

## **PRODUCT RULING - BR Prd 05/04**

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

### **Name of the Person who applied for the Ruling**

This Ruling has been applied for by New Zealand Bloodstock Leasing Limited.

### **Taxation Laws**

All legislative references are to the Income Tax Act 1994 unless otherwise stated.

This Ruling applies in respect of sections BD 2(1)(b), BG 1, EF 1, EM 1, EO 2A, FC 8A to FC 10, GB 1, GD 1 and the definitions of “excepted financial arrangement”, “hire purchase agreement”, “lease”, “lease asset” and “operating lease” contained in section OB 1.

### **The Arrangement to which this Ruling applies**

The Arrangement is the leasing of bloodstock by New Zealand Bloodstock Leasing Limited (“NZBL”) to its customers for use in breeding bloodstock progeny on the terms provided in the “Bloodstock Lease to Purchase Agreement” (a copy of which was provided to Inland Revenue on 2 February 2005) entered into by NZBL and its customers. Further details of the Arrangement are set out in the paragraphs below.

1. NZBL is a wholly owned subsidiary of New Zealand Bloodstock Limited (“NZB”). NZB established NZBL to expand its business and increase sales of bloodstock in New Zealand by making investment in the bloodstock industry more attractive to existing and new entrants. The availability of leasing reduces the initial level of cash required by existing and new entrants to the bloodstock business to acquire bloodstock.
2. NZBL acquires bloodstock from third party owners, then leases this bloodstock to the customer. Alternatively, the customer purchases the bloodstock from the third party owner, sells it to NZBL, then leases the bloodstock from NZBL. This helps protect NZBL from involvement in any subsequent contractual claims regarding the purchase of the bloodstock from the third party owner. In both cases the transaction as a whole (ie, sale and lease-back) is contemplated by the parties at the outset. In either case, the customer sources the bloodstock, drawing on bloodstock consulting, freight, and insurance services provided by NZB.
3. The terms and duration of leases are based on individual requirements, credit risk, and potential breeding expectations. Lease periods may vary. A typical lease term is three years for fillies or mares, and two years for colts or stallions.

4. The bloodstock has a residual value under the Bloodstock Lease to Purchase Agreement (the “Residual Value”). The Residual Value is an estimate (at the time of signing the lease) of the value the bloodstock will have at the end of the lease. Where there is an opportunity to secure the rights to sell future progeny through NZB’s annual sales (in practical terms this will only be where the bloodstock in question is a mare), NZBL sells the bloodstock to New Zealand Bloodstock Progeny Limited (“NZBP”) for the discounted value of the residual value payment. The discounted value is calculated using market rates used by third party companies providing financial facilities. Accordingly, when there is an opportunity to secure the rights to future progeny, NZBP holds title to the bloodstock during the term of the lease, otherwise the title is retained by NZBL.
5. On termination of the lease (the “Lease Termination Date”) the customer may purchase the bloodstock for the Residual Value. NZBP or NZBL will transfer title to the customer in return for payment of the Residual Value.

### **Conditions stipulated by the Commissioner**

This Ruling is made subject to the following conditions:

- a) The customer is in the business, as defined in section OB 1, of breeding bloodstock.
- b) The customer has entered into the Bloodstock Lease to Purchase Agreement for the sole purpose of breeding from the leased bloodstock and intends to use the leased bloodstock in the production of gross income.
- c) The lease payments are genuine, arms-length amounts for the possession and use of the bloodstock.
- d) The leased bloodstock is mature for use in breeding and is capable of being used for breeding throughout the period to which each lease payment relates.
- e) Any racing undertaken by the leased bloodstock is only incidental to the actual use of the bloodstock for breeding during the lease term.
- f) The lessee will have title to any progeny produced during the lease term.
- g) The bloodstock becomes the property of the customer only when the customer makes payment of the Residual Value after the Lease Termination Date.
- h) The Residual Value of the bloodstock is a reasonable, and the parties’ best, estimate of the likely market value of the bloodstock at the Lease Termination Date.
- i) The Residual Value amount when paid by the customer is not materially less than the open market value of the bloodstock at the Lease Termination Date.

### **How the Taxation Law applies to the Arrangement**

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

- The bloodstock lease payments are allowable deductions under section BD 2(1)(b) and are not excluded from being deductible under section BD 2(2)(e);
- At the end of an income year, the unexpired portion of any lease payments paid in advance is included in gross income and deductible in the subsequent year (unless excluded from this requirement pursuant to determination by the Commissioner) under section EF 1;
- The valuation and specified writedown provisions in section EM 1 apply to the customer when the bloodstock is purchased by payment of the Residual Value after the Lease Termination Date;
- The cost price of the bloodstock for the purposes of section EM 1 is the Residual Value stated in the Bloodstock Lease to Purchase Agreement;
- Sections BG 1 and GB 1 do not apply to the Arrangement to negate or vary any of the above conclusions;
- Section GD 1(1) does not apply to the Arrangement;
- The Accrual Rules in sections EH 19 to EH 59 do not apply to the Arrangement;
- The operating lease provision section EO 2A does not apply to the Arrangement;
- The finance lease provisions in sections FC 8A to FC 8I do not apply to the Arrangement;
- The hire purchase provisions in sections FC 9 and FC 10 do not apply to the Arrangement.

**The period or income year for which this Ruling applies**

This Ruling will apply for the period 10 February 2005 to 4 December 2007.

This Ruling is signed by me on the 9<sup>th</sup> day of February 2005.

**Martin Smith**

Chief Tax Counsel