



PRODUCT RULING – BR PRD 20/04

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by StockCo Limited and StockCo Capital Limited.

Taxation Laws

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

This Ruling applies in respect of ss BG 1, DA 1(1), DA 2, EA 3, EJ 10, FA 6 to FA 11, FA 12 and GA 1 and subpart EW.

The Arrangement to which this Ruling applies

The Arrangement is the leasing of ewes by either StockCo Limited or StockCo Capital Limited (both referred to as StockCo in this Ruling) to their customers to use solely in a farming business. Each customer will be a "New Zealand resident" (as defined in s YA 1). StockCo will purchase the ewes from either the customer and then lease them back to the customer or from a third party and then lease them to the customer. The customer will lease the ewes over a period of usually four years. The ewes will be progressively culled (or may go missing or die) over the period of the lease with cull payments being returned to StockCo.

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

Purchase of the ewes

1. The StockCo Group considered it commercially prudent to separate its livestock-leasing business from its usual banking arrangements and relationships, so incorporated StockCo Capital Limited (as a sister company to StockCo Limited) for this purpose.
2. StockCo will purchase an agreed number of "specified livestock" (as defined in s YA 1) – in this case, ewes – from the customer or a third party for the purchase price as provided for in cls 4 to 6 of the Sheep Flock Lease Master Terms:

WE WILL PURCHASE THE FLOCK

- 4 We will purchase the Ewes specified in each Lease Agreement for the Purchase Price detailed in the Lease Agreement on the Commencement Date.
- 5 When we purchase Ewes from you we will create a buyer generated invoice.
- 6 We are purchasing the Ewes at your request. You are responsible for inspecting and approving all Ewes prior to us purchasing them.

3. The purchase price is the equivalent of the market value of the purchased ewes at the time of acquisition.
4. Where the ewes are purchased from a third party, StockCo will pay the purchase price to the third-party vendor.
5. The customer will apply the purchase price to debt or other farming costs (such as expanding their farming operations or covering other business-related costs).

The Lease

6. The agreement entered into between StockCo and its customers is made up of two documents: the Sheep Flock Lease Master Terms and the Lease Agreement (together, "the Lease"). The Lease sets out the terms of the sale (where StockCo purchases ewes from the customer) and the lease of the ewes.
7. The terms of the Lease will not be materially different from those in the versions provided to Inland Revenue on 17 February 2020 and 24 April 2020.
8. As provided for in cls 7 and 8 of the Master Terms, StockCo owns the ewes and leases the purchased ewes to the customer for the lease period, and the customer owns all progeny the leased ewes produce:
 - 7 We will own the Ewes. You will own all progeny produced by the Ewes during the Lease period.
9. The progeny will be valued in accordance with the livestock valuation rules set out in part EC of the Act.
10. Clauses 11 and 12 of the Master Terms set out the customer's payment obligations:

YOUR PAYMENT OBLIGATIONS

- 11 You will pay us for each Flock:
 - 11.1 **Lease Payments:** the Lease Payments as set out in the relevant Lease Agreement. The Lease Payments are the rent payable for the lease of the Flock.
 - 11.2 **Cull Payments:** the Cull Payments as set out in the relevant Lease Agreement.
 - (a) The Cull Payments are the amounts we agree to realise from Cull Ewes when they are culled. You agree to realise this amount for us by selling the Cull Ewes on our behalf.
 - (b) You will pay us the Cull Payments regardless of the amount you realise from selling the Cull Ewes on our behalf. If you realise more than the Cull Payments you may keep the additional amount.
- 12 On the Commencement Date (or as otherwise specified) you will also pay us any establishment fee or other fee specified in a Lease Agreement.

11. The customer will use the livestock valuation regime in subpart EC of the Act to determine the value of the leased livestock.

Early termination of the Lease and events of default

12. Clause 20 of the Master Terms provides for the customer to terminate the lease early in certain situations:

EARLY TERMINATION

20 Where there is a material change in your circumstances, you may terminate the Lease early by:

20.1 purchasing the remainder of the Flock for the Net Present Value of the unpaid Lease Payments and Cull Payments; and

20.2 paying us any other amount owing to us under this agreement in relation to the relevant Lease;

13. It is expected that this clause would be applied only in rare cases, as a cost-benefit analysis would usually favour the customer remaining in the Lease and continuing to meet the Lease obligations.

14. Clause 21 of the Master Terms provides for early termination by StockCo:

21 We can end the Lease under clause 24.2 because of your default.

15. Clause 24.2 of the Master Terms states:

24 If an Event of Default has occurred, we may:

...

24.2 end the Lease with effect from any date specified by us and require you to, at our option:

(a) return the Flock to us at the location and by the date nominated by us. If we end the Lease under this clause 24.2(a) you will pay us liquidated damages equal to the amount (if any) by which the market value of the Flock (as determined by us, acting reasonably) is less than the Net Present Value of the unpaid Lease Payments and Cull Payments; or

(b) purchase the Flock the sum of the Net Present Value of the unpaid Lease Payments and Cull Payments.

16. Clause 24.1 allows for StockCo to repossess all (the flock) or any ewes following an event of default:

24.1 enter the Land (or any land where we consider the Flock or any Ewes may be) without notice and repossess any or all of the Ewes;

17. This Ruling does not consider or rule on early termination or events of default that occur as part of the Arrangement.

Return of the leased ewes

18. The leased ewes are returned to StockCo by way of an agreed culling process over the term of the Lease. In this respect, cls 9 and 10 of the Master Terms state:

YOU WILL CULL THE EWES ON OUR BEHALF

- 9 We recognise that the Flock will progressively reach the end of its useful Breeding life over the Lease period.
- 10 You agree to reduce the Flock to zero over the Lease period at the approximate Annual Cull Rate specified in the relevant Lease Agreement. The Annual Cull Amount Due has been determined on the basis of the Annual Cull Rate and Cull Value specified in the relevant Lease Agreement.
19. Despite this clause, it is acknowledged in the Lease that ewes may die or go missing. Clauses 14 and 15 of the Master Terms set out terms relating to missing and dead ewes:
- MISSING AND DEAD EWES**
- 14 We understand that deaths occur and that Ewes may go missing. We have included an annual death and missing sheep allowance of 5% of the Flock within the Lease Payment calculation.
- 15 You agree that the Ewes are at your sole risk. You must pay the Lease Payments and Cull Payments regardless of anything else, including the reason for, or the number of, deaths or missing Ewes.
20. A flock generally loses about 25% of its mature ewes annually through culling and selling of older ewes and natural attrition. Therefore, it is expected that none of the leased livestock will remain at the end of the lease period.

Deferred cull payment

21. The amount and timing of the cull payments are agreed when the lease is entered into and are reflected in the payment schedule. As the amounts payable are fixed, the customer takes on the risk of under-recovery from the meat works on the culled sheep but gets the benefit of any over-recovery.
22. The customer and StockCo negotiate the frequency and timing of cull payments, but payment will generally be at the time the livestock are culled or deferred until the end of the lease term and paid as a lump sum.
23. As StockCo retains legal ownership of cull payments, it will return them as income in the year in which those payments are derived.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- a) The lease payments are deductible under s DA 1(1) and none of the general limitations in s DA 2 apply to prevent deductibility, provided that no provision in subparts DB to DZ applies to prevent a deduction under s DA 1(1).
- b) At the end of an income year, unless the customer is excused from this requirement pursuant to a determination issued by the Commissioner, s EA 3 applies to require the unexpired portion of any lease payments to be included in the customer's income in the current income year and to be an amount for which the customer is allowed a deduction in the following income year, provided the Lease is not the customer's "revenue account property" or "trading stock" (within the meaning of s YA 1).

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- c) The financial arrangements rules in subpart EW do not apply to the Arrangement because the lease is an excepted financial arrangement.
 - d) Section EJ 10 does not apply to the Arrangement.
 - e) Sections FA 6 to FA 11 do not apply to the Arrangement.
 - f) Section FA 12 does not apply to the Arrangement.
 - g) Sections BG 1 and GA 1 do not apply to negate or vary the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 15 July 2020 and ending on 15 July 2024.

This Ruling is signed by me on the 15th day of July 2020.

Dinesh Gupta
Tax Counsel Lead
Tax Counsel Office