

PRODUCT RULING – BR PRD 19/03

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.

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, GA 1 and subpart EW.

The Arrangement to which this Ruling applies

The Arrangement

The Arrangement is the leasing of livestock by StockCo Limited (StockCo) to its customers (Customers) to use in a farming business. Each Customer will be a “New Zealand resident” (as defined in s YA 1). The leased livestock will either be purchased by StockCo from the Customer and will then be leased back to them, or will be specifically purchased by StockCo from a third party and then leased to the Customer. The Customer will lease the livestock over a period of usually four years. The livestock will be progressively culled (or will otherwise 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 below.

The Purchase of Livestock

1. StockCo will purchase an agreed number of “specified livestock” (as defined in s YA 1), in this case cows, from the Customer, or a third party, for the purchase price (Purchase Price):

WE WILL PURCHASE THE HERD

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

...

WITHDRAWN

2. The Purchase Price is the equivalent of the market value of the purchased cows at the time of acquisition.
3. Where the livestock are purchased from a third party, the Purchase Price will be paid by StockCo to the third party vendor.
4. 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

5. The Agreement entered into between StockCo and its customers comprises of two documents: the Dairy Herd Lease Master Terms (Master Terms) and the Lease Agreement (Lease Agreement) (together, the Lease). The Lease sets out the terms of the sale (where StockCo purchases livestock from the Customer) and the lease of the livestock.
6. The terms of the Lease Agreement and the Master Terms will not be materially different from the version provided to Inland Revenue on 25 October 2019.
7. As provided for in clause 7 of the Master Terms, StockCo owns the cows and leases the purchased cows to the Customer for the lease period, while the Customer owns all milk and progeny produced by the leased cows:

- 7 We will own the Cows. You will own all progeny and milk produced by the Cows during the Lease period.

WE WILL LEASE YOU THE HERD

- 8 We lease to you, and you take on lease, the Herd for the term specified in the Lease Agreement from the time we purchase the Herd.
8. The progeny will be valued in accordance with the livestock valuation rules set out in Part EC of the Act.
9. Clauses 11 to 13 of the Master Terms set out the payment obligations of the Customer:

YOUR PAYMENT OBLIGATIONS

- 11 You will pay us for each Herd:
 - 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 Herd.
 - 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 Cows when they are culled. You agree to realise this amount for us by selling the Cull Cows on our behalf.

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- (b) You will pay us the Cull Payments regardless of the amount you realise from selling the Cull Cows 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.
- 13 You will provide us with a signed Dairy Order so that the Lease Payments are paid directly to us by the Dairy Company.
- 10. Under clause 13 the Customer must arrange for the Lease Payments to be made directly to StockCo by the Dairy Company (defined in clause 59 of the Master Terms as "Fonterra"). Accordingly, only Fonterra members are eligible to enter into the 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 21 of the Master Terms provides for the early termination of the Lease by the customer in certain situations:

EARLY TERMINATION

- 21 Where there is a material change in your circumstances, you may terminate the Lease early by:
 - 21.1 purchasing the remainder of the Herd for the Net Present Value of the unpaid Lease Payments and Cull Payments; and
 - 21.2 paying us any other amount owing to us under this agreement in relation to the relevant Lease; or
- 13. It is expected that this clause would be applied only in rare cases as a cost/benefit analysis would normally favour the Customer remaining in the lease and continuing to meet the Lease obligations.
- 14. Clause 22 of the Master Terms provides for early termination by StockCo:
 - 22 We can end the Lease under clause 25.2 because of your default.
- 15. Clause 25.2 of the Master Terms states:
 - 25 If an Event of Default has occurred, we may:
 - ...
 - 25.2 end the Lease with effect from any date specified by us and require you to, at our option:
 - (a) return the Herd to us at the location and by the date nominated by us. If we end the Lease under this clause 25.2(a) you will pay us liquidated damages equal to the amount (if any) by which the market value of the Herd (as determined by us, acting reasonably) is less

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than the Net Present Value of the unpaid Lease Payments and Cull Payments; or

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

16. Clause 25.1 allows for StockCo to repossess the Herd or any Cows following an Event of Default:

25.1 enter the Land (or any land where we consider the Herd or any Cows may be) without notice and repossess any or all of the Cows; ...

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 cows

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

YOU WILL CULL THE COWS ON OUR BEHALF

9 We recognise that the Herd will progressively reach the end of its useful milking life over the Lease period.

10 You agree to reduce the Herd 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 clause 10, it is acknowledged in the Lease that cows may die or go missing. Clauses 15 and 16 of the Lease set out terms relating to missing and dead cows:

MISSING AND DEAD COWS

15 We understand that deaths occur and that Cows may go missing. We have included an annual death and missing cow allowance of 2.5% of the Herd within the Lease Payment calculation.

16 You agree that the Cows 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 cows.

20. A dairy herd generally loses approximately 25% of its mature cows annually through culling of the older cows 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 at the time of entering into the Lease and is 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 cows but gets the benefit of any over-recovery.

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22. The frequency and timing of the Cull Payments are negotiated between the Customer and StockCo, but payment will generally be either at the time the livestock are culled, or deferred until the end of the Lease term and paid as a lump sum.
23. As legal ownership of the Cull Payments remains with StockCo, it will return the Cull Payments 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 applies to prevent deductibility, provided that:
 - no provision in subparts DB to DZ applies to prevent a deduction under s DA (1).
- b) At the end of an income year, unless 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 that the Lease is not "revenue account property" or "trading stock" (within the meaning of s YA 1) of the Customer.
- c) The financial arrangements rules in subpart EW do not apply to the Arrangement as 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 because the lease is not a finance lease.
- f) Section FA 12 does not apply to the Arrangement because the lease is not a hire purchase agreement.
- 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 the date this Ruling is signed and ending on 31 December 2023.

This Ruling is signed by me on the 19th day of December 2019.

Howard Davis
Director (Taxpayer Rulings)