

PRODUCT RULING - BR Prd 06/03

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 Westpac Banking Corporation (“Westpac”), BT Financial Group (NZ) Limited (“BT”) and Westpac New Zealand Limited (“Newco”).

Taxation Laws

All legislative references are to the Income Tax Act 2004 unless otherwise stated.

This Ruling applies in respect of sections BD 3, BG 1, CA 1, CE 1, CE 5, GB 1, GC 17 and the definitions of “salary or wages”, “extra pay”, “withholding payment” (in section OB 1) and “source deduction payment” (in section OB 2).

The Arrangement to which this Ruling applies

The Arrangement is the provision of childcare services (referred to as the “Westpac Child Care Centre Benefit”) by Westpac, the parent company of BT and Newco, to employees of the Westpac Group (which for the purposes of this Ruling is defined to mean Westpac, BT, and Newco), on Westpac’s premises.

Westpac, BT and Newco will not charge employees for the cost of the childcare services and the services will be provided as a benefit to employees in addition to the salary or wages normally paid to such employees. Employees will enter into a salary reduction agreement with their respective employer, modifying the existing employment contract, pursuant to which an employee’s pre-tax salary will be reduced by an amount equivalent to the value of the childcare services provided to that employee by Westpac. BT and Newco will pay Westpac for the cost of the childcare services provided to their respective employees. This agreement will be legally effective so as to operate as a contractually binding and enforceable agreement to reduce the amount of pre-tax salary by the value of the childcare services provided.

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

1. 1. Westpac, BT and Newco satisfy the section IG 1(2) definition of “group of companies”.



2. 2. Westpac will enter into a management agreement with ABC Developmental Learning Centres (NZ) Ltd (“ABC”), the draft of which was provided to the Rulings Unit on 11 November 2005. Pursuant to this management agreement, ABC is to provide childcare management services at each childcare centre to Westpac. Westpac will provide a licence of the premises to ABC to enable ABC to carry out its obligations to Westpac.
3. 3. Westpac has been planning for some time to provide childcare centres to be made available to its employees, to enable employees in the Westpac Group to achieve a better work/life balance. Westpac is committed to providing childcare services to employees of the Westpac Group, as this is of obvious benefit to its employees and also because it is consistent with Government policies to achieve greater participation in the workforce for employees with children. It is also expected that the provision of childcare services will have flow-on commercial benefits for Westpac in the form of a higher level of employee satisfaction with Westpac as an employer and a resulting improvement in employee morale and retention.
4. 4. In 2004 Westpac entered into negotiations with ABC Learning Centres Limited (“ABC Learning”), an experienced operator of childcare facilities in Australia. Westpac and ABC Learning entered into a memorandum of understanding to provide the framework for negotiating a more detailed management agreement. This memorandum of understanding was dated 29 November 2004, and was provided to the Rulings Unit on 11 November 2005.
5. 5. It is intended that Westpac will establish a pilot site, to be operational in 2006, in Auckland, Wellington or Christchurch. It is expected that childcare centres will be established in the other two cities shortly after the pilot site becomes operational. It is possible that Westpac may establish childcare centres in other cities. Westpac sent out a request for employees to register their interest for the planned childcare centres. As a result of this request, 196 employees registered their interest in respect of a total of 227 children. Registrations of interest for 91 of these children were for the Auckland childcare centre, 80 for the Wellington childcare centre, and 56 for the Christchurch childcare centre.
6. 6. Westpac and ABC Learning entered into the memorandum of understanding to provide a framework for negotiating the terms of a management agreement between ABC and Westpac, pursuant to which Westpac will contract with ABC for ABC to provide, on Westpac’s behalf, quality tailored childcare management services on Westpac’s premises, for the benefit of New Zealand employees in the Westpac Group.
7. 7. The memorandum of understanding is no more than a commitment by the parties to negotiate the terms of a more detailed management agreement and, consequently, the memorandum of understanding does not deal in any detail with the nature of the arrangement to be entered into between Westpac and ABC.
- .8. Since entering into the memorandum of understanding, the parties have negotiated a detailed management agreement, including schedules, dealing
.with various aspects of the operation of the childcare centres to be established by Westpac. (As noted above, a draft form of this management agreement was provided to the Rulings Unit on 11 November 2005). In addition, Westpac has prepared a salary

reduction agreement (also provided on 11 November 2005), which contains the terms on which Westpac will provide childcare services to its employees. Westpac provided an amended version of the salary reduction agreement on 1 May 2006, incorporating the adjustment for accrued leave referred to in paragraph 32 below. The same form of salary reduction agreement (with some modifications) will be used for BT's and Newco's employees.

.9. Broadly, the management agreement:

.(i) sets out the agreed services to be provided by ABC, on behalf of Westpac (refer Schedule 1 of the agreement), and the applicable service standards;

.(ii) provides that ABC is responsible for the day-to-day administration of each centre and dealing with parents in relation to children at the centre;

.(iii) requires that each childcare centre be licensed at all times (and that ABC will be required to apply for the licence for each childcare centre), and that ABC will comply at all times with its obligations under the Education (Early Childhood Centres) Regulations 1998;

.(iv) requires that ABC will indemnify Westpac for any breach of the Regulations and other applicable regulatory requirements; and

.(v) provides for termination rights, including termination at Westpac's discretion.

8. 10. The management agreement contemplates that there will be a separate licence agreement for each childcare centre, which will outline the terms of the licence to be provided by Westpac to ABC, to enable ABC to carry out its obligations under the management agreement at a particular site.

9. 11. Westpac and ABC will co-operate to identify and develop suitable sites as childcare centres, pursuant to clause 4 of the management agreement and in accordance with Schedule 7. When a suitable site has been identified and developed as a childcare centre, Westpac will take a lease of the site (if Westpac does not own or already lease the site), Westpac and ABC will enter into a site licence in respect of that site and ABC will then commence providing the childcare services, on behalf of Westpac to Westpac Group's employees, through the childcare centre at that site. ABC will be required to pay a licence fee to Westpac.

.12. The Auckland District Law Society model lease (4th Edition) is intended to be the form of lease that Westpac will use for a childcare centre. However, the provisions relating to the "Guarantor" (who would normally guarantee the

.lessee's obligations) will be deleted from the lease agreement. In addition, the lease agreement will be subject to any amendments negotiated with the owner of the premises. It is possible that the owner of the premises may have its own form of lease agreement, in which case Westpac would negotiate over the terms of that lease agreement. Any such lease agreement entered into will be a standard and conventional lease that is on arm's length and commercial terms.

10. 13. The signage on each childcare centre is likely to incorporate the following information:

"[Location] Child Care Centre

Managed by ABC Corporate Care Pty Ltd A wholly owned subsidiary of ABC Learning Centres"

1. 14. Westpac will incur certain direct costs in relation to each site operated as a childcare centre, which will be principally the costs payable under the lease for the site. Westpac will also incur the cost of any increase in insurance premiums, as a result of the premises being used as a childcare centre, and other costs which Westpac reasonably considers are necessary for the premises to be used as a childcare centre. Westpac will recoup these costs from ABC, by way of the licence fee. The licence fee is to be paid monthly in advance (clause 3.1 of Schedule 2 of the Licence for Use and Occupation of Premises).

2. 15. ABC will charge a fee to Westpac, referred to as the Westpac Usage Fee, in consideration for the services provided by ABC at each childcare centre (clause 6.1(a) of the management agreement). The Westpac Usage Fee is defined, in respect of each childcare centre, as the aggregate of the Child Care Fees in each fortnight for services provided by ABC to each child of a Westpac Group employee enrolled at that centre. The Child Care Fees are calculated in accordance with Schedule 5 of the management agreement. Schedule 5 is divided into two parts. Part A provides how ABC must set the Child Care Fees at each centre. These Child Care Fees are to reflect, in Westpac's reasonable opinion, market rates. Part B provides how ABC must invoice the Child Care Fees.

.16. Although each childcare centre will be a Westpac childcare centre and ABC is to be engaged merely to manage each childcare centre on behalf of Westpac, ABC has negotiated the right to contract directly with members of the public to provide childcare services at the childcare centres. For this purpose members of the public will include Westpac Group employees who are not participating in the Westpac Child Care Centre Benefit (and effectively are non-Westpac Group employees for the purposes of access to each childcare centre). Any such contractual arrangements will be directly between ABC and members of the public and will not involve Westpac Group. The ability to offer places to members of the public was considered important by ABC, to ensure the economic viability of each childcare centre. If there are surplus places at any childcare centre after all participating Westpac Group employees have taken up places, ABC will be able to offer such surplus places to members of the public. As a result it is expected that ABC should be able to operate each childcare centre at full capacity and achieve greater economies of

scale. This should assist with minimising the costs to Westpac of providing childcare services to Westpac Group's employees.

3. 17. Westpac's objective in setting up each of the childcare centres is to provide for childcare services for employees of the Westpac Group. Each childcare centre is to have a proposed capacity of 75 children, giving the three childcare centres a total proposed capacity of 225 children (although it is possible that the Auckland childcare centre may have a slightly greater capacity). Based on the 196 employees who registered their interest in respect of a total of 227 children, Westpac's expectation at the outset of the arrangement is that, over time, an average of at least 50% or more of the total number of children at the three childcare centres will be children of employees of Westpac Group who participate in the Westpac Child Care Centre Benefit.

4. 18. Westpac has not adopted a policy that childcare centres will be closed, if the number of children of Westpac Group employees falls below a certain number.

However, where the numbers of children of Westpac Group employees using a particular childcare centre falls to a level where Westpac considers that it no longer fulfils the commercial objectives set out in paragraph 4, Westpac will carry out a review of the viability of that childcare centre and make a decision as to whether to continue to keep the centre operating.

5. 19. Clause 9 of the management agreement regulates the availability of places in a centre between Westpac Group employees and non-Westpac Group employees. Clause 9.1(a) provides that the manager shall ensure that priority of enrolment at each centre is provided to the children of parents employed by Westpac Group, in accordance with the priority access guidelines in schedule 2 to the management agreement. Clause 9.2 provides that where there are vacancies at a centre, the manager may make such vacancies available to children whose parents are not employed by Westpac Group, on terms and conditions no less favourable than the terms and conditions applicable to Westpac employees, but subject always to the application of the guidelines in schedule 2.

.20. Schedule 2 is in three parts. Part 1 deals with the allocation of places at a centre between children of Westpac Group employees and non-Westpac Group employees, prior to the centre opening. Part 2 of the schedule sets out the procedures for allocating vacant places at a centre from the date the centre becomes operational. Clause 18 of the schedule provides that once a parent of a non-Westpac Group child has accepted a place at the centre, that child shall be guaranteed continuity of that place as long as required, unless:

- .(i) the centre is designated as a high use centre under Part 3 of the schedule; and
- .(ii) the child was aged 2 years or under when the child commenced care and has not yet taken up a place in the 3 year old age group; and
- .(iii) the centre continues to have a high use designation.

6. 21. Clause 19 of the schedule provides that places made available to children (aged 2 or under when care commenced) of non-Westpac Group employees can be reclaimed for the children of Westpac Group employees on 6 months notice, in the case of centres with a high use designation. Part 3 of the schedule sets out the process for applying a high use designation to a centre. Essentially, Westpac can request that any centre be classified as high use, except if the manager is able to produce evidence that children of Westpac Group employees are taking up less than 75% of the available places at the centre.

7. 22. The management agreement makes it clear that the manager must not collect any childcare fees directly from any Westpac employee (who is participating in the Westpac Child Care Centre Benefit) who has children at a childcare centre (clause 6.3(a)). The manager must also ensure that priority of enrolment at any childcare centre is provided to the children of parents who are employees of Westpac Group. Any disputes regarding priority of enrolments shall be determined by Westpac, in accordance with an enrolment policy to be formulated by Westpac (clause 9.1).

8. 23. Westpac's right to terminate the management agreement or any site licence is provided for in clause 15.2 and clause 15.3. In addition to having the right to terminate the management agreement or any site licence if the manager is in breach, Westpac has an absolute discretion to terminate the agreement or any site licence, on giving 60 days' written notice to ABC.



9. 24. The structure of the arrangement, as reflected in the management agreement, is as follows. Westpac wishes to provide childcare facilities to its employees and wishes to be able to control the quality and the continuance of those services. Westpac will be able to control the quality and the continuation of the services by having control of the premises as lessee, and by setting the operational standards in the management agreement. If the manager breaches the operational standards, Westpac can terminate the manager's site licence and arrange for another provider of childcare services to manage the particular childcare centre. Also, if for any other reason Westpac is unhappy with the level of services provided by the manager, Westpac has a complete discretion to terminate either the management agreement in its entirety or any particular site licence. Westpac's control of the premises and control of the manager is intended to minimise any operational and regulatory risks to which Westpac could be exposed through the provision of childcare services to its employees.

.25. If Westpac is not the lessee of the premises, Westpac would be subject to the risk that the provision of childcare services through the particular childcare centre would be discontinued if, for example, ABC were to close that childcare centre or if Westpac, for whatever reason, became dissatisfied with ABC's standard of performance. This would not be an acceptable commercial risk for Westpac, because the discontinuance of the provision of childcare services through the particular childcare centre would have a disproportionately adverse effect on its relationship with its employees, who no doubt would feel considerably let down if the provision of childcare services through a particular childcare centre was discontinued. Westpac is able to remove or at

least control that risk, by having control of the premises and having the ability to terminate the manager's performance of services at the particular childcare centre (and arranging for a substitute manager to carry on providing the services at the particular centre).

10. 26. If any of Newco's or BT's employees wish to take up a place at a childcare centre Newco/BT will arrange with Westpac for Westpac to provide the necessary childcare services to those employees. That company will pay Westpac for the cost of the childcare services.

11. 27. The salary reduction agreement serves two purposes. First, the agreement modifies the terms and conditions of an employee's employment contract with Westpac/BT/Newco by providing for a salary reduction. Secondly, the agreement sets out the terms of the childcare benefit available to employees.

12. 28. Under clause 3 of the agreement, an employee's pre-tax salary for future pay periods is reduced by a specified amount, being the amount identified in the application form to be completed by each employee. The amount of the reduction may be adjusted if childcare fees are increased or the employee requires additional childcare services, but such adjustments would apply only for future pay periods. Clause 5 stipulates that the salary reduction does not, under any circumstances, create an entitlement or right to any monetary sum whatsoever.

13. 29. Under clause 4, Westpac/BT/Newco agrees to provide or procure the provision of childcare services to an employee, equivalent in value to the amount of the reduction in salary, on the terms and conditions set out in the schedules to the agreement. This right to receive childcare services is not transferable by the employee.

14. 30. Schedule 1 contains the formula (refer paragraph 10 of section 1) for calculating the amount of the salary reduction, which is calculated from the number of children that the employee wishes to place at the childcare centre, the Child Care Fees set by ABC for each child and the number of fortnightly periods that the particular childcare centre is treated as open each year. For the purposes of the formula, a childcare centre usually will be treated as open for 26.07 fortnightly periods per year, even though there will be times that the centre will be closed, such as during summer holiday periods. If a childcare centre were to be closed temporarily for an unexpected reason (for example, a fire at the centre), the salary reduction would continue to apply. If an unexpected closure were to continue for an indefinite period, it is likely that Westpac/BT/Newco and the employees would renegotiate the salary reduction pursuant to clause 7 of the agreement.

15. 31. Schedule 1 to the agreement does refer to certain contingencies or consequences of the salary reduction agreement, for example, the position of employees who wish to continue to keep a child or children at a centre during periods of unpaid leave. In such cases, the employee must pay the applicable childcare fees to Westpac/BT/Newco (out of after-tax income).

16. 32. Salary reductions cannot be back-dated and will only apply for future pay periods. As noted in paragraph 18 of schedule 1, an employee cannot elect to reduce a salary, after it has been earned. In particular, employees will not be able to receive the childcare services benefit while taking leave, the entitlement to which accrued before the date of the salary reduction agreement. Employees will be required to pay for the childcare services used while taking leave, the entitlement to which accrued before the date of the salary reduction agreement, by way of an adjustment provided for in the salary reduction agreement.

17. 33. Paragraph 16 in the schedule itemises some of the implications of a salary reduction, including the effect on benefits or insurances, ACC entitlements, liable parent payments and the ability to borrow.

18. 34. An employee shall not be able to reduce his or her salary to a level which would be in breach of any applicable minimum wage laws or other legislative requirements.

19. 35. The maximum percentage of salary that an employee is able to sacrifice is based on the policy of Westpac Australia. This policy sets a maximum salary sacrifice of the lower of 40% of gross salary and \$40,000.

20. 36. Employees can only enter into a salary sacrifice agreement in respect of children for whom the employee has legal responsibility (for example, natural or adopted children, or children of whom the employee is the legal guardian).

21. 37. This Ruling only applies to the Arrangement in so far as it relates to the provision of childcare services by Westpac to employees of Westpac, BT and Newco on Westpac's premises.

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:



- a) The maximum level of salary reduction for full time employees is the lower of 40% of gross salary and \$40,000.
- b) The Arrangement will be consistent in all material respects with the following draft or final documents provided to the Rulings Unit:
- the Management Agreement between Westpac Banking Corporation and A.B.C. Learning Centres Limited (ABC) (and the associated Schedules (1,2,4,5,6, and 7)), provided to the Rulings Unit on 11 November 2005;
 - the Licence for Use and Occupation of Premises between Westpac Banking Corporation and A.B.C. Corporate Care Pty Limited (which comprises Schedule 3 to the Management Agreement between Westpac Banking Corporation and A.B.C. as noted above), provided to the Rulings Unit on 11 November 2005; and
 - the amendment made in respect of this document which was provided to the Rulings Unit on 15 June 2006;
 - the Memorandum of Understanding between Westpac Banking Corporation and ABC Learning Centres Limited, provided to the Rulings Unit on 11 November 2005;
 - the amended Salary Reduction Agreement, provided to the Rulings Unit on 1 May 2006; and
 - the Childcare Services Agreement between Westpac Banking Corporation and BT Financial Group provided to the Rulings Unit on 15 March 2006.

How the Taxation Laws apply to the Arrangement

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

- The amount of the reduction in salary agreed to by employees of Westpac, Newco and BT pursuant to the salary reduction agreement, the childcare services supplied by Westpac, and the payments by Westpac to ABC under the management agreement, are not income of those employees under sections BD 3, CA 1(2), CE 1 and CE 5 and are not “salary or wages”, “extra pay” or a “withholding payment” (as defined in section OB 1) and are not “source deduction payments” (as defined in section OB 2)
- Section GC 17 does not apply to the Arrangement.
- Sections BG 1 and GB 1 do not apply to vary or negate the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 7 July 2006 and ending on 6 July 2009.



Inland Revenue
Te Tari Taake

This Ruling is signed by me on the 7th day of July 2006.

Howard Davis
Senior Tax Counsel