

PRODUCT RULING - BR Prd 13/02

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

Name of the Person who applied for the Ruling

This Ruling has been applied for by the:

- University of Canterbury (University); and
- University of Canterbury Foundation (Foundation)

Taxation Laws

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

This Ruling applies in respect of:

- ss BG 1, CA 1(2), CC 3, CC 4, DB 41, EW 15, EW 31, GA 1 and LD 1, and the definition of "interest" in s YA 1;
- s 73 and the definition of "gift" in s 2 of the Estate and Gift Duties Act 1968.

The Arrangement to which this Ruling applies

The Arrangement is the raising of funds by the University for its capital works programme for the advancement of education and excellence at the University. The University has issued philanthropic bonds to the public, with university alumni being a focus of the offer.

The parties to the Arrangement are:

- the University, a tertiary education institution and registered charitable institution, as issuer;
- the Foundation, a registered charitable trust, as promoter;
- the Philanthropic Bond Trust (the Trust), a special purpose sub-trust fund the Foundation established to hold gifts of bond principal for special charitable purposes, being the capital works programme;
- bondholders.

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

Background

1. The University offered up to \$50 million fixed rate unsubordinated unsecured bonds (the Bonds) (with the provision for a further \$50 million for oversubscriptions). The Bonds are fully subscribed. Bonds are listed on the New Zealand Debt Market.
2. The Bonds are conventional bonds, in that the University will pay interest at a fixed rate and will be required to repay the principal after a fixed term. However,

the Bonds also have novel features designed to encourage bondholders to make philanthropic gifts to the University. In particular:

- Bondholders are invited to agree to receive bond interest at a rate of 0% per year for one or more interest periods (a Bond Interest Adjustment).
- Bondholders are invited to request repayment of the Bond principal amount at any time during the term of a Bond for the sole purpose of making a cash donation to the Foundation (a Bond Principal Donation).
- Bondholders are invited to agree to bequeath their Bonds to the Foundation in their will.

3. The material terms of the Arrangement are governed by the:

- University of Canterbury Foundation Trust Deed dated 17 September 2001;
- Registered Prospectus dated 5 October 2009;
- Investment Statement dated 5 October 2009;
- Trust Deed for the Issue of Bonds dated 5 October 2009 (Trust Deed);
- Amended Trust Deed for the Issue of Bonds dated 29 November 2012 (Amended Trust Deed);
- Memorandum of Understanding In Relation to Issue of Philanthropic Bonds and Supplemental Deed to Foundation Trust Deed dated 5 October 2009 (Memorandum of Understanding);
- First Amended Memorandum of Understanding In Relation to Issue of Philanthropic Bonds and Supplemental Deed to Foundation Trust Deed dated 18 October 2012 (Amended Memorandum of Understanding).

University of Canterbury

4. The University is a tertiary education institution established under the Education Act 1989 and University of Canterbury Act 1961. The University is also a charity, because its purposes relate to the advancement of education for the benefit of the general public. The University is registered as a charity with the Charities Commission in accordance with the Charities Act 2005.

5. The University's purposes are set out in the Education Act 1989. In particular:

- the powers of the University's council can be exercised only to advance its charitable purposes (s 181 of the Education Act 1989 - Duties of Councils);
- if the University is disestablished, its assets vest in the Minister of Education (s 217 of the Education Act 1989 - Effect of Disestablishment).

University of Canterbury Foundation and Philanthropic Bond Trust

6. The Foundation is a charitable trust established in 2001 to raise capital for the advancement of education at the University. The Foundation is registered as a board under the Charitable Trusts Act 1957 and registered as a charitable entity

under the Charities Act 2005. The Foundation creates opportunities for supporters of the University and, in particular, alumni, to make gifts for the benefit of advancing education and excellence at the University. The Foundation also enables those gifted funds to be kept separate from the University's general operating budget. The Foundation's mission statement is:

To support the University in its quest for excellence and international reputation in education and research by creating mutual benefit partnerships and opportunities for giving

7. The Memorandum of Understanding between the University and the Foundation established the Trust fund for the benefit of the University. The Trust is a special purpose sub-trust of the Foundation. This sub-trust has its own trustees and is a separate trust fund, but the Registered Prospectus makes it clear that the Trust is and remains part of the Foundation.
8. The Trust will hold donated bond principal amounts and the asset and cash proceeds arising from repayment of the bond principal by the University. The establishment of the Trust ensures the benefits resulting from Bond Principal Donations can be separately identified (from the other funds of the Foundation) and used for certain special purposes stated in the Memorandum of Understanding. Those special purposes, as the trustees decide, are the advancing and promoting of the capital works programme, namely for the construction, acquisition and provision of buildings, plant, equipment, libraries, texts, learning and research tools and capital facilities for the University. These special purposes are charitable because they are for the advancement of education.
9. Clause 6.4 of the Memorandum of Understanding prohibits the trustees of the Trust from paying any part of the Bond Principal Donations to the University for unrestricted application to the general purposes of the University. Accordingly, the Trust funds are to be applied exclusively for charitable purposes. If, for some reason, the Trust funds cannot be applied to the special purposes, they must still be used in accordance with the objects of the Foundation.
10. The Foundation's objects are exclusively charitable, and limited to New Zealand (cls 4 and 5 of the Trust Deed of the University of Canterbury Foundation). Clauses 10 and 11 of the Foundation's trust deed also prohibit any individual from benefiting or profiting from the trust or trust fund and require that trust funds be applied only to charitable purposes if the Foundation is wound up or dissolved. Further, the Foundation's rules cannot be amended if it would cause the board to be declared non-charitable (cl 10 of Schedule 2 of the Foundation's trust deed).

Bonds

11. The University is the issuer of the Bonds. The Bonds are 10-year fixed rate, unsubordinated, unsecured bonds. The offer period for subscribing for the bonds was from 9 October 2009 to 30 November 2009. Over this period, bondholders subscribed for 50,010,000 Bonds at an issue price of \$1 per bond. A total of \$50,010,000 was raised.
12. The Bonds were issued on 7 December 2009 pursuant to the Trust Deed, and currently pay a coupon of 7.25% per year fixed for five years. The coupon payable on the Bonds is reset after five years at 1.75% above the then-prevailing five-year swap rate. Interest is paid six monthly in arrears on each interest payment date (being 15 June and 15 December of each year). The first interest payment date is 15 June 2010. The Bonds mature on 15 December 2019.

13. The Bonds have been amended in accordance with the Amended Trust Deed and the Amended Memorandum of Understanding.

Bond Interest Adjustment

14. Under the terms of the Bond, a bondholder may give notice to the Bond registrar that they agree to a Bond Interest Adjustment. As a result of the bondholder giving notice, the interest rate payable by the University to the bondholder is agreed to be 0% per annum, effective from the first day of the interest period (provided notice of the agreement is received on or before the record date for the interest period).
15. The Bond Interest Adjustment continues until the bondholder withdraws agreement or the Bond is transferred. Bond Interest Adjustments must be made in minimum parcels of 1,000 Bonds and in multiples of 1,000. By making a Bond Interest Adjustment, a bondholder is effectively donating the foregone interest to the University.

Bond Principal Donation

16. Under the terms of the Bond, a bondholder may give notice to the registrar that they wish to make a Bond Principal Donation.
17. To enable bond principal only to be gifted, the Bonds allow for early repayment of the bond principal for the sole purpose of making a cash donation to the Foundation. Despite the repayment and gifting of the principal, the bondholder maintains their right to interest. The Trust Deed provides that on the bond donation date the:
 - University will repay the bond principal (or may pay the bond principal directly to the Foundation on behalf of the bondholder);
 - bond registrar will record in the register that the bond principal amount has been repaid and that the bondholder continues to be entitled to receive interest on the Bonds up until, but excluding, the maturity date; and
 - terms and conditions of the Bonds otherwise remain unchanged.
18. The bondholder may specify a bond donation date, being any date between the date that is 15 business days after the registrar's receipt of the bond donation notice and the bond's maturity date. However, if during any rolling 12-month period the University receives bond donation requests totaling more than \$2 million (or such other amount as is notified by the University from time to time), the University may at its discretion defer any excess requests for a period of 12 months and 10 working days, and that deferred date will become the bond donation date.
19. Gifting of the principal when there is continuing liability for the University to pay interest, will be available exclusively for gifts to the Foundation. Bond Principal Donations must be made in minimum parcels of 1,000 Bonds and in multiples of 1,000.

Donation of Bond on Death

20. Bondholders may contract with the University to bequeath (by their will) their Bonds to the Foundation on the event of their death. Bondholders exercise this option by completing the appropriate form.
21. The form will constitute a contract for valuable consideration between the bondholder and the University that is enforceable by the Foundation. Under the contract, the bondholder agrees to bequeath their Bonds to the Foundation in the bondholder's will. This election may be revoked in writing to the University at any time before the bondholder's death. On the death of the bondholder, the Bond will be registered in the name of the Foundation and the interest rate will be adjusted to nil.

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:

- Bondholders who make a Bond Interest Adjustment:
 - (i) will not derive, by reason of that Bond Interest Adjustment, any "interest" income as defined in s YA 1, income arising under the financial arrangement rules, or income under ordinary concepts in respect of those interest periods under ss CA 1(2), CC 3 and CC 4;
 - (ii) will not be entitled to a refundable tax credit under s LD 1 or a deduction under s DB 41 in any income year; and
 - (iii) will be exempt from gift duty under s 73 of the Estate and Gift Duties Act 1968, if by reason of that Bond Interest Adjustment there is a "gift" as defined by s 2 of that Act.
- Bondholders who make a Bond Principal Donation:
 - (i) will not derive any income or expenditure under the financial arrangement rules under ss EW 15 and EW 31 from the bond principal being repaid for the purpose of making a cash donation to the Foundation, provided the relevant Bonds were acquired for an amount equal to their issue price;
 - (ii) will be entitled to a refundable tax credit under s LD 1 in the income year in which the Bond Principal Donation date falls for the full cash amount of bond principal being repaid and donated, provided they are not an excluded person under s LD 2 and provided the requirements of s 41A of the Tax Administration Act 1994 are met;
 - (iii) will be entitled to a deduction under s DB 41 in the income year in which the Bond Principal Donation date falls, for the cash amount of the bond principal being repaid and donated, if the bondholder is a company, subject to the limitation on the amount of the deduction to the company's net income for the income year in s DB 41(3) and subject to the application of any general limitation in s DA 2; and

- (iv) will be exempt from gift duty under s 73 of the Estate and Gift Duties Act 1968 on any gift made as a result of donating the bond principal repaid.
- Bondholders may contract with the University to bequeath their Bonds to the Foundation in their will. The act of entering into that contract:
 - (i) will not generate taxable income in the hands of the bondholder under s CA 1; and
 - (ii) will not give rise to a dutiable gift under s 63 of the Estate and Gift Duties Act 1968.
- Sections BG 1 and GA 1 of the Act do not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 7 December 2009 and ending on 31 December 2014.

This Ruling is signed by me on the 8th day of April 2013.

Fiona Heiford
Director (Taxpayer Rulings)