

PRODUCT RULING – BR PRD 17/01

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 Kiwibank 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, CC 7, EW 15, EW 31, RE 1(1) and RF 2(1).

The Arrangement to which this Ruling applies

The Arrangement is a product that Kiwibank intends to offer to its customers. The **product is to be marketed as the "Kiwibank Offset Mortgage" (the Product)**. The Product allows a customer to elect that interest payable by the customer on a loan made by Kiwibank should be calculated by offsetting the balance of the loan against the aggregate credit balances of certain nominated transaction and savings and investments bank **accounts (hereafter referred to as "credit accounts") held by either that customer or,** certain other eligible persons. Interest is payable on the net notional balance of these combined accounts.

This Ruling does not consider the tax consequences of any arrangement under which a credit account holder agrees to offset his or her credit account balance against another person's home loan account balance in return for valuable consideration.

Further details of the Arrangement are set out below.

Background

1. The Product is a feature that Kiwibank offers to new and existing customers. Kiwibank intends to extend the class of customers who are eligible to utilise the Product. Previously, Kiwibank has only made the Product available to individual customers. It now intends to increase the functionality of the Product in order to make it available to business customers, including companies and trusts.

2. The Product is capable of affecting the way in which interest is calculated on loans offered by Kiwibank which had an agreed fixed periodic repayment arrangement (also referred to as the “table portion” of a loan). **Kiwibank also offers loans with a revolving credit feature whereby amounts can be repaid or re-borrowed at any time provided the principal, interest, fees and costs on the loans do not exceed the specified maximum credit limit (also referred to as the “revolving portion” of a loan). The Product does not apply to “revolving portion” loans.**
3. In overall commercial terms, the economic consequences for a customer of using the Product, or using a revolving portion loan product bearing a variable interest rate, are broadly the same.
4. Prior to the introduction of the Product, customers of Kiwibank could elect for their table portion loan to have one or more of three components: fixed, variable, and construction components.
5. **The “fixed component” of the loan is subject to a fixed interest rate for a fixed term.** Customers may repay all or part of a fixed component at any time, although in certain circumstances they may be charged with a fixed rate break cost for making any repayment that exceeds an early repayment limit agreed with Kiwibank.
6. **The “variable component” of the loan is subject to a variable interest rate.** Customers may repay all or part of a variable component of a loan at any time without any break costs.
7. **The “construction component” of the home loan is available where the home loan is obtained for the purpose of buying land and building a house on it or renovating a house on land the borrower already owns.** The construction component of the home loan is subject to a variable interest rate and can be borrowed in stages (as opposed to a fixed or variable component which must be borrowed in a lump sum).
8. Kiwibank recognises that customers may have a range of accounts, including various deposit and loan accounts. Therefore, Kiwibank introduced the Product, **which included a new component called the “offset variable component”.**
9. When a customer elects that all or part of a loan is to have an offset variable component, interest accruing on that loan, or that portion of the loan, is to be calculated by reference to a notional balance. The notional balance is calculated by offsetting the debit balance of the offset variable component of the loan against the total credit balances of nominated everyday banking and savings and **investments accounts (referred to as the “credit accounts”). This lowers the interest payable and the variable component of the loan.** Therefore, it results in a **greater proportion of a customer’s regular loan repayments being applied in reduction of the principal of the offset variable component of the loan.**
10. This new feature effectively treats a group of accounts in a collective or aggregated manner for the purposes of calculating interest accrued on the offset variable component of the loan. This feature is intended to make the Kiwibank overall banking relationship more attractive to current and potential customers.

Interest calculations

Calculations of interest on an offset variable component of a loan

11. Interest payable on an offset variable component of the nominated loan is calculated by reference to a notional balance. This notional balance is determined, for the purposes of that calculation only, by reducing the balance of the offset variable component of the loan by the aggregate of the credit balances of the nominated credit accounts.
12. **The rate of interest applicable to the Product is the "offset variable interest rate".** The offset variable interest rate is one of a number of different rates which Kiwibank uses, under the Terms and Conditions of the various loans to which the Product applies. The offset variable interest rate may be above or below **Kiwibank's variable interest rate.**
13. Interest is not calculated separately in respect of each account and then offset. Instead, a net notional balance is calculated across all the relevant accounts. The **notional balance equals the offset variable component of the loan less (ie, "offset" against) the credit balances of the nominated credit accounts.** Interest is then payable on that net balance at the offset variable interest rate. This is the case as a matter of law (in terms of the terms of contractual relationship under the various Terms and Conditions applicable to eligible loans offered by Kiwibank) and as a matter of practice (in terms of **Kiwibank's computer and accounting systems**).
14. The offsetting is solely for the purpose of calculating the notional balance on which interest is calculated. There is no actual transfer of funds, no **set-off or "netting"** of funds together in an account, and no transfer of any interest in or entitlement to funds. Importantly, the customer has no legal entitlement to interest on credit **balances. This is the case even if the customer's total credit balances exceed the customer's loan balance.**
15. Interest is calculated on a daily basis and is debited to the loan account on a regular basis. Loan repayments are credited periodically into the loan accounts, which will pay the periodic interest and reduce the principal outstanding. Such payments are made from a Kiwibank account that the customer has selected. This account may or may not be another credit account that the customer has nominated to participate in the Product.
16. The offsetting aspect of the Product essentially offers the same economic benefits to customers as a revolving portion loan in terms of reduced interest costs (through a reduced balance on which interest is calculated) and consequently will accelerate loan repayments. With a revolving portion loan, funds that would otherwise be in a savings or cheque account are paid into the loan account (but are available to be redrawn).
17. Under the updated terms and conditions of the Product, Kiwibank intends to make the Product available to business customers for the first time. However, business customers will not have the ability to group their accounts with accounts of another entity, as individuals can.

No interest is payable on credit accounts

18. Under the terms and conditions agreed between Kiwibank and its customers for this Product, no interest is payable by Kiwibank on the credit balances of the credit accounts that customers have nominated to participate in the Product. This is regardless of whether those credit balances exceed the debit balance of the loan facility. This means that if the debit balance of a loan facility is less than the aggregate of the credit balances of the nominated credit accounts, no interest is paid or payable by Kiwibank.

Eligibility requirements

19. The product is only available to:
- An individual who holds an eligible loan with Kiwibank;
 - Two individuals who are married, in a civil union, or in a de facto relationship and who hold an eligible loan with Kiwibank;
 - A company which holds an eligible loan with Kiwibank (under the proposed changes to the product); and
 - A trust which holds an eligible loan with Kiwibank (under the proposed changes to the product).
20. "Eligible loans" will be the following loan products currently offered by Kiwibank:
- Business loans secured by residential property; and
 - Home loans.
21. The following **additional persons can elect to "offset" their Kiwibank credit account** against the loan of an individual customer or two individual customers who are married, in a civil union, or in a de facto relationship:
- (a) a child or children of the customer (or one of the customers); or
- (b) a parent or parents of the customer (or one of the customers).
22. Children and parents of individual customers can have a registered address with Kiwibank that is different from that of the customer's.
23. An offset variable component of a **loan can be "offset"** against nominated accounts of the customer(s) or other eligible persons (in the case of individual customers).

Other features of an offset variable component

24. The offset variable component is not an independent product; it is a component of a loan. The following features (amongst others) apply to the offset variable component along with the other components of a table portion loan:
- Interest is calculated on a daily basis, and is debited to the loan account on each specific payment date.
 - Customers may repay all or part of an offset variable component of a loan at any time without any break costs, other than a flat administration fee.

- The interest and principal of an offset variable component are repayable by way of regular payment cycles over the term of the offset variable component, except in relation to any applicable interest-only period. Only interest payments are required to be made during an interest only period. **“Repayment holidays” are also available, where no interest or principal is payable during a specific period.**
- All amounts owing under the table portion (including any offset variable component and other components) must be repaid in full on the last day of the loan term.
- The offset variable interest rate can vary at any time. Kiwibank will give the customer notice before changing the rate:
 - **If the offset variable interest rate increases, the customer’s regular payments for the offset variable component will automatically increase if this is necessary to enable the customer to pay off the offset variable component over the agreed term.**
 - **If the offset variable interest rate decreases, the customer’s regular payments for the offset variable component will remain the same, so the term of the loan will shorten. However, the customer can elect to reduce the amount of the regular payment so that the offset variable component can be repaid over the same term.**
- The Product is offered to customers having an existing variable rate table portion loan facility. If an existing customer elects to convert a part or all of an existing variable rate table portion loan to have an offset variable **component, the customer must agree that Kiwibank’s applicable terms and conditions for the Product will apply.** All new customers will sign new terms and conditions applicable to all Kiwibank accounts, which will, by definition, include the terms and conditions applicable to the Product.
- A customer may have more than one loan account to which the terms and conditions of the Product apply, but each such loan account is treated separately. In the case of individual customers only, they may group their loan and credit accounts with the credit accounts of certain other individuals.
- A transaction or deposit account (eg, everyday banking, savings and investments accounts) may be nominated to link to one or more loan accounts under the Product terms and conditions. If the outstanding balance of the various loan accounts exceeds the balance of the deposit account, the order of offsetting is determined by the **“priority” ranking of each loan, as designated by the customer.**
- Interest cannot be capitalised on any loan to which the Product applies, except to the extent of any interest component on a defaulted payment which **may be “capitalised” only for the purpose** of calculating further interest and default interest owing on the loan. The defaulted interest does not become part of the outstanding principal loan balance and will remain an outstanding interest payment.

Terms and conditions for the Product

25. Each Kiwibank loan is documented under a collection of documents:

- a) In respect of home loans:
- i) The Home Loan Terms and Conditions, which are contained in a booklet that Kiwibank issues (as amended and updated from time to time) and which set out the generic provisions applicable to all Kiwibank home loan facilities.
 - ii) The Home Loan Agreement, which contains specific provisions about the home loan facility that is being made available to a specific customer, including the amount and timing of regular payments calculated on a basis that will repay the loan over the applicable term.
- b) In respect of other loans:
- i) The Lending Terms and Conditions for Business and Rural Banking – effective December 2012, which set out the generic provisions **applicable to all of Kiwibank’s business** lending facilities.
 - ii) The Loan Agreement, which contains particular and specific provisions in relation to the business loan facility that is being made available to a specific customer including the amount and timing of regular payments, calculated on a basis which will repay the loan over the applicable term.
- c) In respect of all loans:
- i) The General Terms and Conditions, that contains the terms that govern the general banking relationship between Kiwibank and its customers. The General Terms and Conditions may also contain specific terms and conditions that apply to particular accounts and services.
 - In the event that there is any conflict between any part of the General Terms and Conditions and the Home Loan Terms and Conditions, the Home Loan Terms and Conditions will apply.
 - In the event that there is any conflict between any part of the General Terms and Conditions and the Lending Terms and Conditions for Business and Rural Banking, the Lending Terms and Conditions for Business and Rural Banking apply.

Groups of accounts

26. The product is based on a group of participating accounts. The following rules explain which accounts can be included in the group:

- (a) The accounts of an individual, or the individual and joint accounts of married, de facto and civil union couples, any of their children, and any of their parents may be combined as part of one group.

To illustrate, Sarah and Peter have a home loan facility with Kiwibank. If Sarah and Peter and their child, Michael, each have a savings account with Kiwibank, the home loan facility could be offset by the credit balances of the various accounts held by them.

- (b) Borrowers of the home loan facility and owner of other transaction **accounts nominated for the "offset" feature must be either:**
 - (i) all residents of New Zealand for tax purposes; or
 - (ii) all non-residents of New Zealand for tax purposes.
- (c) Companies, trusts and sole traders are eligible to participate in the product. Companies, trusts, and sole traders may group their transaction and eligible loan accounts for the purposes of the product. However, a company, trust, or sole trader may not group their accounts with the accounts of any other individual or entity.

Condition stipulated by the Commissioner

This Ruling is made subject to the following conditions:

- a) **All interest rates related to the Product are arm's length market interest rates.**

How the Taxation Laws apply to the Arrangement

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

- a) No consideration is paid, or payable, by virtue of the offset feature of the Product for the purposes of calculating income and expenditure under ss EW 15 or EW 31.
- b) **No income arises under s CC 7 for Kiwibank's customers in relation to the Arrangement.**
- c) **For the purposes of the "resident withholding tax rules" (as defined in s RE 1(1)) and the "non-resident withholding tax rules" (as defined in s RF 1(1)), there is no payment of, or entitlement to, interest in relation to the credit accounts participating under the Arrangement, that would give rise to an obligation to deduct resident withholding tax or non-resident withholding tax or pay an approved issuer levy.**
- d) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 June 2016 and ending on 31 May 2021.

This Ruling is signed by me on the 6th day of March 2017.

Howard Davis
Director (Taxpayer Rulings)