DETERMINATION > FINANCIAL ARRANGEMENTS > GENERAL

Swaps

Issued: 16 January 1995

G27

This Determination may be cited as "Determination G27: Swaps".

1 Explanation (which does not form part of the determination)

What is a swap?

A swap is an agreement to exchange payment streams over a period of time, and these can involve different interest rate types, payment timing or intervals, currencies and/or commodities. However, this determination only applies to an interest rate swap, interest swap, currency swap (sometimes called a cross currency swap) or a swap that is a combination of these, where all payments are expressed in a currency or two different currencies and there is a fixed actual or notional principal agreed or implicit in respect of each side of the swap. This determination does not apply, for example, to commodity swaps, debt-equity swaps, debt-property swaps, swaps involving more than two currencies, or swaps involving the amortisation or accretion of principal.

A swap has two sides (or legs). In the case of an interest rate swap, one side relates to the obligations of the parties to make payments of amounts calculated by reference to the fixed rate of interest. The other side of the swap will be those obligations relating to the floating rate of interest. In the case of a currency swap, one side of the swap relates to those obligations expressed in one currency, and the other side of the swap will be those obligations expressed in the other currency. In the case of other types of interest swaps, the sides of the swap reflect the different bases upon which interest is payable.

It is not necessary for there to be a physical exchange of principal at the beginning and/or end of the swap, in addition to the interest or other payments during the term of the swap.

A swap is a financial arrangement subject to the accrual provisions of the Income Tax Act 1976. This determination sets out the method to be used to calculate income and expenditure under those provisions for swaps to which it applies.

What methods can be used to calculate income and expenditure under a swap to which this determination applies?

Use A, B, C or D

A. A method that has regard to market valuation under section 64C(4) of the Act. This method can be used where your business comprises dealing in swaps, or where the swap constitutes a forward or future contract for foreign exchange.

- Where the requirements of section 64C(4) are satisfied, and you choose to use a method under that provision, this determination

- requires that you adopt a mark to market method,
- requires that (so far as possible) you adopt that method in a consistent manner over the term of the swap, and
- specifies the markets and sources of information which you must use.

B. The method specified in Determination G14: Forward Contracts for Foreign Exchange and Commodities. Use this method where the swap involves a spot exchange at the current market spot rate and a future exchange of fixed amounts at a single fixed date and you do not adopt a method under section 64C(4).

C. The method provided for in this Determination.

Use this method if you do not adopt a method under section 64C(4) and Determination G14 does not apply. This method requires you to

- treat the swap as if it comprised two simultaneous loans, one from each party to the other, and
- then apply the normal accrual rules to these deemed loans.

In this way, the appropriate recognition of income or expenditure under the swap (for income tax purposes) will result from the net effect of the combination of your accounting for the two deemed loans.

D. A method that satisfies the requirements of the proviso to paragraph (a) of section 64C(3) of the Act. You can use this method if it

- has regard to the principles of accrual accounting,
- conforms with commercially acceptable practice,
- (except to the extent that the Commissioner may otherwise allow under section 64C(4A) of the Act) is adopted, and is or will be consistently applied, by you in respect of all such financial arrangements for financial reporting purposes, and
- results in the allocation, to each income year, of amounts that are not materially different from the amounts that would be calculated under Method C.

How to use Method C

Under this method

- ignore any offsetting of payments between the parties, so that every amount that would be payable under each side of the swap (if no provision was made for offsetting) is attributed to the relevant deemed loan and taken into account;
- treat each side of the swap as a separate loan of the appropriate amount, being the amount that is used to calculate the payments to be made under that side of the swap during its term [In situations where the swap contract does not provide

for the Principal Amount relating to each side of the swap to be both paid on the Effective Date and repaid on the Maturity Date, this Determination treats such payment and repayment as taking place, by specifying the actual and deemed cash flows that are to be taken into account in the calculation of each party's income or expenditure under each side of the swap];

- take into account, as cash flows subject to the yield to maturity or other method of calculating income or expenditure applicable under the accrual provisions or relevant determinations, fees payable in relation to the swap that qualify as Fee Amounts (reduced by the amount of item z in section 64BA(2) or 64BA(3) of the Act), any payment made that is intended to compensate one of the parties for a difference in the values of the anticipated cash flows under the swap, and any consideration paid in connection with the assignment of a swap by or to an assignee [Apply each of them to only one of the two loans that the swap is deemed to comprise. You must elect which of the loans is to be treated in this way.];
- then, calculate the income derived or expenditure incurred by you for each of these deemed loans by applying the accrual provisions of the Act and determinations that would be applicable to such cash flows;
- where the relevant deemed loan is denominated in a currency other than New Zealand dollars and the swap does not provide for any actual payment of principal on the Maturity Date, and you are applying Determination G9A in calculating the income or expenditure, ignore any actual or deemed payments of principal on the Effective Date when applying Determination G9A (except for the calculation of base currency income and expenditure). [This is to ensure that the calculations do not take account of fluctuations in the New Zealand dollar value of principal amounts denominated in the other currency where there is no actual repayment of principal.]

How are the parties to a swap described?

According to the definition in the Act, each party is a “holder” in relation to the swap. However, since the swap is treated as if it comprised two simultaneous loans, each party will be a “holder” and an “issuer” for the purposes of the calculations under this Determination.

How is income or expenditure calculated in the year the swap matures or is disposed of?

Calculate income or expenditure under the base price adjustment described in section 64F of the Act. Make that adjustment in relation to the swap as a whole, and treat each party as a “holder”.

2 Reference

This determination is made pursuant to paragraphs (b) and (d) of section 64E(1) of the Income Tax Act 1976.

3 Scope of Determination

This determination applies to any arrangement that is an Interest Rate Swap, Interest Swap, Currency Swap, Interest Rate and Currency Swap, or Interest and Currency Swap entered into after the date upon which this determination is published in the *New Zealand Gazette* (except where it was entered into pursuant to a binding contract entered into before that date), where

(a) all payments under the swap are expressed in a currency or two (but not more than two) different currencies; and

(b) either—

(i) a notional or actual principal is specified in the swap contract in relation to each side of the swap; or

(ii) a notional principal is implicit in the computation of the cash flows payable by the parties in relation to each side of the swap, and

(c) the Principal Amount relating to each side of the swap is fixed in terms of the relevant currency; and

(d) there are no payments made, or to be made, under or in relation to the swap other than payments that are

(i) actual payments of the Principal Amount made on either or both of the Effective Date and the Maturity Date that form part of a Principal Exchange;

(ii) payments made during the term of the swap of amounts calculated by applying the Agreed Rate to the Principal Amount;

(iii) a payment made on the Effective Date of any Compensatory Amount;

(iv) a payment made on the Effective Date of any Fee Amount that is less than the Principal Amount; or

(v) a combination of any two or more of the payments referred to in paragraphs (i) to (iv) above.

4 Principle

1. Subject to sub-clauses 4(3) and 4(5) below, if you are a party to a swap to which this Determination applies, calculate income derived or expenditure incurred as if each side of the swap was a separate, simultaneous and mutual loan between you and the other party.

   Then apply the accrual provisions of the Act and determinations that would be applicable to such loans to calculate the income derived or expenditure incurred by you.

2. Take fees payable in relation to the swap that qualify as Fee Amounts (reduced by the amount of item z in section 64BA(2) or 64BA(3) of the Act) into account as cash flows subject to the yield to maturity or other method of calculating income or expenditure applicable under the accrual provisions or determinations made thereunder. Apply them to either one of the two loans the swap is deemed to comprise, at your option. Accord the same treatment to any payment made by one party to the swap to the other that is intended to compensate the latter for a difference in the values of the anticipated cash flows under the swap, and to any consideration paid in connection with the assignment of the swap by or to the assignee.

3. If your business comprises dealing in swaps, or if you are a party to a swap that constitutes a forward or future contract for foreign exchange, you may use a mark to market method to calculate the income derived or expenditure incurred under a relevant swap provided that the requirements of section 64C(4) of the Act are satisfied.

4. For the purposes of sub-clause 4(3) above, a mark to market method is one that reflects the revaluation of the swap at its current market value. You must compute such market value by reference to or by interpolation from one or more rates or yields, published electronically by Reuters New Zealand Limited or Telerate New Zealand Limited on the relevant date, that are

   (a) relevant (as regards quality, term and currency) to the particular swap or the relevant side of it; and

   (b) quoted with respect to markets that have been approved by the Commissioner by Determination.

5. If you are a party to a swap that involves a spot exchange at the current spot rate and a future exchange of fixed amounts at a single fixed date, and you do not use a mark to market method under section 64C(4), use the method specified in Determination G14: Forward Contracts For Foreign Exchange And Commodities.

5 Interpretation

1. In this determination, unless the context otherwise requires—

Expressions used have the same meanings as in the Act, and where a word or expression is given a particular meaning for the purposes of sections 64B to 64M of the Act, it shall have the same meaning as in the said sections 64B to 64M;

“Accrual Provisions” means sections 64B to 64M of the Act;

“Accrual Rules” means the principles of calculating income and expenditure for income tax purposes under the accrual provisions and determinations made thereunder;

“Acquisition Date”, in relation to the assignee of a swap, is the date upon which that person becomes a party to the swap;

“Agreed Rate” means the interest rate or other indicator rate that is, according to the terms of the swap, to be applied to the Principal Amount in calculating payments to be made under the swap, and includes a floating rate where the parties have agreed the basis upon which that rate is to be identified or computed for the purposes of the swap;

“Approved Exchange” has the same meaning as in Determination G7C: Futures and Options Markets;

“Assignment Amount” means any consideration paid by or to the assignee in connection with the assignment of a swap;

“Compensatory Amount” means a payment made by one party to a swap to the other that is intended to compensate the latter for a difference in the values of the anticipated cash flows under the swap;

“Currency Swap” means any swap under which the parties agree to exchange a specified amount of currency, on a notional or physical basis, at an agreed rate of exchange;

“Deemed Borrower” means, in relation to one side of a swap, the party who is required to make the payments under the deemed loan relating to that side of the swap calculated by applying an Agreed Rate to the Principal Amount in relation to that side of the swap;

“Deemed Lender” means, in relation to one side of a swap, the party who is entitled to receive the payments under the deemed loan relating to that side of the swap calculated by applying an Agreed Rate to the Principal Amount in relation to that side of the swap;

“Effective Date” means the date upon which the swap commences to operate (being the first day of the period in respect of which calculations under the swap are to be applied) or, in relation to the assignee of a swap, the Acquisition Date;

“Fee Amount” means any fee or similar amount paid to or by either of the parties to a swap for, or in connection with, the arrangement, negotiation or implementation of that swap (whether the same is paid by or to the other party or by or to a third person);

“Interest and Currency Swap” means any swap under which the parties agree to exchange interest payments in one currency for interest payments in another currency where the payment streams also differ with respect to the basis upon which interest amounts are payable (such as monthly and quarterly payment intervals, or payments in arrears and in advance);

“Interest Rate and Currency Swap” means any swap under which the parties agree to exchange fixed rate or floating rate interest payments in one currency for fixed or floating rate interest payments in another currency, calculated with reference to a specified actual or notional amount of principal;

“Interest Rate Swap” means any swap under which the parties agree to exchange fixed rate interest payments for floating rate interest, in the same currency, calculated with reference to a specified actual or notional amount of principal;

“Interest Swap” means any swap under which the parties agree to exchange interest payments where the payment streams differ with respect to the basis upon which interest amounts are payable (such as monthly and quarterly payment intervals, or payments in arrears and in advance);

“Mark to Market Method” means a method that reflects the revaluation of the swap at its current market value. That market value must be computed by reference to one or more rates or yields, published electronically by Reuters New Zealand Limited or Telerate New Zealand Limited on the relevant date, that are relevant (as regards quality, term and currency) to the particular swap or the relevant side of it;

“Maturity Date” means the date upon which, according to its terms, the swap terminates (being the last day of the period in respect of which calculations under the swap are to be applied);

“Principal Amount” means, in relation to one side of a swap, the actual or notional principal that is specified in the swap contract in relation to that side of the swap or, where no such principal is specified, the notional principal implicit in the computation of the cash flows payable by the parties in relation to that side of the swap;

"Principal Exchange" means the payment by one party of the Principal Amount relating to one side of the swap on the same date as there is a payment by the other party of the Principal Amount relating to the other side of the swap, and includes the situation where such payments are offset in accordance with the terms of the swap and any balancing amount is paid;

"Reuters New Zealand Limited" means Reuters New Zealand Limited or any company that is associated with Reuters New Zealand Limited and is in the business of providing financial information in the form of multicontributor screens or contributor screens;

"Telerate New Zealand Limited" means Telerate New Zealand Limited or any company that is associated with Telerate New Zealand Limited and is in the business of providing financial information in the form of multicontributor screens or contributor screens;

"The Act" means the Income Tax Act 1976.

2. For the purposes of this Determination each "side of the swap" must be identified.

(a) Where the swap is an Interest Rate Swap

(i) the rights and obligations of the parties to the swap that relate to the payment and computation of amounts calculated by reference to the fixed rate of interest constitute one "side of the swap"; and

(ii) the rights and obligations of the parties to the swap that relate to the payment and computation of amounts calculated by reference to the floating rate of interest constitute the other "side of the swap".

(b) Where the swap is an Interest Swap

(i) the rights and obligations of the parties to the swap that relate to one basis of payment of interest constitute one "side of the swap"; and

(ii) the rights and obligations of the parties to the swap that relate to the other basis of payment of interest constitute the other "side of the swap".

(c) Where the swap is a Currency Swap, an Interest Rate and Currency Swap or an Interest and Currency Swap

(i) the rights and obligations of the parties to the swap that relate to the payment and computation of amounts expressed in one currency constitute one "side of the swap"; and

(ii) the rights and obligations of the parties to the swap that relate to the payment and computation of amounts expressed in the other currency constitute the other "side of the swap".

3. A determination to which this Determination refers may be varied, rescinded, restricted or extended by a new determination made by the Commissioner. In such a case, the reference to the old determination is taken to be extended to the new determination.

6 Method

1. If you may adopt a method that has regard to market valuation to calculate income and expenditure in respect of a swap pursuant to section 64C(4) of the Act, and you choose to do so, you must use a mark to market method. That method must also satisfy the requirements of section 64C(4) of the Act.

   For these purposes, this Determination approves the use of any rates or yields quoted with respect to markets that have been approved by the Commissioner by determination, and approves the use of any sources of information that have been approved by the Commissioner by determination.

   If you have adopted such a method for calculating the income or expenditure in respect of a swap in one income year, you must, so far as is possible, apply that method consistently, and having regard to the same published rates and yields, for subsequent income years over the term of the swap, unless the Commissioner otherwise allows.

2. If you are a party to a swap that involves a spot exchange at the current spot rate and a future exchange of fixed amounts at a single fixed date, and you do not use a mark to market method under section 64C(4), you must use the method specified in Determination G14: Forward Contracts For Foreign Exchange And Commodities.

3. If you are a party to a swap to which this Determination applies and Determination G14 does not apply, and you do not adopt a method under section 64C(4), you must (unless the proviso to paragraph (a) of section 64C(3) of the Act applies) calculate income deemed to be derived or expenditure deemed to be incurred by you as if each side of the swap comprised a separate, simultaneous and mutual loan between the parties to the swap. Each of the loans is to be characterised and treated according to the principles outlined in sub-clauses 6(4) to (7) below.

4. If the terms of the swap provide for the netting off or offsetting of any amounts payable to or by one party to the swap with any amounts payable to or by the other

party to the swap, ignore such netting off or offsetting for the purposes of sub-clauses 6(3), (5), (6), and (7) of this Determination.

5. Subject to sub-clause 6(4) above, treat the deemed loans referred to in sub-clause 6(3) above relating to each side of the swap as comprising the following cash flows:

(a) Where the terms of the swap provide for both the payment of the Principal Amount by the Deemed Lender to the Deemed Borrower on the Effective Date, and the payment of the Principal Amount by the Deemed Borrower to the Deemed Lender on the Maturity Date,

(i) the payment of the Principal Amount made by the Deemed Lender to the Deemed Borrower, on the Effective Date;

(ii) the payment of the Principal Amount made by the Deemed Borrower to the Deemed Lender on the Maturity Date; and

(iii) payments of all other amounts that are payable by either party to the other under the terms of the swap contract, and that relate to the relevant side of the swap, on the dates on which they are specified to be payable in the swap contract.

(b) Where the terms of the swap provide for the payment of the Principal Amount by the Deemed Lender to the Deemed Borrower on the Effective Date, and no payment of the Principal Amount by the Deemed Borrower to the Deemed Lender on the Maturity Date,

(i) the payment of the Principal Amount made by the Deemed Lender to the Deemed Borrower, on the Effective Date;

(ii) a deemed payment of the Principal Amount made by the Deemed Borrower to the Deemed Lender on the Maturity Date; and

(iii) payments of all other amounts that are payable by either party to the other under the terms of the swap contract, and that relate to the relevant side of the swap, on the dates on which they are specified to be payable in the swap contract.

(c) Where the terms of the swap provide for no payment of the Principal Amount by the Deemed Lender to the Deemed Borrower on the Effective Date, but a payment of the Principal Amount by the Deemed Borrower to the Deemed Lender on the Maturity Date,

(i) a deemed payment of the Principal Amount made by the Deemed Lender to the Deemed Borrower, on the Effective Date;

(ii) the payment of the Principal Amount made by the Deemed Borrower to the Deemed Lender on the Maturity Date; and

(iii) payments of all other amounts that are payable by either party to the other under the terms of the swap contract, and that relate to the relevant side of the swap, on the dates on which they are specified to be payable in the swap contract.

(d) Where the terms of the swap do not provide for the payment of the Principal Amount by the Deemed Lender to the Deemed Borrower on the Effective Date, or for payment of the Principal Amount by the Deemed Borrower to the Deemed Lender on the Maturity Date,

(i) a deemed payment of the Principal Amount made by the Deemed Lender to the Deemed Borrower, on the Effective Date;

(ii) a deemed payment of the Principal Amount made by the Deemed Borrower to the Deemed Lender on the Maturity Date; and

(iii) payments of all amounts that are payable by either party to the other under the terms of the swap contract, and that relate to the relevant side of the swap, on the dates on which they are specified to be payable in the swap contract.

6. Subject to sub-clause 6(4) above, apply the following provisions for the purpose of calculating the income derived and expenditure incurred by a party to a swap:

(a) Subject to paragraphs (b), (c) and (d) below, apply the accrual provisions and any relevant determinations to each of the deemed loans described in sub-clause 6(5) above.

(b) Although both parties to the swap will be “holders” under the swap, in relation to each of the deemed loans treat a party as either a “holder” or an “issuer” in accordance with the terms of the loan (as described in sub-clause 6(5) above) and the definitions of “holder” and “issuer” in section 64B.

(c) Where

(i) a deemed loan is denominated in a currency other than New Zealand Dollars and Determination G9A would be applied to calculate the income and expenditure under the deemed loan, and

(ii) there is no actual payment of the Principal Amount on the Maturity Date, and

(iii) either paragraph (b) or paragraph (d) of sub-clause 6(5) of this Determination applies to deem amounts to be paid or payable on the Maturity Date,

then [notwithstanding the requirements of Determination G9A and the terms of paragraphs (b) and (d) of sub-clause 6(5) of this Determination] apply Determination G9A, in respect of that deemed loan, on the basis that any actual or deemed payment of the Principal Amount on the Effective Date is not included as "consideration given" for the purposes of items b and d in the formula contained in sub-clause 6(1) of that Determination G9A and items f and h in the meaning of "closing tax book value" in clause 5 of that Determination.

(d) Take into account any Fee Amount payable in relation to the swap (reduced by the amount of item z in section 64BA(2) or 64BA(3) of the Act), any Compensatory Amount payable, and any Assignment Amount payable to or by a party as the assignee of the swap, as an amount or amounts subject to the yield to maturity or other method of calculating income or expenditure applicable under the accrual provisions or determinations made thereunder. However, apply each such amount to only one of the two loans the swap is deemed to comprise. You must elect which of the loans is to be treated in this way.

7. Where the terms of a swap are varied after the date it was entered into, and that variation alters the amounts payable (or the basis upon which the amounts payable are to be calculated) under the swap, or the dates upon which they are payable, apply Determination G25: Variations In The Terms of a Financial Arrangement (in combination with this determination) as if the corresponding variation and alterations occurred with respect to the deemed loans described in sub-clause 6(5) above.

7 Examples

1. **Example 1 — Deemed Loans**

Background Information

This example illustrates the method outlined in sub-clause 6(3) of this determination. The swap is treated as if it comprised two simultaneous loans from each party to the other. Income derived or expenditure incurred is then calculated in accordance with the Act and relevant determinations.

In this example, there is a three year interest rate and currency swap from 15 September 1993 to 15 September 1996 between—

(a) a New Zealand corporate borrower who has arranged a floating loan in United States dollars, with interest at LIBOR plus a margin, payable semi-annually on 15 March and 15 September, and

(b) a counterparty who has a fixed rate loan in New Zealand dollars, with interest at 12.5% payable semi-annually on 15 March and 15 September.

The swap involves the LIBOR interest only, not the margin.

Draw down of both loans occur on 15 September 1993. There are no fees.

If the New Zealand dollar amount is $20 million and the spot rate on 15 September 1993 is 0.5900, then the cash flows of the two parties before the swap are as follows—

	Corporate $million USD	*Counterparty* $million NZD
15 September 1993	11.80	20.00
15 March 1994	(6 months LIBOR plus margin	(1.25)
15 September 1994	(6 months LIBOR plus margin)	(1.25)
15 March 1995	(6 months LIBOR plus margin)	(1.25)
15 September 1995	(6 months LIBOR plus margin)	(1.25)
15 March 1996	(6 months LIBOR plus margin)	(1.25)
15 September 1996	(11.80 plus 6 months LIBOR plus margin	(21.25)

(brackets denote payments)

The notional principal specified in the swap contract is $NZ20.00 million = $US11.80 million as at the starting date, since these have the same value. There is no exchange of principal on that date.

Deemed Cash Flows for the Corporate under the Swap

Under the swap, the cash flows for the corporate (for the purposes of applying this determination) are as follows:

Date	Loan by Corporate US dollars $ million	Loan to Corporate NZ dollars $ million
15 September 1993		
— Deemed principal exchange	(11.80)	20.00
15 March 1994	6 months LIBOR	(1.25)
15 September 1994	6 months LIBOR	(1.25)
15 March 1995	6 months LIBOR	(1.25)
15 September 1995	6 months LIBOR	(1.25)
15 March 1996	6 months LIBOR	(1.25)
15 September 1996		
— Actual principal exchange	11.80	(20.00)
— Interest	6 months LIBOR	(1.25)

where brackets denote payments **by** the corporate to the swap counterparty.

Accrual Calculations

Therefore, in determining its assessable income, the corporate would, using a Yield to Maturity or other method acceptable under the Act and the determinations, calculate:

(i) expenditure under the fixed rate loan in New Zealand dollars (this could be done by Determination G3: Yield to Maturity Method, or Determinations G10B: Present Value Calculation Methods and G11A: Present Value Based Yield to Maturity Method); and

(ii) income under the floating rate loan in United States dollars (this could be done using Determination G26: Variable Rate Financial Arrangements, Determination G9A: Financial Arrangements That Are Denominated In A Currency Or Commodity Other Than New Zealand Dollars, and Determination G6D: Foreign Currency Rates).

The corporate remains responsible for settling its floating rate US dollar based loan with the original lender, and for the margin above LIBOR.

If the original borrowings were already in existence on 15 September 1993, the analysis would be the same. Again, no payments would need to be made between the corporate and the swap counterparty on that date, but a notional principal is still required to calculate the floating rate interest amounts, and this principal would be used in the two notional loans.

Final Calculation

To calculate income or expenditure for the final year of the arrangement, the base price adjustment (described in section 64F of the Act) must be applied. The formula is a − (b + c). In making the base price adjustment at 31 March 1997, both parties are considered to be "holders". The corporate would bring into account the following items (assuming no exchange of principal on 15 September 1993)—

a	=	consideration paid or payable to the holder
	=	the NZ dollar equivalent of $US11.80 million on 15 September 1996 + the NZ dollar equivalents of LIBOR payments made from 15 March 1994 to 15 September 1996 inclusive.
b	=	acquisition price (assume no fees)
	=	value of all consideration provided by the holder
	=	$NZ1.25 million × 6 + 20.00 million
	=	$NZ27.50 million
c	=	amounts of income deemed to be derived less expenditure deemed to be incurred in the years ending 31 March 1994 to 31 March inclusive.

2. Example 2 — Deemed Loans and a Fee Payment

Background Information

To illustrate the allocation of a fee payment, it will be assumed that, in the example of sub-clause 7(1), the corporate pays fees of 30BP contingent upon the implementation of the swap, and that the corporate wishes to pay interest in advance in relation to a loan in New Zealand dollars.

Deemed Cash Flows for the Corporate under the Swap

Therefore, under the swap, the cash flows for the corporate (for the purposes of applying this determination) are as follows:

Date	Loan by Corporate US Dollars $ million	Fees NZ dollars $ million	Loan to Corporate NZ dollars $ million
15 September 1993			
— Deemed principal exchange	(11.80)		20.00
— Fees		(.06)	
— Interest (paid in advance)			(5.50)
15 March 1996	6 months LIBOR		
15 September 1994	6 months LIBOR		
15 March 1995	6 months LIBOR		
15 September 1995	6 months LIBOR		
15 March 1996	6 months LIBOR		
15 September 1996			
— Actual principal exchange	11.80		(20.00)
— Interest	6 months LIBOR		

where brackets denote payment by the corporate to the swap counterparty.

Accrual Calculations

In determining its assessable income, the corporate must take into account the fees paid and allocate them to one of the loans. If the fees are treated by the corporate as being attached to the US dollar loan, they may be spread on a straight-line basis over the three years under method A of Determination G26.

If, on the other hand, the fees were allocated to the NZ dollar loan, they would be spread using a yield to maturity method acceptable under the Act.

In addition, the same methods outlined in sub-clause 7(1) would be used to determine:

(i) expenditure under the fixed rate loan in New Zealand dollars (for example, Determination G3, or Determinations G10B and G11A — under these methods the $5.5 million will be spread over the term of the swap); and

(ii) income under the floating rate loan in United States dollars (for example, Determinations G26, G9A and G6D).

3. Example 3 — Assigning a Swap

Background Information

The situation where a party assigns a swap can be considered by assuming that, in the example in sub-clause 7(1), the corporate (“corporate A”) assigned the swap to another corporate (“corporate B”) for consideration of $250,000 on 31 December 1994.

Final Calculation for the Assignor

In such a case, corporate A would apply the base price adjustment in the 1995 income year.

Therefore, corporate A would bring into account the following items (assuming no exchange of principal on 15 September 1993)—

a	=	consideration paid or payable to the holder
	=	the NZ dollar equivalent of LIBOR payments made on 15 March 1994 and 15 September 1994 + $250,000
b	=	acquisition price
	=	value of all consideration provided by the holder
	=	$NZ1.25 million × 2
	=	$NZ2.5 million
c	=	amounts of income deemed to be derived less expenditure deemed to be incurred in the years ending 31 March 1994.

The formula is a − (b + c) and if the result is positive it will be income derived by the corporate. If the result is negative the amount is an allowable deduction.

Deemed Cash Flows for the Assignee

Under the swap, the cash flows for the assignee, corporate B (for the purposes of applying this determination) are as follows:

Date	Loan by "B" US dollars $ million	Loan to "B" NZ dollars $ million
31 December 1994 ["effective date"]		
— Deemed principal exchange	(11.8)	20.00
— Assignment fee		(0.25)
15 March 1995	6 months LIBOR	(1.25)
15 September 1995	6 months LIBOR	(1.25)
15 March 1996	6 months LIBOR	(1.25)
15 September 1996		
— Actual principal exchange	11.80	(20.00)
— Interest	6 months LIBOR	(1.25)

where brackets denote payments by the Corporate B to the swap counterparty. The assignment fee was allocated to the NZ dollar loan.

Accrual Calculations for the Assignee

Therefore, in determining its assessable income for the years ended 31 March 1995 and 1996, corporate B would, using a Yield to Maturity or other method acceptable under the Act and the determinations, calculate:

(i) expenditure under the fixed rate loan in New Zealand dollars (this could be done by Determination G3, or Determinations G10B and G11A, resulting in the spreading of the $250,000 assignment consideration over the remaining term of the swap); and

(ii) income under the floating rate loan in United States dollars (this could be done using Determinations G26 and G9A, and G6D).

Final Calculation for the Assignee

To calculate income or expenditure for the final year of the arrangement (ending 31 March 1997) the base price adjustment must be applied.

Corporate B would bring to account the following items:

a	=	consideration paid or payable to the holder
	=	the NZ dollar equivalent of $US11.8 million principal exchange on 15 September 1996 + NZ dollar equivalents of LIBOR payments made from 15 March 1995 to 15 September 1996 inclusive
b	=	acquisition price
	=	value of all consideration provided by the holder
	=	$NZ0.25 million assignment fee + $20.0 million principal exchange on 15 September 1996 + $NZ1.25 millioin × 4
c	=	amounts of income deemed to be derived less expenditure deemed to be incurred in the years ending 31 March 1995 and 1996 inclusive.

Under the formula described in section 64F of the Act, the exchange variation on the principal sums included in the assignee's base price adjustment will be the total movement from the initial date of the swap until maturity. That is, any exchange variation prior to the assignment is taken into account. It is assumed that the effect would be included in any assignment fee paid or received by the assignee.

About this document

General determinations set out the Commissioner’s view on how the financial arrangements rules apply to a specific type of financial arrangement. All general determinations are binding on the Commissioner and some are also binding on taxpayers.