold a neutral view on the issue.

4 To what extent do you agree that the location of the debt defeasance activities is the place where the originating debt is repaid?

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	15%	69%	8%	8%	0%
AF	0%	75%	0%	25%	0%
TSC	0%	0%	100%	0%	0%

Eighty-four percent of the bank respondents and 75% of the auditing firm respondents do not agree with the statement that the location of the debt defeasance activities is the place where the originating debt is repaid. The taxation senior counsel holds a neutral view on the matter.

5 *To what extent do you agree that the location of the debt defeasance activities is the place where the investments, if any, are made?*

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	0%	54%	15%	31%	0%
AF	0%	25%	50%	25%	0%
TSC	0%	0%	100%	0%	0%

Fifty-four percent of the bank respondents and 25% of the auditing firm respondents do not agree with the statement that the location of the debt defeasance activities is the place where the investments are made. The taxation senior counsel and 50% of auditing firm respondents hold a neutral view on the matter.

6 *To what extent do you agree that the same court cases could be used to determine the source of a debt defeasance receipt as are used to determine the source of business income?*

	Totally disagree		Neutral		Totally agree
	1	2	3	4	5
B	0%	15%	23%	54%	8%
AF	0%	0%	25%	50%	25%
TSC	0%	0%	0%	0%	100%

Sixty-two percent of the bank respondents, 75% of the auditing firm respondents as well as the taxation senior counsel agree with the statement that court cases regarding "business income" could be used to determine the source of a debt defeasance receipt.

3.5.2 Conclusion

The respondents hold the opinion that a business income receipt is comparable to a debt defeasance receipt and that the same court cases could be used to determine the source of both types of receipt. The majority of respondents agree that the originating cause of a debt defeasance receipt is the debt defeasance activities that are performed by the recipient of the debt defeasance receipt, but the respondents are not in agreement on the location of the activities.

3.6 Opinions requested

3.6.1 Results

1 *What, in your opinion, is the possible originating cause(s) of a debt defeasance receipt?*

The bank respondents hold a variety of views on what the originating cause of a debt defeasance receipt is. The majority of these respondents are of the opinion

that it is the debt defeasance activities that are performed and the rendering of the defeasance service. Some respondents agree that the originating debt is the originating cause and others agree that the implementation of the structure is the originating cause. The following individual views are also held, but they are not shared by any of the other bank respondent:

- Trading of a commodity (the original debt).
- The disposal of the originating debt.
- The debt defeasance contract.

The auditing firm respondents hold the view that the originating cause of a debt defeasance receipt is the rendering of the service and specifically the defeasance of the debt.

The taxation senior counsel respondent is of the opinion that the originating cause could be the debt defeasance activities, but that it could also possibly be the debt defeasance contract or specifically the activity of making the investments.

2 Where, in your opinion, is the location(s) of the originating causes that is (are) mentioned in question 1 above?

The bank respondents have a variety of views on what is the location of the originating cause of a debt defeasance receipt. The majority of them are of the opinion that it is where the debt defeasance business activities are performed. Some are of the opinion that it is where the originating debt is located or made available. The following individual opinions are also held, but are not shared by any of the other bank respondents:

- Where the service contract is entered into.
- Where the main components of the structure are implemented.
- Where the proceeds of the original debt are utilised.
- Where the debtor's main business activities are conducted.
- Where the lender conducts his or her business activities.

The auditing firm respondents are of the opinion that the location of the originating cause of a debt defeasance receipt is either where the debt defeasance service is rendered, where the debtor is resident, where the debt defeasance contract is signed or where the debtor or trust or assumer conducts its business.

Taxation senior counsel is of the opinion that the location is the place where the trust or assumer performs its debt defeasance activities.

3 In your opinion, which of the following is the source of a debt defeasance receipt and why?

- 3.1 Where the original debt contract is concluded.
- 3.2 Where the originating debt is advanced.
- 3.3 Where the assumer or the trust performs its debt defeasance activities.
- 3.4 Where the service is rendered (i.e. the repayment of the principal debt).
- 3.5 Where the debt defeasance arrangement is invented.
- 3.6 Where the debt defeasance contract is concluded.

Most bank respondents are of the opinion that more than one of the options that are stated could be the source of a debt defeasance receipt. Eight of the bank respondents indicate that the source of a debt defeasance receipt is the place where the assumer or trust performs its debt defeasance activities. Two are of the opinion that it is where the originating debt is advanced; two that it is where the debt defeasance contract is concluded; and two more that it is where the service of repaying the debt is rendered. One respondent holds the opinion that it is where the originating debt contract is entered into. The bank respondents therefore select all the options, except for option 3.5, i.e. the option that states that the source of a debt defeasance receipt is the place where the debt defeasance arrangement is invented.

Three of the four auditing firm respondents select two possible sources from the options that are stated as the possible sources of a debt defeasance receipt. Three respondents indicate that the source of a debt defeasance receipt is where the assumer or trust performs its debt defeasance activities, two indicate that it is where the service of repaying the debt is rendered and one that it is the place where the originating debt is advanced. One respondent selects the option that states that the source is where the debt defeasance contract is concluded.

The taxation senior counsel selects the place where the assumer or the trust performs its debt defeasance activities as being the source of a debt defeasance receipt.

3.6.2 Conclusion

The majority of the respondents are of the opinion that the originating cause of a debt defeasance receipt is the debt defeasance business activities that are conducted by the trust or assumer. The majority of the respondents also hold the view that the location of the originating cause of a debt defeasance receipt is where the trust or assumer performs its debt defeasance activities.

A large majority (67%) of the respondents who completed sections C and D of the questionnaire are of the opinion that the source of a debt defeasance receipt could possibly be where the assumer or trust performs its debt defeasance activities. Twenty-two percent of all respondents hold the view that the place where the service of repaying the principal debt occurs could possibly be the source of the debt defeasance receipt, whereas 17% agree that it could even be where the originating debt is advanced or where the debt defeasance contract is entered into. Several respondents select more than one alternative.

Respondents select all the alternatives suggested, except for the option that indicates the place of inventing the debt defeasance arrangement, as being a possible source of a debt defeasance receipt.

4 Summary

The respondents devoted considerable time and effort to completing the questionnaire. Although it required a great deal of commitment and perseverance to retrieve the completed questionnaires, the response rate and the quality of the responses are good.

Respondents hold a variety of views. However, it is clear that the majority of them hold the same view. This agreement is apparent from the responses given in section C, in which the various types of income are analysed, and in section D in which opinions are elicited.

The analysis of the responses provided in section C resulted in the finding that respondents are of the opinion that business income relates more closely to a debt defeasance receipt than does dividend income, income received from services rendered, royalty income and trading commodity income.

The above finding is confirmed by the responses provided in section D of the questionnaire, which comprises open questions and requires respondents to state their professional opinion. The analyses of the opinions obtained indicate that most respondents are of the opinion that the originating cause of a debt defeasance receipt is the debt defeasance activities of the trust or assumer; that the location of this originating cause is the place where the trust or assumer performs its debt defeasance activities; and that the source of a debt defeasance receipt is therefore where the trust or assumer performs its debt defeasance activities.

The study aimed at determining the source of a debt defeasance receipt that is received by a non-resident in South Africa. It was found that the source of a debt defeasance receipt is the place where the recipient thereof performs debt defeasance activities. Should the recipient performs debt defeasance activities in South Africa, the source is South Africa and the debt defeasance receipt should be included in the gross income of the non-resident.

The research topic gave rise to an interesting investigation into a subject that is as yet unexplored in South Africa. As the debt defeasance arrangement becomes more commonly used in South Africa, more investigations will be required. It will be necessary to again address the question about where the source of a debt defeasance receipt is when it is received by a non-resident in South Africa.

This topic is broad and complex and warrants further investigation. Debt defeasance activities include, but are not limited, to the following:

- Soliciting of a debt defeasance debtor.
- Contracting with a debt defeasance partner.
- Receipt of the debt defeasance receipt.
- Investment of the debt defeasance receipt received.
- Repayment of the original debt.

Further investigation could address the determination of exactly which one of the debt defeasance activities is the dominant activity in deciding the place which is the source of a debt defeasance receipt. Another topical research issue is the determination of the set of debt defeasance activities that should be performed in a particular location to cause that location to be the place where the debt defeasance activities are performed. The topic is far from exhausted and provides interesting and challenging research issues for further investigation.

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