

PRODUCT RULING – BR PRD 11/04

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

Name of the Person who applied for the Ruling (“the Applicant”)

This Ruling has been applied for by Kiwibank Limited (“Kiwibank”).

Taxation laws

This Ruling applies in respect of:

- (a) ss BG 1, CC 7, EW 15, EW 31, GA 1, RE 1 to RE 10, RF 2, RF 3 and RF 4 of the Income Tax Act 2007;
- (b) ss 86F and 86I of the Stamp and Cheque Duties Act 1971;
- (c) the s 2 definition of “disposition of property” in the Estate and Gift Duty Act 1968.

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

The Arrangement to which this Ruling applies

The Arrangement is a product that Kiwibank intends to offer to its customers. The product is to be marketed as the Kiwibank Offset Mortgage. For the purposes of this application, the Kiwibank Offset Mortgage is referred to as “**the product**” or “**the Arrangement**”.

The product allows a customer to elect that interest payable by the customer on a loan made by Kiwibank should be calculated by offsetting the balance of the loan against the aggregate credit balances of certain nominated transaction and savings and investments bank accounts (hereafter referred to as “**credit accounts**”) held by either that customer or, certain other eligible persons. Interest is payable on the net notional balance of these combined accounts.

This Ruling does not consider the tax consequences of any arrangement under which a credit account holder agrees to offset his or her credit account balance against another person's home loan account balance in return for valuable consideration. Further details of the Arrangement are set out below.

Background

1. The product is a new feature that Kiwibank is seeking to offer to new and existing customers. The product is intended to enhance Kiwibank's competitiveness and to give Kiwibank customers a new way to manage their money. The product can affect the way in which interest is calculated on home loans offered by Kiwibank that have an agreed fixed periodic repayment arrangement (also referred to as the "table portion" of a home loan).
2. Kiwibank also offers home loans with a revolving credit feature whereby amounts can be repaid or re-borrowed at any time provided the principal, interest, fees and costs on the home loans do not exceed the specified maximum credit limit (also referred to as the "revolving portion" of a home loan). The product does not apply to "revolving portion" home loans.
3. In overall commercial terms, the economic consequences for a customer of using the product, or using a revolving portion home loan product bearing a variable interest rate, are broadly the same.
4. Currently, customers of Kiwibank may elect for their table portion home loan to have one or more of three components: fixed, variable, and construction components.
5. The "fixed component" of the home loan is subject to a fixed interest rate for a fixed term. Customers may repay all or part of a fixed component at any time, although in certain circumstances they may be charged with a fixed rate break cost for making any repayment that exceeds an early repayment limit agreed with Kiwibank.
6. The "variable component" of the home loan is subject to a variable interest rate. Customers may repay all or part of a variable component of a home loan at any time without any break costs.
7. The "construction component" of the home loan is available where the home loan is obtained for the purpose of buying land and building a house on it or renovating a house on land the borrower already owns. The construction component of the home loan is subject to a variable interest rate and can be borrowed in stages (as opposed to a fixed or variable component which must be borrowed in a lump sum).
8. Kiwibank recognises that customers may have a range of accounts, including various deposit and loan accounts. Therefore, Kiwibank is introducing with the product a new component called an "offset variable component",
9. When a customer elects that all or part of a home loan is to have an offset variable component, interest accruing on that home loan, or that portion of the home loan, is to be calculated by reference to a notional balance. The notional balance is calculated by offsetting the debit balance of the offset variable component of the home loan against the total credit balances of nominated everyday banking and savings and investments accounts (referred to as the "credit accounts"). This lowers the interest payable and the variable component of the home loan. Therefore, it results in a greater proportion of a customer's regular loan repayments being applied in reduction of the principal of the offset variable component of the home loan.
10. This new feature effectively treats a group of accounts in a collective or aggregated manner for the purposes of calculating interest accrued on the

offset variable component of the home loan. This new feature is intended to make the Kiwibank overall banking relationship more attractive to current and potential customers.

11. Outlined in this section are the primary features of the product:

- interest calculations
- eligibility requirements
- other features
- terms and conditions
- groups of account

Interest calculations

Calculations of interest on an offset variable component of a home loan

12. Interest payable on an offset variable component of the nominated home loan is calculated by reference to a notional balance. This notional balance is determined, for the purposes of that calculation only, by reducing the balance of the offset variable component of the home loan by the aggregate of the credit balances of the nominated credit accounts.
13. The rate of interest applicable to the product is the “offset variable interest rate” that is specified from time to time to be applicable to the product. The offset variable interest rate is one of several different rates that Kiwibank uses under its Home Loan Terms and Conditions. The offset variable interest rate may be above or below Kiwibank’s variable interest rate. Initially, the offset variable interest rate will be set below the variable interest rate to attract new customers.
14. Interest is *not* calculated separately in respect of each account and then offset. Instead, a net notional balance is calculated across all the relevant accounts. The notional balance equals the offset variable component of the home loan less (ie, “offset” against) the credit balances of up to eight nominated credit accounts. Interest is then payable on that net balance at the offset variable interest rate. This is the case as a matter of law (in terms of the terms of contractual relationship under the Home Loan Agreement and the terms and conditions applicable to home loans offered by Kiwibank) and as a matter of practice (in terms of Kiwibank’s computer and accounting systems).
15. The offsetting is solely for the purpose of calculating the notional balance on which interest is calculated. 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. Importantly, the customer has no legal entitlement to interest on credit balances. This is the case, even if the customer’s total credit balances exceed the customer’s home loan balance.
16. Interest is calculated on a daily basis and is debited to the home loan account on a regular basis. Loan repayments are credited periodically into the home loan accounts, which will pay the periodic interest and reduce the principal outstanding. Such payments are made from a Kiwibank account that the customer has selected. This account may be an account that the customer has nominated to participate in the product.

17. The offsetting aspect of the product essentially offers the same economic benefits to customers as a revolving portion home loan in terms of reduced interest costs (through a reduced balance on which interest is calculated) and consequently accelerated loan repayment. With a revolving portion home loan, funds that would otherwise be in a savings or cheque account are paid into the loan account (but are available to be redrawn).

No interest is payable on credit accounts

18. No interest is payable by Kiwibank on the credit balances of the credit accounts that customers have nominated to participate in the product. This is regardless of whether those credit balances exceed the debit balance of the home loan facility. This means that if the debit balance of a home loan facility is less than the aggregate of the credit balances of the nominated credit accounts, no interest is paid or payable by Kiwibank.

Eligibility requirements

19. The product is only available to:
- an individual who holds a home loan with Kiwibank
 - two individuals who are married, in a civil union, or in a de facto relationship and who hold a home loan with Kiwibank.
20. Additional people who may elect to offset their Kiwibank credit account against the home loan of a customer are:
- child or children of the customer (or one of the customers)
 - parent or parents of the customer (or one of the customers).
21. Children and parents of customers may have a registered address with Kiwibank that is different from that of the customers.
22. An offset variable component of a home loan may be offset by up to eight credit accounts of the customers or other eligible people.

Other features of an offset variable component

23. The offset variable component is not an independent product; it is a component of a home loan. The following features (amongst others) apply to the offset variable component along with the other components of a table portion home loan:
- Interest is calculated on a daily basis, and is debited to the home loan account on each specific payment date.
 - Customers may repay all or part of an offset variable component of a home loan at any time without any break costs.
 - The interest and principal of an offset variable component are repayable by way of regular payment cycles over the term of the offset variable component, except in relation to any applicable interest - only period. Only interest payments are required to be made during an interest only period.

- All amounts owing under the table portion (including any offset variable component and other components) must be repaid in full on the last day of the home loan term.
- The offset variable interest rate can vary at any time. Kiwibank will give the customer notice before changing the rate:
 - If the offset variable interest rate increases, the customer's regular payments for the offset variable component will automatically increase if this is necessary to enable the customer to pay off the offset variable component over the agreed term.
 - If the offset variable interest rate decreases, the customer's regular payments for the offset variable component will remain the same, so the term of the home loan will shorten. However, the customer can elect to reduce the amount of the regular payment so that the offset variable component can be repaid over the same term.
- The product will be offered to customers having an existing variable rate table portion home loan facility. If an existing customer elects to convert a part or all of an existing variable rate table portion home loan to have an offset variable component, the customer must agree that Kiwibank's applicable terms and conditions for the product will apply. All new customers will sign new terms and conditions applicable to all Kiwibank accounts, which will, by definition, include the terms and conditions applicable to the product.
- A customer may have more than one loan account to which the terms and conditions of the product apply, but each such loan account is treated separately.
- A transaction or deposit account (eg, everyday banking and savings and investments accounts) may be nominated to link to a single home loan account only under the product terms and conditions.
- A monthly fee will be charged to the customer of the home loan account. The fee is charged against one of the customer's Kiwibank accounts other than the home loan account.

Terms and conditions for the product

24. Each Kiwibank home loan is documented under a collection of documents:
- The Home Loan Terms and Conditions, which are contained in a booklet that Kiwibank issues (as amended and updated from time to time) and which set out the generic provisions applicable to all Kiwibank home loan facilities.
 - The Home Loan Agreement, which contains specific provisions about the home loan facility that is being made available to a specific customer, including the amount and timing of regular payments calculated on a basis that will repay the loan over the applicable term.
 - The General Terms and Conditions, which contains the terms that govern the general banking relationship between Kiwibank and its customers. The General Terms and Conditions may also contain specific terms and

conditions that apply to particular accounts and services. If any part of the General Terms and Conditions and the Home Loan Terms and Conditions conflict, then the Home Loan Terms and Conditions will prevail.

Groups of accounts

25. The product is based on a group of participating accounts. The following rules explain the accounts that may be included in the group.
26. The accounts of an individual, or the individual and joint accounts of married, de-facto, and civil union couples, any of their children, and any of their parents may be combined as part of one group.
27. To illustrate, Sarah and Peter have a home loan facility with Kiwibank. Sarah, Peter, and their child Michael each have a savings account with Kiwibank. Sarah and Peter's home loan facility could be offset by any or all of the credit balances of the various accounts held by Sarah, Peter and Michael.
28. Borrowers of the home loan facility and owner of other transaction accounts nominated for the offset feature must be either:
 - all residents of New Zealand for tax purposes; or
 - all non-residents of New Zealand for tax purposes.
29. Companies, trusts and sole traders are ineligible to participate in this product.

Conditions stipulated by the Commissioner

The amount of interest payable under the product is determined by Kiwibank in accordance with arm's length market interest rates.

How the Taxation Laws apply to the Applicant and the Arrangement

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

Financial arrangements rules

For the purposes of applying ss EW 15 and EW 31 in calculating income and expenditure arising under the operation of the "financial arrangements rules" (as defined in s EW 1(2)), no amount of consideration is paid or is payable by virtue of a debit balance of a home loan account being offset by a credit balance of a credit account under the Arrangement.

Section CC 7

No income arises under s CC 7 for Kiwibank or its customers in relation to the Arrangement.

Resident withholding tax, non- resident withholding tax, and approved issuer levy

For the purposes of the resident withholding tax rules (as defined in s RE 1(1)) and the non-resident withholding tax rules (as defined in s RF 1(1)), there is no payment of, or entitlement to, interest in relation to the credit accounts participating under the Arrangement that would give rise to an obligation to deduct resident withholding tax or non-resident withholding tax or to pay approved issuer levy.

Tax avoidance

Section BG 1 does not apply to the Arrangement.

Gift duty

Where the balance of a credit account owned by one person is offset against the balance of the offset variable component of a home loan account of another person, there is no "disposition of property" (as defined under s 2(2) of the Estate and Gift Duty Act 1968). Therefore, gift duty does not apply.

The period or income year for which this Rulings applies

The Ruling will apply for the period beginning on 27 May 2011 and ending on 31 May 2016.

This Ruling is signed by me on the 26th day of August 2011.

Fiona Heiford
Manager, Taxpayer Rulings