Inland Revenue
Te Tari Taake

RULINGS > PRODUCT

Fonterra Co-operative Group Limited

15 May 2023

BR Prd 23/01

The Arrangement is the operation of the Fonterra Shareholders' Fund (FSF). The FSF is a New Zealand–resident unit trust through which non–milk-supplying investors (Public Investors) and farmers supplying milk to Fonterra (Supplying Shareholders) can invest in Units. Units in the FSF give economic rights in Fonterra shares (Shares), but do not give Unit Holders any legal interest in the Shares.

START DATE – END DATE
(28/03/2023 – 31/07/2028)

(THIS TITLE PAGE DOES NOT FORM PART OF THE RULING.)

Product Ruling – BR Prd 23/01

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of person who applied for the Ruling

This Ruling has been applied for by Fonterra Co-operative Group Limited (Fonterra).

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss BG 1, CD 4, CD 5, CD 6, CX 56, CX 56B, DA 1, DB 23, subpart HM, and the definition of "foreign investment variable-rate PIE" in s YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the operation of the Fonterra Shareholders' Fund (FSF). The FSF is a New Zealand–resident unit trust through which non–milk-supplying investors (Public Investors) and farmers supplying milk to Fonterra (Supplying Shareholders) can invest in Units. Units in the FSF give economic rights in Fonterra shares (Shares), but do not give Unit Holders any legal interest in the Shares.

The FSF was established in November 2012. Trading in FSF Units commenced on the NZX Main Board on 30 November 2012. A total of 95,454,545 Units were on issue at that date, for a total consideration of $525 million. As at 28 March 2023, the FSF had 107.4 million Units issued.

Further details of the Arrangement are set out in the paragraphs below.

Parties to the Arrangement

1. The parties to the Arrangement are:

    a) Fonterra,

    b) the FSF (through the Manager or Supervisor),

    c) Donald Hammond, John Nicholls and Ian Brown in their capacity as trustees of the Fonterra Farmer Custodian Trust (Farmer Trustees),

    d) the Custodian,

- e) the Supervisor,
- f) FSF Management Company Limited as manager of the FSF (Manager),
- g) Supplying Shareholders, and
- h) Public Investors.

2. Supplying Shareholders, Farmer Trustees, Fonterra and Public Investors may invest in the FSF. Together, they are referred to as the Unit Holders.

3. The Farmer Trustees hold one Unit in the FSF (the Fonterra Unit) which has special, essentially veto, rights (cls 4.5 to 4.8 of the Trust Deed). These special rights mean the Farmer Trustees must approve, for example, an amendment to, removal of or alteration of a provision in the Trust Deed where that amendment, removal or alteration would change the:
   - a) governance structure of the board of the Manager,
   - b) scope and role of the FSF,
   - c) obligation of the trust to facilitate the exchange of a Share for a Unit or a Unit for a Share, or
   - d) 15% limit on the number of Units that any person or their associated persons (other than Fonterra or a wholly-owned subsidiary of Fonterra) can hold, or
   - e) terms of the Fonterra Unit.

4. The rights of the Fonterra Unit to proceeds and distributions from the FSF are the same as for all other Units (cl 4.5(h) of the Trust Deed).

Documents relevant to the Arrangement

5. The following documents are relevant to the Arrangement:
   - a) Fonterra Shareholders' Fund Trust Deed dated 23 October 2012 and as amended and restated on 1 November 2016 and on 17 June 2019 (which established the FSF) (Trust Deed),
   - b) Fonterra Shareholders' Fund Authorised Fund Contract dated 25 October 2012 and as amended and restated from 1 November 2016, under which the FSF was established as an "Authorised Fund" under Fonterra's Constitution,
   - c) Deed of Trust establishing the Fonterra Farmer Custodian Trust dated 25 October 2012, which holds all shares in the Custodian and the Fonterra Unit,

d) Custody Trust Deed for the Fonterra Economic Rights Trust dated 25 October 2012, under which the Custodian holds the legal title to Shares and holds the economic rights in Shares on trust for the Supervisor, and

e) Constitution of Fonterra Co-operative Group Limited (Constitution), which was approved by shareholders on 9 December 2021 and which will be effective on a date to be advised by the Fonterra board when it is satisfied all steps necessary to implement the new structure have been or will be implemented. (This is to occur on and with effect from 28 March 2023).

Background to the Arrangement

6. Fonterra is simultaneously registered as a co-operative dairy company under Part 3 of the Co-operative Companies Act 1996 and as a company under the Companies Act 1993. The Dairy Industry Restructuring Act 2001 (DIRA) governs many aspects of Fonterra's structure and operation.

Trading Among Farmers Structure

7. Prior to November 2012, s 98 of the DIRA required Fonterra to pay a surrender value for Shares when a Supplying Shareholder gave a notice of withdrawal under s 97 of the DIRA. The ability for farmers to surrender their Shares in this way led to volatility in Fonterra's capital, referred to by Fonterra as redemption risk.

8. To address this redemption risk, Fonterra introduced its Trading Among Farmers (TAF) structure in 2012, which included:

    a) enabling farmers to acquire up to 100% of the number of Shares they must hold under the share standard as dry Shares,

    b) establishing the FSF to enable public investment, and

    c) creating a "private market" (the Fonterra Shareholders' Market (FSM)) for the trading of Shares between Supplying Shareholders, and Fonterra (together referred to as Permitted Persons).

9. The DIRA was also amended to remove the requirement for Fonterra to accept the surrender of Shares on request. This amendment was brought into force in November 2012 by Order-in-Council and removed the redemption risk.

Capital Restructure

10. In December 2021, Fonterra shareholders voted in favour of a change to Fonterra's capital structure (Capital Restructure) to replace the previous TAF capital structure. In April 2022, the Government announced its support for the changes. The Dairy Industry Restructuring (Fonterra Capital Restructuring) Amendment Act 2022 (Amendment Act) received royal assent on 28 November 2022. The Amendment Act was introduced to support the Capital Restructure (including an amendment requested by Fonterra to reduce the risk that legal action could be taken against Fonterra under section 109M of the DIRA).

11. The Capital Restructure takes effect from 28 March 2023.

12. A key change under the Capital Restructure is capping the size of the Fund by removing the exchangeability of Shares for Units in the FSF on a day to day basis. As a result, Shares will be tradeable in the FSM only and no new Units will be issued in the FSF on a day to day basis.

13. Previously, in accordance with Fonterra's Constitution, the FSF could hold economic rights to no more than 20% of Fonterra Shares. That percentage will be reduced to 10% on implementation of the Capital Restructure.

14. In addition, prior to the Capital Restructure, Supplying Shareholders generally needed to hold such number of Shares as is determined by the share standard, being one share for each kilogram of milksolids obtainable from the average milk supplied by the farmer in the previous three seasons. On implementation of the Capital Restructure, the share standard remains unchanged however the minimum shareholding that Supplying Shareholders will be required to hold will be one share for every three kilograms of milksolids obtained from the average milk supplied by the farmer (being 33% of the share standard).

15. Shares up to the share standard are informally known as "wet" shares, as they are backed by the supply of milk.

16. In addition to their "wet" Shares, Supplying Shareholders may acquire further Shares (under the Capital Restructure the acquisition limit in relation to such shares is 4 times the share standard for the Supplying Shareholder). These Shares held above the share standard are informally known as "dry" Shares, as they are not backed by the supply of milk. Despite the informal distinction between wet Shares and dry Shares, all Shares of Fonterra belong to a single class of share.

The Arrangement

17. The FSF is a passive investment vehicle through which a Public Investor can invest indirectly in Fonterra. The FSF was initially established as a unit trust under the Unit Trusts Act 1960 on 23 October 2012. Following the repeal of the Units Trust Act 1960 in December 2014, the FSF became a managed investment scheme (as defined in section 9 of the Financial Market Conducts Act 2013).

18. The FSF has elected to be a "foreign investment variable-rate PIE" (as defined in s YA 1) and to use the exit calculation option (under s HM 42). The Commissioner confirmed this by letter dated 13 November 2012.

19. The FSF is a vehicle for investors to access the underlying economic rights in a Share. While Supplying Shareholders may invest in the FSF, most of the Unit Holders are not Supplying Shareholders.

Registered volume provider

20. The role of the RVP is to facilitate trades and liquidity in the FSM. Prior to the Capital Restructure, the RVP could sell economic rights in relation to Shares to the FSF, which promoted price convergence between the FSM and FSF. With the size of the Fund capped, from implementation of the Capital Restructure, the RVP will no longer be able to sell economic rights of Shares into the FSF.

Supervisor, Manager and Custodian

21. Fonterra appointed the initial Supervisor as trustee of the FSF. The Supervisor is licensed under the Financial Markets Supervisors Act 2011.

22. Fonterra also appointed the initial Manager of the FSF. The Manager is a company wholly owned by Trustees Executors Limited. Under the Financial Markets Conduct Act 2013, the role of the Manager is to manage the investments of the FSF. The Manager manages the FSF as an investment vehicle and does not undertake an active role (such as actively soliciting farmers to sell economic rights in their Shares). Fonterra provided a licence (the Licence) to the Manager to use Fonterra's name and brand for the purposes of the FSF.

23. The Supervisor and Manager are party to an arrangement (the Funding Arrangement) with Fonterra under which Fonterra provides the FSF with funds at the start of each financial year to cover the reasonable expenses incurred by the FSF, or the Manager, on behalf of the FSF (Operating Expenses) in accordance with a budget agreed between the parties.

24. The Custodian is a limited liability company set up to hold legal title to the Shares. The Custodian holds legal title to any Shares in which economic rights have been sold to the FSF and holds the economic rights in Shares on trust for the Supervisor (under the Fonterra Economic Rights Trust).

25. The Custodian is wholly owned by the Farmer Trustees, as trustees of the Fonterra Farmer Custodian Trust. The Fonterra Farmer Custodian Trust is a trust set up for the sole purpose of holding the shares in the Custodian and the Fonterra Unit. The Farmer Trustees are three farmer representatives (a farmer directly elected by Supplying Shareholders, a director of Fonterra elected by Supplying Shareholders, and a member of the Fonterra Shareholders' Council). The discretionary beneficiaries of the trust are Supplying Shareholders, and Fonterra is the final beneficiary of the trust.

26. The Custodian (and the FSF) does not have voting rights in Fonterra under the Constitution, which restricts voting rights to Supplying Shareholders (that is, production-based voting rights), except at a meeting of an interest group where there would otherwise be no shareholder entitled to vote at that meeting under cl 24.2(c) of the Constitution. Under cl 7.8 of the Constitution, the Authorised Fund Contract is required to prohibit the FSF and the Custodian from exercising, controlling or exerting any influence over any voting rights attached to the Shares. The Trust Deed and Custody Trust Deed also contain provisions preventing the FSF and the Custodian from exercising any influence over voting rights attached to the Shares.

27. Under cl 7.1 of the Custody Trust Deed, the income of the Fonterra Economic Rights Trust includes amounts of deemed income that arise under tax law, and the Custodian is permitted to distribute this income to the FSF.

Operation of the Fonterra Shareholders' Fund

28. The FSF provides outside investors the opportunity to invest in the performance of Fonterra by way of investing in Units. Units are listed on the NZX Main Board and on the ASX in the same way as other listed securities.

29. Under the Trust Deed, each Unit issued in the FSF evidences the holder's entitlement to the economic benefits (including distributions and other benefits) in the whole of the trust fund. As the number of Units the FSF issues equals the number of Shares the Custodian holds (in which economic rights are being held in favour of the Supervisor), in effect, each Unit provides rights to receive the distributions and other benefits in respect of one Share. Individuals and their associates must not hold more than 15% of the lesser of the total number of Units on issue or the total voting rights in the FSF (cl 6.1 of the Trust Deed).

30. The Units in the FSF (including the Fonterra Unit) carry in respect of the FSF a right to vote or participate in any decision-making concerning at least one of the following:

    a) a dividend or other distribution to be paid or made by the FSF, or

    b) any variation to the Trust Deed.

31. Clause 4.1(c) of the Trust Deed sets out that the Units do not confer any interest in certain amounts under the Trust Deed, as follows:

    > c) Unless the Manager directs otherwise, Units shall not confer any interest in interest income of the Trust. Units shall not confer any interest in monies paid to the Supervisor or the Manager to meet their fees or to reimburse either of those parties for (or any advance payment in respect of) any expenses, liabilities, losses and costs incurred by them respectively in or about acting as Supervisor or Manager (as the case may be) under this Deed. In all cases, all interest income and such monies will be applied by the Manager to meet the fees and expenses, liabilities, losses and costs incurred by the Manager or the Supervisor in or about acting as Manager or Supervisor (as the case may be).

32. The FSF Units trade on a registered market (the NZX Main Board and ASX) in which Supplying Shareholders, Fonterra and other Public Investors may participate. Standard listing rules (but with various exemptions to those rules recognising that it is a managed investment scheme and to accommodate other characteristics apply to the FSF. Fonterra and the FSF co-operate with each other in relation to matters such as disclosure of information to enable the FSF to comply with the listing rules applicable to the FSF.

33. Supplying Shareholders and Fonterra can exchange Units for Shares subject to various limits. After the Capital Restructure, there is likely to be a price differential between the Units and Shares (in which case Supplying Shareholders and Fonterra may prefer to sell their Units and use the proceeds to purchase Shares).

34. Under cls 6.5 and 7.8 of the Constitution and cl 15.2 of the Trust Deed, neither the RVPs nor the FSF (or the Custodian in relation to either) is entitled to exercise any voting rights attached to Shares that the Custodian, from time to time, holds for them (except on an interest group resolution where otherwise no shareholder can vote: cl 24.2(c) of the Constitution).

35. No Unit Holder may require the transfer to themselves of any of the property of the FSF or any Share. The Supervisor covenants that it will not call for a transfer of the Shares (cl 4.8 of the Custody Trust Deed). In addition, no Unit Holder may redeem their Units for cash other than as described in cl 15.1(h) of the Trust Deed. However, Unit Holders may sell their Units to other investors on the NZX Main Board or ASX.

36. In addition to dividends, which are expected to be paid twice a year, other potential distributions in respect of the Shares include:

    a) taxable and non-taxable bonus issues,

    b) in-specie distributions of property,

    c) share buy-backs,

    d) dividend reinvestment schemes,

    e) renounceable and non-renounceable rights issues, and

    f) notional distributions.

37. Section 16 of the Dairy Industry Restructuring Amendment Act 2012 inserted ss 161A and 161B into the DIRA to allow Fonterra to hold Units in the FSF. Fonterra maintains a unit-holding in the FSF that may increase or decrease but will always hold at least one Unit. In respect of Units Fonterra holds, the DIRA prevents Fonterra from exercising any voting rights carried by those Units (s 161A(i)).

38. The FSF may derive income other than from the Shares the Custodian holds on its behalf such as interest on cash held in a bank account and amounts received under the Funding Arrangement (Other Income). To the extent the Fund derives Other Income, cl 4.1(c) of the Trust Deed provides that no Unit Holder has an interest in such Other Income, unless the Manager directs otherwise. Any Other Income that is available to the FSF is paid to the Supervisor as part of the fees due to the Supervisor.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) The requirements of ss HM 55D(5), (6) and (7), HM 55E, HM 55F and HM 55FB are met in relation to notified foreign investors in the FSF.

(b) The FSF is not treated under any double tax agreement as not being resident in New Zealand.

(c) The FSF is not in the business of life insurance.

(d) 90% or more of the FSF's investments (by value of its assets) are investments of a type referred to in s HM 11, other than an interest in land in New Zealand or a right or option in relation to land in New Zealand, in accordance with s HM 19C(1).

(e) 90% or more of the income derived by the FSF is of a type referred to in s HM 12, other than an amount derived from an interest in land in New Zealand or the disposal of an interest in land in New Zealand, in accordance with s HM 19C(2). For the avoidance of doubt, this condition will not be breached if any failure to meet the requirement of s HM 12 is not "significant and within control of the FSF" and is remedied by the last day of the next quarter, in accordance with s HM 25.

(f) The FSF has not lost its PIE status through the application of s HM 25, s HM 27 and/or s HM 29.

(g) The FSF has not changed its election to use the exit calculation option in s HM 42.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any conditions stated above, the Taxation Laws apply to the Arrangement as follows:

(a) The FSF qualifies as a "foreign investment variable-rate PIE" (as defined in s YA 1).

(b) The FSF's interest in the Shares is an investment of a type referred to in s HM 11.

(c) Income derived by the FSF from its interest in the Shares is income of a type referred to in s HM 12.

(d) Income attributed by the FSF to its investors is "excluded income" (as defined in s BD 1(3)) of the investor under s CX 56(3) provided that:

   (i) the prescribed investor rate for the investor is more than zero and not more than the investor's notified investor rate when the PIE calculates its income tax liability under s HM 47, or makes a voluntary payment under s HM 45, or

   (ii) the investor is one of those listed in s CX 56(1B), or

   (iii) the investor is one of those listed in s CX 56(1C) and has made the necessary election under s HC 33, and

   (iv) the amount is not an amount of attributed PIE income that is derived by a trustee who has chosen a prescribed investor rate referred to in sch 6, table 1, row 5 or 7, as applicable, and

   (v) the investor is not a new New Zealand resident to whom s HM 57B would have applied but who has chosen not to apply that section to determine their prescribed investor rate for a "resident year" (as defined in s HM 57B(3)), and

   (vi) the amount is not an amount of PIE schedular income derived by a natural person who is an investor in the PIE.

(e) Where a Permitted Person acquires a Share on redemption of a Unit, and is entitled to a deduction under ss DA 1 and/or DB 23, the cost or amount of expenditure incurred in acquiring the Share for the purposes of those sections will be the market value of the redeemed Unit on the day it was redeemed.

(f) The redemption of a Unit in the FSF by a Unit Holder, in exchange for a Share, will not give rise to a dividend under ss CD 4 to CD 6.

(g) Any distributions from the FSF are excluded income of each Unit Holder under s CX 56B (and therefore not taxable), other than where the FSF elects to pay non-resident withholding tax in accordance with s HM 44B in respect of the distribution.

(h) An investor in the FSF who is a natural person will have no adjustment to their terminal tax liability under s HM 36B in respect of income attributed by the FSF to the investor if that investor has notified the correct prescribed investor rate and the FSF has satisfied the investor's tax liability by applying that notified rate.

(i) The Arrangement is not subject to s BG 1.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 28 March 2023 (being the date on which the Capital Restructure is implemented by Fonterra) and ending on 31 July 2028.

This Ruling is signed by me on the 15th day of May 2023.

Fiona Wellgreen
Senior Tax Counsel

About this document

Product Rulings are issued by the Tax Counsel Office and Customer and Compliance Services. Product Rulings set out the Commissioner's view on how tax laws apply to a particular "product" – which is an arrangement that a specified taxpayer is likely to enter into with a number of people on identical terms. Taxpayers who enter into the arrangement described in a Product Ruling may apply the ruling, but are not obliged to do so. Product Rulings are binding on the Commissioner. This means that if you are entitled to apply a Product Ruling and you have calculated your tax liability in accordance with the ruling, the Commissioner must accept that assessment. A Product Ruling applies only to the taxation laws and arrangement set out in the ruling, and only for the period specified in the ruling. It is important to note that a general similarity to an arrangement covered by a Product Ruling will not necessarily lead to the same tax result.