

PRODUCT RULING – BR Prd 07/01

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 the Bank of New Zealand.

Taxation Laws

This Ruling applies in respect of:

- (a) sections BG 1, CC 7, EW 15, EW 31, GB 1, NF 1, NF 2, NG 1 and NG 8 of the Income Tax Act 2004; and
- (b) sections 86F and 86I of the Stamp and Cheque Duties Act 1971; and
- (c) the section 2 definition of “disposition of property” in the Estate and Gift Duty Act 1968.

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

The Arrangement to which this Ruling applies

The Arrangement is a new product (“TotalMoney”) that Bank of New Zealand (“BNZ”) will offer to customers. TotalMoney involves the creation of new types of accounts which must be in a group of accounts, and the facility to elect to group any number of these new types of accounts into one or more groups for the purpose of either “pooling” or “offsetting” the account balances. “Pooling” involves the aggregation of account credit balances for the purpose of determining the interest rate that will apply to the calculation and crediting of interest to each account balance. “Offsetting” involves the aggregation of account balances for the purpose of calculating the amount of interest debited to a lending facility account balance.

Further details of the Arrangement are set out below.

1. Customers in general have a range of accounts with BNZ, including current accounts, savings accounts, and various loans. TotalMoney offers new types of accounts, and the ability effectively to treat a group of these accounts in a collective or aggregated manner. TotalMoney is based around the concept of a group of new accounts, which will comprise new transaction accounts that can also be used for savings purposes (“transaction accounts”) and which can include new lending facility account(s) (“loan accounts”).
2. Transaction accounts will provide full deposit and withdrawal facilities through all existing channels providing ready access to funds including via EFTPOS, direct debits, automatic payments, internet and phone banking

systems. An overdraft facility may be made available for a transaction account.

3. Loan accounts will be table and non-table home loans.
4. To participate in TotalMoney, these new transaction accounts and loan accounts must be opened by customers, or existing accounts must be converted into these accounts, and all the accounts must be in a group of accounts. The customer elects which accounts will be in which group, and for each group whether the accounts will be “pooled” or “offset”.
5. Under the terms and conditions applicable to TotalMoney, TotalMoney is not available for business accounts.

Primary features of TotalMoney

6. The special features that TotalMoney offers in relation to the accounts within the group are “pooling” and “offsetting”:

(a) *Pooling*

The pooling aspect of TotalMoney can operate in circumstances where there are several transaction accounts with credit balances. Interest on these credit balance accounts would be calculated and paid having regard to the cumulative balance of all transaction accounts in the group that are nominated for the pooling feature. Normally interest-bearing accounts attract interest in accordance with interest rate brackets that apply to the balance of its own account. The cumulative balance is calculated purely for the purpose of ascertaining the relevant interest rate tier applicable to the accounts. There is no actual transfer of the separate funds to one account before the interest is calculated. Interest is calculated by reference to the applicable interest rate tier that applies to the accumulated balance.

(b) *Offsetting*

With the offset feature of TotalMoney, interest on a loan account within the group would be calculated and paid by the customer on the difference between the loan account balance and the credit balances of transaction accounts in the group that are nominated for the offset feature. Under the terms and conditions agreed between BNZ and its customers for TotalMoney, no interest is paid by BNZ on the credit balances that are “offset” against the loan account. The “offsetting” is purely for the purpose of calculating the balance of the loan account on which interest is payable, or, where the credit balances nominated for the “offset” feature exceed the balance of the loan account, the balance of the credit balances on which interest is receivable. There is no actual transfer of funds, or set-off or “netting” of funds together in an account, or transfer of any interest in or entitlement to funds.

7. Every transaction account in TotalMoney group must be selected to either “pool” or “offset”. That is, customers can choose whether (some or all of) their transaction accounts with credit balances are “pooled” (in which case credit interest will be paid by BNZ to those accounts), or “offset” (against the loan account(s)). By default all accounts will be set to the “offset” feature unless changed to “pooled” (by the customer or BNZ on the customer’s instructions). A customer can select and change between an account participating in either the “offset” or “pooling” features at any time for any period.

Pooling – further detail

8. BNZ will have a contractual obligation to pay interest to each transaction account with a credit balance participating in the pooling feature, based on the applicable interest rate tier that applies based on the total cumulative balance of all accounts being “pooled”. BNZ will make a separate determination in relation to withholding tax on each interest payment made to each account, in accordance with its usual practice.
9. Account owners will have full deposit and withdrawal access to their transaction accounts. Overdraft facilities may be available in relation to these accounts. However, any overdraft balance is not taken into account for “pooling” purposes, in that debit interest is charged by BNZ in relation to the overdrawn balance of that account. The overdrawn balance does not reduce the “pooled” balance of the accounts with credit balances for the purposes of calculating interest in relation to those accounts.

Offsetting – further detail

10. Where one loan account is in the group, the interest payable on the loan account is calculated by reference to the balance of the loan account less the credit balances of accounts set to the “offset” feature. This will be the case as a matter of law (in terms of TotalMoney documentation) and as a matter of practice (in terms of BNZ’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.
11. For example, in the case of a loan account which would otherwise be the same as a standard variable rate table home loan facility over 20 years with a “minimum payment”, there will be no provision for the amount of interest saved under “offsetting” to reduce the “minimum payment”. In other words, 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” – in either case, the term of the loan is reduced because the principal portion of the payment is effectively increased. (In the case of a non-table loan, interest payments will be reduced by “offsetting”, principal repayments will not change and the loan term will not reduce).
12. Where there is more than one loan account in the group, the default position is that the loan accounts in the group are given a default priority, namely the

oldest loan account in the group will receive a higher priority. However, the customer may elect that two or any number of those loan accounts can be prioritised into an order for “offsetting” purposes. The loan account with the highest priority will receive the benefit of “offsetting” first, and it is only where the credit balances of transaction accounts set to offset exceed the balance of that highest priority loan account that the next highest priority loan account balance is offset, and so on.

13. If the total credit balances of the transaction accounts set to “offset” are greater than the total debit balance of loan accounts, credit interest will be applied to the difference and paid pro rata to the credit balance accounts in accordance with the balance of those accounts (essentially in line with the “pooling” feature of TotalMoney).
14. Interest is calculated by BNZ on a daily basis. If, during a month, there is both an entitlement of BNZ to receive interest (where the balance of participating loan accounts exceeds the balance of all transaction accounts set to the offset feature) and at another point in the month an obligation on BNZ to pay interest (if the balance of transaction accounts set to offset exceeds the balance of the relevant loan accounts), then the two interest payments (to and from BNZ) would actually be made, and would not be set-off.

Groups

15. TotalMoney is based on a group of participating accounts. A group of participating accounts can only be comprised of multiple accounts owned by customers in the following categories (or subset of these categories):

- (a) *Natural persons*

An individual, or the individual and joint accounts of married, de facto and civil union couples, and any of their dependent and independent children (including natural children, adopted children, step-children and wards). The accounts of a sole trader used for their business can not be included in this group, however it is noted that the account of an individual (who may be a sole trader) may sometimes be used for business purposes.

- (b) *A company*

Only the accounts owned by one company can be included in a group of accounts. For example, the accounts of a parent and a subsidiary company or of two associated companies can not be grouped. Any type of company can group their accounts.

- (c) *A trust*

Only the accounts owned by one trust can be included in a group of accounts. Any type of trust can group their accounts.

16. There will be no grouping and pooling or offsetting of accounts in different categories.

Residency status

17. Customers may be either resident or non-resident in New Zealand for tax purposes. However, where a group of accounts consists of accounts owned by more than one legal person, either all of those persons must be residents of New Zealand for tax purposes or all of those persons must be non-residents of New Zealand for tax purposes.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

- (a) The documentation of the transaction account terms and conditions (as comprised in the documents entitled “Terms and Conditions for your Bank of New Zealand TotalMoney Account” and “Terms and Conditions for your Bank of New Zealand TotalMoney Account for Companies & Trusts”) and of the loan account terms and conditions (as comprised in the documents entitled “Facility Master Agreement” and the “Letter of Advice – TotalMoney Home Loan”) will not be materially different to the draft documentation provided to the Commissioner on 23 February 2007 and 6 December 2006 respectively.
- (b) There is no arrangement between the customers who have grouped their accounts which provides for the loan account owner(s) to make a payment(s) to the transaction account owner(s) in consideration for the transaction account owner(s) electing the “offset” feature of TotalMoney. For the avoidance of any doubt, a failure to satisfy this condition by the customers who enter into this arrangement means that this ruling does not apply only in relation to that arrangement.

How the Taxation Laws apply to the Arrangement

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

Gift duty

- In relation to a group where the participating accounts are owned by different legal persons, where a credit balance account owned by one person is offset against the loan account balance of another person, with the effect that the interest liability of that other person is less, there is no “disposition of property” for the purposes of section 2 of the Estate and Gift Duty Act 1968 and gift duty cannot apply.

Financial arrangements rules

- When a credit balance of a transaction account and a debit balance of a loan account are “offset”, there is no amount of consideration paid or payable by virtue of that “offset” for the purposes of the calculation of income and expenditure under sections EW 15 and EW 31 of the “financial arrangements rules” (as defined in section EW 1(2)).

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

- Under the “pooling” feature of TotalMoney:
 - “resident withholding tax” (as defined in section NF 2) and “non-resident withholding tax” (as defined in section NG 2) must be deducted by BNZ from the interest credited to the participating transaction accounts in a group, in accordance with the RWT rules (as defined in section OB 1) and the NRWT rules (as defined in section OB 1);
 - in relation to an account that is a “registered security” (as defined in section 86F of the Stamp and Cheque Duties Act 1971 “SCDA”), “approved issuer levy” (as defined in section 86F of the SCDA) may be paid by an “approved issuer” (as defined in section 86F of the SCDA) in relation to the interest credited to that account pursuant to section 86I of the SCDA.
- Under the “offsetting” feature of TotalMoney:
 - There is no payment of or entitlement to “interest” (as defined in section OB 1) in relation to the credit balances of participating transaction accounts in a group, and no obligation to deduct RWT or NRWT or pay AIL, except to the extent that the combined credit balance of those accounts exceeds the combined debit balance of the lending facility accounts.
 - To the extent that interest is credited to participating transaction accounts in a group:
 - “resident withholding tax” (as defined in section NF 2) and “non-resident withholding tax” (as defined in section NG 2) must be deducted by BNZ from the interest credited to the participating transaction accounts in a group, in accordance with the RWT rules (as defined in section OB 1) and the NRWT rules (as defined in section OB 1);
 - in relation to an account that is a “registered security” (as defined in section 86F of the Stamp and Cheque Duties Act 1971 “SCDA”), “approved issuer levy” (as defined in section 86F of the SCDA) may be paid by an “approved issuer” (as defined in section 86F of the SCDA) in relation to the interest credited to that account pursuant to sections 86F and 86I of the SCDA.

Section CC 7

- No income arises under section CC 7 for BNZ or its customers in relation to the Arrangement.

Tax avoidance

- Section BG 1 does not apply to vary or negate any of the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 12 March 2007 and ending on 31 March 2010.

This Ruling is signed by me on the 12th day of March 2007.

Martin Smith
Chief Tax Counsel