

## PRODUCT RULING — BR PRD 18/06

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 the Industrial and Commercial Bank of China (New Zealand) Limited (the Bank).

### 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, GA 1, RE 1–6, RE 10, RF 1–4; and
- ss 86F and 86I of the Stamp and Cheque Duties Act 1971 (SCDA).

### The Arrangement to which this Ruling applies

The Arrangement is a mortgage offset banking product (the Product) that the Bank offers to those customers (individuals) who take out a home loan.

For the purposes of this product **ruling, the term “Specified Account” as defined in the Home Loan and Personal Loan General Terms and Conditions documentation means “Specified Deposit Account”.**

The Product involves “offsetting” (for interest calculation purposes) a home loan account balance (the “offset portion”) against a credit balance in a Specified Deposit Account. This reduces the interest payable by a customer on their home loan balance.

The Arrangement is set out in the documents listed below, copies of which were received by the Taxpayer Rulings Unit, Inland Revenue, on 20 August 2018:

- General Terms and Conditions;
- Home Loan Application Form;
- Home Loan and Personal Loan Letter of Offer;
- Home Loan and Personal Loan General Terms and Conditions;
- Home Loan and Personal Loan Agreement;
- Home Loan and Personal Loan Component Tables; and
- Retail Banking Fees and Charges Brochure.

Further details of the Arrangement are set out in paragraphs 1 to 17 below.



1. Customers may have a range of accounts with the Bank, including transaction accounts, savings accounts, and loan accounts. Loan accounts may be table only, reducing, principal and interest, interest only, fixed or variable home loan accounts.

#### *Primary feature of the Product*

2. The primary feature of the Product is the offsetting feature.
3. To participate in the Product, a customer must have a home loan with an offset portion. Customers may convert an existing non-offset home loan to an offset home loan account.
4. Where a customer has a loan account with an offset portion, the customer must also have a Specified Deposit Account so interest can be calculated on **the offset portion of a customer's loan.**
5. **The Product applies an "offset" to an offset portion** of a home loan against a Specified Deposit Account, with "offset" being one category of loan applicable to home loans.

#### *How the offsetting works*

6. **The "offsetting" is only to calculate the** interest payable on the offset portion of the home loan.
7. Interest on the offset portion of the home loan is calculated, and paid by the customer, on the difference between the offset portion of the home **loan balance and the credit balance of the customer's Specified Deposit Account.** Under the terms and conditions agreed between the Bank and its customers for the Product, the Bank pays no interest on the credit balance **that is "offset" against the offset portion of the home loan.**
8. Where the credit balance of the customer's Specified Deposit Account exceeds the balance of the offset portion of the home loan it is "offset" against, the balance of the excess credit balance on which interest is receivable will be subject to the RWT rules, NRWT rules or the AIL rules.
9. The interest payable on the home loan account is calculated by reference to the balance of the offset portion of the home loan less the credit balance of the Specified Deposit Account. This will be the case as a matter of law (in terms of the Product's documentation) and as a matter of practice (in terms of the Bank's computer system). There is no actual set-off, netting, or transfer of funds, or transfer of any interest in or entitlement to funds. "Offsetting" occurs before debit or credit interest is calculated.
10. There is no provision for any interest saved under "offsetting" to reduce the "minimum payment". The effect of "offsetting" is the same as a decrease in the floating interest rate and a decision not to reduce the amount of the "minimum payment". The term of the loan is reduced because the principal portion of the payment is effectively increased.



11. If the credit balance of the Specified Deposit Account is greater than the debit balance of the offset portion of the home loan, credit interest will be applied to the difference and paid to the credit balance account.
12. Interest is calculated by the Bank on a daily basis. If, during a month, the Bank is both entitled to receive interest (that is, the balance of the offset portion of the home loan exceeds the balance of the Specified Deposit Account) and, at another point in the month, is obliged to pay interest (that is, the balance of the Specified Deposit Account exceeds the balance of the offset portion of the home loan), then the two interest payments are made and are not set-off.
13. The "offsetting" feature of the Product essentially offers the same benefits to customers as a revolving credit loan in terms of lower interest costs and a shorter time to repay the loan. However, this feature overcomes a perceived disadvantage of a revolving credit loan because it allows customers to retain separate account balances (which customers may prefer when managing their finances).

*Terms and conditions for the Bank's home loan products*

14. Each of the Bank's home loans is explained in a collection of documents. These include:
  - a) a Home Loan and Personal Loan General Terms and Conditions (a standard form "master" document, which contains primarily generic provisions that apply to all of the Bank's personal and home loan facilities);
  - b) a Letter of Offer, which conditionally approves the Bank's lending arrangements outlining the type of loan and loan amount, as well as any loan-to-value ratio applicable to the loan; and
  - c) a Loan Agreement, which contains details of the parties to the loan, the amounts borrowed and terms and conditions applicable to the loan drawn down by the customer.
15. Table loans provide for regular payments and a set date when they will be paid off. Most payments early in the loan term comprise interest, while most of the later payments comprise principal repayments. Reducing loans have two separate repayments, one of interest and one of principal. Customers repay the same amount of principal each time and interest is charged separately. The Product can be used for both table and reducing home loans, to the extent the loan is subject to a variable offset interest rate.
16. Where an amount of a home loan is subject to offsetting, there are two separate repayments: one of interest and one of principal. Customers repay an amount of principal each time and interest is charged separately. If there is an increase in the variable offset interest rate during the term of the loan, the payment amounts increase so the loan is paid off over the same term as originally agreed between the Bank and the customer. If there is a decrease in the variable offset interest rate during the term of the loan, the payment amounts remain the same and

the term of the offset portion of the home loan is reduced (however, a customer has the option to reduce the payment amounts instead if the variable offset interest rates reduce over the term of the loan).

#### *The Bank's objectives*

17. The Bank's objectives in providing the Product are to:
- a) increase its market share, particularly for home loans and transaction-type accounts;
  - b) increase customer satisfaction and customer retention; and
  - c) improve its brand awareness and be seen as a market leader.

#### Condition[s] stipulated by the Commissioner

This Ruling is made subject to the following condition:

- 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.

#### *Financial arrangements rules*

When a credit balance of a Specified Deposit Account and a debit balance of the offset portion of the home loan are "offset", no amount of consideration is paid or payable because of that "offset" for the calculation of income and expenditure under ss EW 15 and EW 31 of the "financial arrangements rules" (as defined in s EW 1(2)).

#### *Resident withholding tax (RWT), non-resident withholding tax (NRWT) and approved issuer levy (AIL)*

Under the "offsetting" feature of the Product, the following apply:

- a) There is no payment of or entitlement to "interest" (as defined in s YA 1) for the credit balance of a Specified Deposit Account, and no obligation to deduct RWT or NRWT or pay AIL, except to the extent that the credit balance exceeds the debit balance of the offset portion of the home loan.
- b) To the extent that interest is credited to a Specified Deposit Account:
  - i) RWT and NRWT (as defined in s YA 1) must be deducted by the Bank from the interest credited to the Specified Deposit Account in accordance with the RWT rules (as defined in ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1); and
  - ii) for an account that is a "registered security" (as defined in s 86F of

the SCDA), "approved issuer levy" (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account pursuant to ss 86F and 86I of the SCDA.

*Section CC 7*

No income arises under s CC 7 for the Bank or its customers in relation to the Arrangement.

*Section BG 1*

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 October 2018 and ending on 30 September 2022.

This Ruling is signed by me on the 15 November 2018.

Vasu Naidu

Group Lead, Customer Compliance - Significant Enterprises