

PRODUCT RULING - BR Prd 08/02

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 StockCo Limited ("StockCo").

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of sections BG 1, DA 1(1), DA 2, EA 3, EC 6 to EC 27, EC 32 to EC 37, and EJ 10, subpart EW, and sections FA 6 to FA 11, FA 12, and GC 1.

The Arrangement to which this Ruling applies

The Arrangement is the leasing of specified or high-priced livestock ("Stock") on the terms provided in the Deed of Stock Lease (the "Lease") entered into by StockCo, StockCo Holdings Limited ("StockCo Holdings") and StockCo Residual Limited ("StockCo Residual") (together the Group Companies") and farmers and people entering the farming industry (together the "customers") for these customers to use in a farming business. Further details of the Arrangement are set out in the paragraphs below.

- 1 This Arrangement involves sale and lease back transactions of Stock whereby StockCo purchases the Stock, usually dairy and beef cattle and sheep, from a farmer (or third party) and then leases that Stock back to the farmer. Once the Lease is executed, StockCo assigns the Lease income to StockCo Holdings, and sells the residual value of the Stock to StockCo Residual. At the end of the Lease ("the Lease Termination Date"), the farmer may ask to purchase the Stock for its residual value. StockCo Residual is under no obligation to accept that offer.
- 2 The Group Companies are in the business of Stock leasing and financing.

Summary

- 3 StockCo has identified a market for Stock leasing in the farming industry. As at 2 September 2008, StockCo has entered into more than 100 Stock leasing transactions with various farmers. It estimates that over the next 12 months it is likely to enter into at least another 100 transactions.
- 4 Leases result from either one or a combination of the following two transactions:
 - StockCo and the farmer enter into a sale and lease back transaction (for all or part of the farmer's Stock), whereby StockCo buys Stock from the farmer and then leases it back to the farmer.
 - StockCo purchases Stock from a third party, at the farmer's request, and then leases it to the farmer.
- 5 The purpose of the Arrangement is for the farmers to realise capital that was tied up in Stock, retire external debt, or fund the expansion of herds, land and/or the business as a result of proceeds from the sale of their Stock. This type of Arrangement can also assist new farmers in setting up a business, as capital set-up costs can be a barrier for new farmers wanting to enter the market. This type of Arrangement also gives farmers certainty of income and expenditure that is not guaranteed under the current Stock valuation methods.
- 6 Farmers are responsible for maintaining the Stock and in the event of any loss of Stock, must pay the remainder of the value of that animal in full to StockCo. Should farmers seek and gain permission to cull stock, they may do so throughout the life of the Lease. In doing so, the Lease requires that the farmers act as agents for StockCo and any proceeds from the cull are returned to StockCo.
- 7 After the termination of the Lease, farmers may offer to purchase the Stock. However, StockCo Residual is under no obligation to accept those offers (see clause 13 of the Lease reproduced in paragraph 19). If the farmers do not purchase the Stock after the Lease expires, StockCo Residual endeavours to sell the Stock for at least the residual value of the animal, within 30 days of the Lease expiry date. Any difference between the sale price and Residual Value is paid by StockCo Residual or the farmer so the net proceeds StockCo Residual receives are exactly the market value of the Stock at the Lease expiry date.
- 8 Clause 2 of the Lease sets out the purchase and ownership provisions in relation to the initial sale of the Stock to StockCo.

2. PURCHASE AND OWNERSHIP OF THE STOCK.

- (a) We will purchase the relevant Stock for the Purchase Price on the Commencement Date.
- (b) We will EITHER:
 - (i) Purchase the Stock from you for the Purchase Price and will create a buyer generated invoice and will pay the Purchase Price to you on the Commencement Date or on any other agreed settlement date;
OR

- (ii) Purchase the Stock from another person's and provide the same to you on the Commencement Date or any other agreed settlement date;
OR
 - (iii) Undertake a combination of purchase methods set out in subparagraphs 2(b)(i) and (ii) above.
- (c) You covenant that the Stock will upon acquisition pursuant to this Deed be our absolute property free from any security interest and other encumbrance. You will do all things necessary and further warrant that pursuant to the transfers under clause 2(b) clear title to all of the stock referred to in the Stock Schedule has been or will be transferred to us free of any security interest or other encumbrance.
 - (d) You covenant that the Stock Schedule is accurate, the Stock is located on the Land and the Stock is healthy and free from disease.
 - (e) Legal and beneficial ownership of the Stock, free of any security interest or other encumbrance will be deemed to be transferred to us on the Commencement Date, We own the Stock.

9 Clause 3 sets out the general lease of Stock provisions:

3. LEASE OF THE STOCK. On completion of the purchase contemplated in clause 2, we will lease the Stock to you for the Term in consideration of you paying the Lease Payments, and subject to the covenants, conditions, terms, reservations and restrictions contained in this Deed, and the following clauses will apply to the Lease.

10 Once the Lease is executed, the farmers must make lease payments based on their individual cash flow. This means that dairy farmers typically make payments from December through May and dry stock farmers typically make lease payments from February through May each year of the Lease.

11 Existing farmers would enter into this Arrangement to access capital, to retire debt or to purchase additional Stock or land, or to expand their business. Such leases also help new farmers set up a business, as leases require much less start up capital than is required to purchase stock. At the end of the transaction, farmers may offer to purchase the Stock they have leased. However, StockCo Residual is under no obligation to accept those offers (see clause 13 of the Lease reproduced in paragraph 19).

12 The length of each Lease may vary up to a maximum lease period of five years for cattle and four years for sheep. Supplementary leases may be entered into in respect of replacement and/or additional Stock.

Use, treatment and obligations of farmers in respect of the Stock

13 Clause 4 of the Lease provides for the protection of StockCo's interest in the Stock and the circumstances under which the farmers have enjoyment over the Stock without interruption or disturbance from StockCo.

4. PROTECTION AND QUIET ENJOYMENT

- (a) You must protect our ownership of the Stock and not attempt to sell, hire or otherwise dispose of, or deal with the Stock, in any way other than in accordance with this Deed. You will not use, or attempt to use, the Stock as security for any loans or other obligation, sell or part with possession of any Stock otherwise than in accordance with this Deed, or register, attempt to register or allow to be registered, any security

interest on the Personal Property Securities Register in respect of the Stock.

- (b) As long as you make all Lease Payments and duly and punctually observe and perform all your obligations under this Deed, you may peaceably possess and enjoy the Stock without interruption or disturbance from us on the terms contained in this Deed.

14 Clause 8 of the Lease contains provisions relating to the farmers expected use and maintenance of the leased Stock:

8. USE AND MAINTENANCE OF STOCK

- (a) You will farm the Stock according to the best principles of good animal husbandry and take all possible care for the safety, well-being and security of the Stock and maintain the Stock's number, quality and type.
- (b) All costs regarding the farming, health, levies, taxes and any other maintenance or compliance costs are payable by you.
- (c) We may, at any time, determine whether you are in compliance with clause 8(a) and may employ such consultants or persons as in our absolute discretion we think fit to assist in making that determination. You must reimburse us for any fees paid by us to any such persons upon receipt of a written demand, and will pay any fees due direct to any such persons upon request by us. Any determination by us that you are not in compliance with clause 8(a) will in the absence of manifest error be final and binding on you.

15 Clause 9 of the Lease sets out the actions the farmers must take if there is a loss of any leased Stock.

9. STOCK LOSSES.

- (a) If requested by us, following the death or loss of any Stock you will immediately notify us of such death or loss setting out the circumstances in which such death or loss took place and whether remedial steps have been taken to protect the remainder of the Stock. If requested by us, you will forthwith produce a report certified by a Veterinary Surgeon as to the fact and cause(s) of death.
- (b) When Stock dies or is lost, irrespective of the cause of death or loss, you are responsible for the value thereof and you will either:
 - (i) replace the Stock with similar stock, ensuring continuing compliance with clause 8; or
 - (ii) pay to us by way of liquidated damages an amount equal to the total agreed lease payments relating to the Stock, less any lease payments received to date and less any rebate which we may in our absolute discretion allow you.
- (c) You are responsible for the removal and disposal of any Stock which has died.

16 Clause 10 of the Lease sets out the farmer's rights and obligations in relation to annual culls, replacement and variations of leased Stock.

10. ANNUAL CULLS, REPLACEMENTS AND VARIATIONS. It is agreed that the Stock may be varied by progressive Culling and replacement of Stock, provided prior written consent is first obtained from us.

- (a) **Culls.** You may from time to time seek our approval to Cull and remove Stock. Following notification (and where approval is given) you are authorised and agree to act as our agent for the removal and disposal of any animals Culled for any reason from time to time.

- (b) You must notify us annually before the 30th day of June in every year, with full particulars of the number, age, breed and type of each unit of the Stock that you wish to Cull from the Flock.
- (c) Following notification (and where approval is given) we will calculate and send you an invoice outlining the residual amount owed by you for all Stock Culled calculated as the total agreed lease payments relating to the Stock, less any lease payments received to date and less any rebate which we may in our absolute discretion allow you.
- (d) You will pay the residual amount calculated by direct debit from your bank account on a date that is mutually agreed.
- (e) You are responsible for the removal and disposal of the animals Culled from the Stock. Upon the receipt of any proceeds received as consideration for the Stock Culled, you agree to hold the proceeds as constructive trustee for us.
- (f) You shall pay to us GST payable on all payments due under the Deed relating to the Stock which are culled.
- (g) **Replacements.** You may from time to time seek our approval to lease from us additional Stock (whether purchased from you or otherwise acquired).
- (h) Unless otherwise consented to by us, in Culling and replacing any Stock you must comply with the requirements as to maintenance of the Stock in clause 8.

17 Clause 14 of the Lease sets out the farmer's obligations in relation to identification and annual verification of the leased Stock.

14. IDENTIFICATION AND ANNUAL VERIFICATION.

- (a) You must at all times ensure that the Stock is separately identifiable from any other stock that may be depastured on the Land.
- (b) You must maintain complete and up to date records and details of all Stock.
- (c) We may request at any time, that you will send to us a written report that certifies the number of Stock and the breed, age, quality, pregnancy status and type. Following such request, you will supply the same within 7 days.
- (d) If, following such report, any Stock are missing then you will be deemed to have Culled the number of Stock so missing and the provisions of clause 10 will apply.

18 Clause 15 of the Lease sets out the parties' rights in relation to the progeny of leased Stock.

15. PROGENY.

- (a) You own the Progeny.
- (b) You will, upon our request grant us a first ranking security agreement over the Progeny.
- (c) You will not in any way encumber or create any security interest in the Progeny without obtaining prior written consent from us.

Termination

- 19 On the expiry of the Lease, the farmer may offer to purchase the Stock, but StockCo Residual is under no obligation to accept that offer. Clause 13 of the Lease sets out the termination provisions:
- 13. TERMINATION.** At the expiry or earlier termination of this Deed you must, at your cost, deliver to us the Stock forthwith, and in any event within 5 business days.
- (a) If you fail to deliver the Stock to us in the time period specified, we may collect and remove the Stock from any property where we believe the Stock may be located, and you hereby licence us to do so, and you will be liable to us for any cost, loss, expense or liability in so collecting and removing the Stock.
 - (b) Upon termination of this Deed, whether by way of early termination, or by expiry or otherwise we may sell the Stock to any person we choose, in our absolute discretion, using any reasonable method.
 - (c) We reserve the right to sell the Stock at then current market value, AND in the event that we exercise such right then we will endeavour to effect sale for a price no less than the Residual Value, and to do so within 30 days after termination. Upon sale of the Stock, if the Net Proceeds:
 - (i) are less than the Residual Value, you must pay us the difference between the Residual Value and the Net Proceeds;
 - (ii) are greater than the Residual Value, we must pay to you the difference between the Residual Value and the Net Proceeds.
 - (d) You may offer to purchase the Stock, but we are under no obligation to sell the Stock to you.
- 20 The termination provisions provide StockCo Residual will endeavour to sell the Stock within 30 days of the Lease Termination Date. The farmer may offer to purchase the Stock, but StockCo Residual is under no obligation to accept that offer.
- 21 Once the sale of Stock has taken place, if the net proceeds (the gross income from the sale less any expenditure) are less than Residual Value, the farmer pays the difference between the net proceeds and the Residual Value, to StockCo Residual. Alternatively if the net proceeds are greater than the Residual Value, StockCo Residual pays the farmer the difference between the net proceeds and 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 by section YA 1) of farming.
- b) The customer has entered into the Lease for the sole purpose of undertaking a farming business and intends to use the leased Stock in the production of assessable income.
- c) The Stock becomes the property of the customer only if the customer makes payment of the Residual Value after the Lease Termination Date, subject to approval by StockCo.

- d) The lease payments are genuine, arm's length amounts for the possession and use of the Stock.
- e) At the time the lease is entered into the Residual Value of the Stock is a reasonable, and the parties best, estimate of the likely market value of the Stock at the Lease Termination Date.
- f) The customer is not in the "business" (as defined in section YA 1) of selling or exchanging leases.
- g) At the time of entering into each Lease, the customer does not intend to dispose of the Lease.
- h) The customer is not carrying on or undertaking a scheme of trading leases entered into or devised for the purpose of making a profit.
- i) The Stock, when purchased by the customer after the Lease Termination Date, are not used in, or as part of, a Stock dealing "business" (as defined in section YA 1).
- j) The customers will enter into the Leases for one or a number of the following reasons which are, in each case, the main reasons for entering into the Arrangement:
 - The need to refinance livestock already owned for further investment in the farming business or to retire existing debt;
 - The need for certainty of cash flows through structuring the lease payments;
 - The need for certainty of income and expenditure; and/or
 - The need to reduce the initial level of cash required to enter the farming industry or to purchase new livestock.

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:

- The Stock lease payments are deductible under section DA 1(1) and none of the general limitations in section DA 2 apply to prevent deductibility, provided that:
 - (i) no provision in subparts DB to DZ applies to prevent a deduction in section DA 1(1); and
 - (ii) the income arising from the Arrangement is derived by the customer in New Zealand.
- The valuation provisions in sections EC 6 to EC 27 apply to the customer when the "specified Stock" (as defined in section YA 1) is purchased by payment of the Residual Value after the Lease Termination Date.

- The valuation provisions in sections EC 32 to EC 37 apply to the customer when the "high-priced Stock" (as defined in section YA 1) is purchased by payment of the Residual Value after the Lease Termination Date.
- The cost price of the "specified livestock" (as defined in section YA 1) for the purposes of sections EC 6 to EC 27, for customers purchasing that Stock at the end of the Lease, is the Residual Value stated in the Lease.
- The cost price of the "high-priced livestock" (as defined in section YA 1) for the purposes of sections EC 32 to EC 37, for customers purchasing that Stock at the end of the Lease, is the Residual Value stated in the Lease.
- At the end of an income year, unless excused from this requirement pursuant to a determination issued by the Commissioner, section EA 3 applies to require the unexpired portion of any lease payments paid in advance 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.
- The financial arrangements rules in subpart EW do not apply to the Arrangement.
- Section EJ 10 does not apply to the Arrangement as the Lease is not an operating lease.
- Sections FA 6 to FA 11 do not apply to the Arrangement as the Lease is not a finance lease.
- Section FA 12 does not apply to the Arrangement as the Lease is not a hire purchase agreement.
- Section GC 1 does not apply to any sale of the livestock to the customer at the Lease Termination Date.
- Section BG 1 will not apply to negate or vary any of the above conclusions.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 April 2008 and ending on 31 March 2011.

This Ruling is signed by me on the 20th day of November 2008.

Howard Davis
Director (Taxpayer Rulings)