

## **PRODUCT RULING – BR Prd 10/03**

This is a Product Ruling made under section 91F of the Tax Administration Act 1994.

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

Bank of New Zealand (BNZ) has applied for this Ruling.

### **Taxation Laws**

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

This Ruling applies in respect of:

- (a) sections BG 1, CC 7, EW 15, EW 31, GA 1, RE 1 to RE 6, RE 10, RF 2, RF 3 and RF 4;
- (b) sections 86F and 86I of the Stamp and Cheque Duties Act 1971 (SCDA); and
- (c) the definition of “disposition of property” in section 2 of the Estate and Gift Duties Act 1968 (EGDA).

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

The Arrangement is a product (TotalMoney) that BNZ offers to its customers. These customers may be only individuals, companies, or trusts.

TotalMoney involves the creation of new types of accounts that 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.

The Arrangement is set out in the documents listed below, copies of which were received by the Taxpayer Rulings Unit, Inland Revenue, on 12 February 2010:

- Terms and Conditions for your Bank of New Zealand TotalMoney Account for Personal Customers;
- Terms and Conditions for your Bank of New Zealand TotalMoney Account for Companies and Trusts;
- Bank of New Zealand Facility Master Agreement; and
- Letter of Advice – TotalMoney Home Loan.

Additional changes will be made to the documents listed in the first two bullet points above to enable business customers to use TotalMoney in the manner described below. For example, the reference to TotalMoney not being available for business purposes in clause 5 of each of these documents will be removed.

Further details of the Arrangement are set out in paragraphs 1 to 28 below.

1. TotalMoney is a package of accounts and loans that BNZ offers to its customers. These customers may be only individuals, companies, or trusts.
2. Customers in general have a range of accounts with BNZ, including transaction accounts, savings accounts, and various loan accounts. Loan accounts may be only table, non-table, tailored, principal and interest, interest only, fixed or floating home loan accounts, or business loan accounts.
3. Interest under a TotalMoney loan account cannot be capitalised, for example, by virtue of a "mortgage holiday". TotalMoney allows customers to group or aggregate these accounts for the purposes of either "pooling" or "offsetting" the account balances.

#### ***Primary features of TotalMoney***

4. The primary features of TotalMoney are the "pooling" and "offsetting" features. These features operate in the manner described below.

#### *Pooling*

- (a) The pooling aspect of TotalMoney can operate when there are several transaction accounts with credit balances. Interest on these credit balance accounts is calculated and paid having regard to the cumulative credit balance of all transaction accounts in the group that are nominated for the pooling feature. Interest-bearing accounts usually attract interest in accordance with interest rate brackets that apply to the balance of each relevant individual account.
- (b) The cumulative credit balance is calculated purely for BNZ to ascertain the relevant interest rate tier applicable to the relevant accounts. The separate funds are not actually transferred to one account before the interest is calculated. BNZ calculates interest by reference to the applicable interest rate tier that applies to the accumulated balance.

#### *Offsetting*

- (a) With the offset feature of TotalMoney, interest on a lending facility or facilities within the group is calculated and paid by the customer on the difference between the lending facility balances 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, BNZ pays no interest on the credit balances that are "offset" against the lending facility.

- (b) The “offsetting” is only for the purpose of calculating the balance of the lending facility or facilities on which interest is payable, or, where the credit balances nominated for the “offset” feature exceed the balance of the lending facility, the balance of the credit balances on which interest is receivable. There is no actual transfer of funds, no set-off or “netting” of funds together in an account, and no transfer of any interest in or entitlement to funds.
5. Every transaction account in a 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 BNZ will pay interest to those accounts) or “offset” against the product lending facility. 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) except where the customer has no loan account (in which case the customer’s TotalMoney accounts will automatically “pool”).
6. TotalMoney does not provide a facility for existing accounts. TotalMoney involves the creation of a new type of account. To participate in TotalMoney, a customer must open specific TotalMoney accounts that are particular to the TotalMoney product. Customers may convert an existing non-TotalMoney transaction or savings account that they have with BNZ to a new TotalMoney account. However, the customer must agree that the existing terms and conditions that apply to those accounts cease to apply, and are replaced by the TotalMoney Terms and Conditions.
7. In relation to the new TotalMoney accounts, the customer can select and change between that account participating in either the “offset” or the “pooling” features at any time and for any period.

*Pooling – further detail*

8. BNZ has 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”. In accordance with its usual business practice, BNZ makes a separate determination in relation to withholding tax on each interest payment made to each account.
9. The benefit of the “pooling” feature for customers is that they can earn more interest by combining smaller balances and reaching higher interest-rate tiers and still maintain their money in separate accounts for separate purposes. The customer may consider this an advantageous way to manage their money.
10. Account owners 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 ignored for “pooling” purposes. BNZ charges debit interest on the overdrawn balance of any account. The overdrawn balance does not reduce the “pooled” balance of the accounts with credit balances when BNZ is calculating interest in relation to those accounts.

*Offsetting – further detail*

11. 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.
12. For example, in the case of a loan account that 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". 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.
13. 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 the highest priority. However, the customer may elect two or more of those loan accounts to be prioritised 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.
14. If the total credit balances of the transaction accounts set to "offset" are greater than the total debit balance of the loan accounts, credit interest will be applied to the difference and paid on a prorated basis to the credit balance accounts in accordance with the balance of those accounts (essentially in line with the "pooling" feature of TotalMoney).
15. BNZ calculates interest daily. If, during a month, BNZ has both an entitlement to receive interest (that is, 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, BNZ has an obligation to pay interest (that is, the balance of transaction accounts set to offset exceeds the balance of the relevant loan accounts), then the two interest payments are made and are not set-off.
16. The "offsetting" feature of TotalMoney essentially offers the same benefits to customers as offered by a revolving credit loan (such as BNZ's "Rapid Repay" product) in terms of lower interest costs and a shorter time to repay the loan. However, this feature overcomes a primary perceived disadvantage of a revolving credit loan, because it allows customers to retain separate account balances (which customers may prefer when managing their finances).
17. Where a customer has a TotalMoney loan account, this account must be grouped with at least one other TotalMoney transaction account.
18. 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.

***Terms and Conditions for the TotalMoney loan products***

19. Each of BNZ's home loans is explained in a collection of documents. These documents include primarily a Facility Master Agreement (which is a standard form master document that contains generic provisions that apply to all BNZ home loan facilities), and a Letter of Advice (which contains particular and specific provisions in relation to the home loan facility being made available to the customer). The Letter of Advice is produced from a computer system that contains a master list of possible provisions that can apply to BNZ's home loans. Under this system, the provisions applicable to a particular home loan are selected, collated, and produced in a document.
20. The TotalMoney product home loans are also documented in a Facility Master Agreement and Letter of Advice. Customers may also enter into another Letter of Advice if they want to be able to redraw amounts that they have repaid under a fixed home loan at a later stage. The Facility Master Agreement is the standard document that applies to all BNZ home loans. The Letter of Advice contains only small differences compared with the Letter of Advice for other loans, primarily relating to branding (that is, the name BNZ has given to this particular form of home loan) and the interest calculation in relation to the variable rate components of the home loan (to account for the "offset" feature of TotalMoney).
21. Table loans provide for regular payments and a set date when they will be paid off. Most payments early in the loan term comprise interest, while most of the payments later in the term comprise repayments of the principal. Non-table loans have two separate repayments, one of interest and one of principal. Customers repay the same amount of principal each time and interest is charged separately.
22. The documentation for a TotalMoney standard variable rate table home loan facility over 20 years will largely be the same as that for current BNZ home loan facilities that are standard variable rate table home loans over 20 years. The only differences are; branding (the name on the Letter of Advice), the interest calculation (which provides for the effect of the "offset"), and, in relation to table loans, the provision stating that where the loan has the benefit of the "offset" to reduce the interest cost, the "minimum payment" specified for the loan will not decrease because of any interest savings but instead the loan term will reduce. In relation to this latter point, under a non-table loan, any interest saving (whether arising as a result of a reduction in the applicable interest rate for the loan because of a general decrease in interest rates, or because of the offset feature), would result in either a reduction of the interest repayment of the loan or a reduction in the loan term (if the original repayment amount is maintained despite the interest saving). In relation to a TotalMoney product home loan that is a table home loan, a reduction is allowed only in the loan term.

***Groups***

23. TotalMoney is based on a group of participating accounts. Groups can be comprised of one of the following categories only:

- (a) *Natural persons:*
    - (i) The accounts of an individual, or the individual and joint accounts of married, de facto, and civil union couples, and any of their children may be combined as part of one group.
    - (ii) For example, the various accounts of one natural person, Jane, or, the various accounts (individual or joint) of Jane and her husband John and their child Joe. The group is not limited to residents of New Zealand.
  - (b) *One company or one trust:*
    - (i) Multiple accounts of one company (including a qualifying company or loss attributing qualifying company) or one trust may be combined as part of a group. Only one entity can be in a group at any time.
    - (ii) Accounts of different entities (including the entity and any related individual) cannot be pooled or offset. Business rules will be implemented to specify those companies and trusts entitled to use TotalMoney.
24. A customer may be a resident or non-resident of New Zealand for tax purposes. However, where a group of accounts consists of accounts owned by more than one legal person, BNZ will obtain representations from the owners of those accounts that the owners do not have multiple residency status. That is, where more than one legal person is participating in a group of accounts, either all persons must be residents of New Zealand for tax purposes or all persons must be non-residents of New Zealand for tax purposes.

***Business purposes***

25. When TotalMoney was established, customers were contractually prohibited from using TotalMoney for business purposes. BNZ is removing the prohibition on the business use of TotalMoney. BNZ intends to extend the availability of TotalMoney to business customers to give them the same tools for managing their financial affairs as it gives to personal customers.
26. In the period following the introduction of TotalMoney, BNZ's staff noted that operating multiple accounts enables a business customer to set aside funds for specific purposes (for example, GST, provisional tax, payroll and other costs), while obtaining the benefits of pooling and offsetting. The greater visibility that customers have of their funds when they are not held in one overall transactional account is expected to bring cash management benefits to some customers. Essentially, the benefits that TotalMoney brings to retail customers are equally valid for business customers. BNZ considers that making TotalMoney available to those customers will provide BNZ with a competitive advantage in an important market segment.
27. Under the terms and conditions applicable to TotalMoney, customers will be able to use TotalMoney accounts for business purposes, which means that, in future, customers will be able to group business and non-business

product accounts. This will mean that a sole trader, for example, will be able to group their business and non-business accounts.

### ***BNZ's objectives***

28. BNZ's objectives in providing TotalMoney are to:
- (a) increase its market share, particularly in relation to home loans and transaction-type accounts;
  - (b) increase the proportion of its home loans that are charged variable interest rates;
  - (c) increase customer satisfaction and customer retention; and
  - (d) improve its brand awareness and be seen as a market leader.

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

This Ruling is made subject to the following condition:

- (a) All interest rates related to the TotalMoney product are arm's length market interest rates.

### **How the Taxation Laws apply to the Arrangement**

Subject in all respects to the 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 EGDA 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:
  - "RWT" (as defined in section YA 1) and "NRWT" (as defined in section YA 1) 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 sections RE 1(1) and YA 1) and the NRWT rules (as defined in sections RF 1(1) and YA 1);

- in relation to an account that is a “registered security” (as defined in section 86F of the 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 YA 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:
    - “RWT” (as defined in section YA 1) and “NRWT” (as defined in section YA 1) 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 sections RE 1(1) and YA 1) and the NRWT rules (as defined in sections RF 1(1) and YA 1);
    - in relation to an account that is a “registered security” (as defined in section 86F of the 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 the Arrangement.

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

This Ruling will apply for the period beginning on 1 April 2010 and ending on 31 March 2014.

This Ruling is signed by me on the 30<sup>th</sup> day of June 2010.

**Howard Davis**  
Director (Taxpayer Rulings)