

PRODUCT RULING - BR Prd 13/06

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 New Zealand Bloodstock Leasing Limited (NZBL)

Taxation Law[s]

All legislative references are to the Income Tax Act 2007.

This Ruling applies in respect of sections BD 4(2), BG 1, DA 1(1), DA 2, EA 3, EC 38 to EC 48, EJ 10, FA 6 to FA 12 and subpart EW.

The Arrangement to which this Ruling applies

The Arrangement is the leasing of a thoroughbred breed of horse (bloodstock) on the terms provided in the Bloodstock Lease to Purchase Agreement (Bloodstock Agreement) entered into by NZBL and its customers for customers to use in breeding bloodstock progeny.

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

Purpose of the Arrangement

1. NZBL, New Zealand Bloodstock Limited (NZB), New Zealand Bloodstock Finance Limited (NZB Finance) and New Zealand Bloodstock Progeny Limited (NZB Progeny) are all 100% owned subsidiaries of New Zealand Bloodstock Holdings Limited (NZB Holdings). Together they are referred to in this ruling as the "NZB Group".
2. NZB Holdings established NZBL to expand its business and increase sales of bloodstock in New Zealand by making investment in the bloodstock industry more attractive to existing and new entrants. The availability of leasing reduces the initial level of cash required by existing and new entrants to the bloodstock business to acquire bloodstock. The leasing arrangement gives the customers the opportunity to participate in the business of breeding bloodstock by leasing the bloodstock. NZB is contractually entitled to provide the auctioning services for any progeny of the bloodstock. The benefit for the NZB Group from the leasing arrangement is that NZB gets the commissions from selling the bloodstock and the commissions from any sale of progeny from the bloodstock, in addition to NZBL's right to receive the lease payments.

Sourcing of the bloodstock

3. NZBL acquires new bloodstock from third party owners, and then leases this bloodstock to the customer. Alternatively, the customer purchases the new bloodstock from the third party owner, sells it to NZBL, and then leases the bloodstock from NZBL. This helps to protect NZBL from involvement in any subsequent contractual claims regarding the purchase of the bloodstock from the third party owner. In both cases, the parties contemplate the transaction as a whole at the outset. In either case, the customer sources the bloodstock, drawing on bloodstock consulting, freight, and insurance services provided by NZB.
4. NZBL may also acquire bloodstock that is already owned by the customer, either through an earlier purchase or because it is homebred (the already owned bloodstock) and the proceeds or sale of the already owned bloodstock are only used for the further investment in the customer's bloodstock breeding business.
5. It is agreed in the Bloodstock Agreement that the customer may purchase the bloodstock at the end of the lease. The Bloodstock Agreement describes the Arrangement:

WHEREAS

- A. The Lessee has requested the Lessor to purchase the Animal described in the Schedule hereto (hereinafter called 'the Animal') and upon purchase thereof to lease and, if required, to re-sell the Animal to the Lessee in accordance with the terms hereof.
- B. The Lessor has purchased the Animal and has agreed to lease the Animal to the Lessee and the Lessee has agreed to lease the Animal with the right to purchase it upon the terms and conditions more particularly outlined herein.
- C. The Animal secures the payment or performance of the Lessee's obligations hereunder and this Agreement creates a security interest in the Animal in terms of the Personal Property Securities Act 1999.
- D. The Lessor has agreed to this Lease to Purchase Agreement for the specific purpose of assisting the Lessee in the business of breeding bloodstock for sale by adding to its inventory and upon the basis that the Lessee, if it wishes to sell the leased animal or, if a mare, the progeny thereof, will sell the same through the bloodstock auctions conducted by its parent company New Zealand Bloodstock Limited.
- E. The Lessee has entered into this agreement for the purpose of obtaining breeding stock to use in the Lessee's business of bloodstock breeding for sale.

Lease particulars

6. The terms and duration of leases are based on individual requirements, credit risk, and potential breeding expectations. Lease periods may vary, but a typical lease term is three years for fillies or mares, and two years for colts or stallions.

Lease Assignment

7. When the lease is executed, in some instances NZBL may assign the lease to NZB Finance for the discounted value of the cash flow. The discount is equivalent to the market rate offered by third party companies providing such financing facilities. The assignment is on a non-recourse basis, and NZBL is not liable to NZB Finance in the event of default by the lessee.
8. The Notice of Assignment describes this assignment as:

TAKE NOTICE that on the _____ New Zealand Bloodstock Leasing Limited being the Lessor under the Bloodstock Lease to Purchase Agreement between it and you as Lessee has absolutely assigned all of its right title and interest therein as Lessor as follows

(a) To New Zealand Bloodstock Finance Limited a duly incorporated company having its principal place of business at Karaka Sales Centre, Hingaia Road, Papakura, New Zealand all of its rights and obligations relating to the leasing of the Animal under the said Agreement and without limiting the generality of the foregoing all of the rights of the Lessor to receive payments of rental as and when they shall become due or other monies payable under the said Agreement by the Lessee to the Lessor or in respect of the Lessor enforcing such rights and receiving such payments as are prescribed by the said Agreement.

You are directed to pay all payments of rental due under the said Agreement and all other payments due in respect of the lease of the Animal therein described to the said New Zealand Bloodstock Finance Limited and in future to deal with that company in respect of all matters pertaining to the leasing arrangement under the said Agreement.

Residual Value

9. The bloodstock has a defined Residual Value under the Bloodstock Agreement. The Residual Value is an estimate (at the time of signing the lease) of the value the bloodstock will have at the end of the lease. "Residual Value" is defined in the Bloodstock Agreement as:

'Residual value' means the amount specified in the Schedule hereto as such being a pre-estimate of the value of the Animal upon the expiry of this Lease.

Bloodstock Assignment

10. After the lease has been entered into and assigned to NZB Finance, NZBL may assign the title to the bloodstock to NZB Progeny. Because the Residual Value, if realised at all, is not realised by NZB Progeny until the end of the lease, NZB Progeny pays to NZBL the discounted value of the residual value payment. The discounted value is calculated using market rates materially the same as those used by third party companies providing financial facilities.
11. Transferring the bloodstock titles to NZB Progeny gives additional asset protection benefit to the NZB Group. In this way the group's interest in the bloodstock is separated and protected from the day to day business activities of NZB, NZB Finance and NZBL. The Notice of Assignment from NZBL to the lessee describes this assignment as:

TAKE NOTICE that on the New Zealand Bloodstock Leasing Limited being the Lessor under the Bloodstock Lease to Purchase Agreement between it and you as Lessee has absolutely assigned all of its right title and interest therein as Lessor as follows

(a)...

(b) To New Zealand Bloodstock Progeny Limited a duly incorporated company having its principal place of business at Karaka Sales Centre, Hingaia Road, Papakura, New Zealand all of its rights and obligations relating to the title to and property in the Animal and the right to receive payment of the Residual value outlined in the said Agreement and any other monies due under the said Agreement in respect of the title to or ownership of the Animal.

You are directed to pay the amount of Residual Value of the Animal on the date payable under the said Agreement to New Zealand Bloodstock Progeny Limited and in future to deal with that company in respect of all matters relating to the ownership and wellbeing of the Animal(s).

Lease Termination Date

12. The "Lease Termination Date" is the date on which the lease ends. The customer may purchase the bloodstock on the Lease Termination Date for the Residual Value. If the customer does exercise their option to purchase the bloodstock, NZB Progeny or NZBL will transfer title to the customer in return for payment of the 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 in section YA 1, of breeding bloodstock.
- b) Where the bloodstock is already owned bloodstock, the customers will enter into the Bloodstock Agreement for one or both of the following reasons which are, in each case, the main reason or reasons for entering into the Arrangement:
 - The need to refinance bloodstock already owned for further investment in the customer's bloodstock breeding business, and/or
 - The need for certainty of cash inflows for further investment in the customer's bloodstock breeding business through the sale of the bloodstock to NZBL.
- c) Where the bloodstock is new bloodstock, the customers will enter into the Bloodstock Agreement for one or a number of the following reasons which are, in each case, the main reason or reasons for entering into the Arrangement:
 - The need to refinance bloodstock already owned for further investment in the customer's bloodstock breeding business
 - The need for certainty of cash outflows through structuring the lease payments, and/or
 - The need to reduce the initial level of cash required to enter the bloodstock breeding business or to purchase new bloodstock.
- d) The customer has not entered into two or more consecutive or successive leases (within the meaning of paragraph (d)(iv) of the "lease" definition in section YA 1, if

the reference to “the same personal property lease asset” is read as a reference to “the same bloodstock”) of the same bloodstock.

- e) The customer has entered into the Bloodstock Agreement for the sole purpose of breeding from the leased bloodstock and intends to use the leased bloodstock in deriving assessable income.
- f) The lease payments are genuine, arm’s length amounts for the possession and use of the bloodstock.
- g) The leased bloodstock is mature for use in breeding and is capable of being used for breeding at all times during the period to which each lease payment relates.
- h) Any racing undertaken by the leased bloodstock is incidental to the actual use of the bloodstock for breeding during the lease term.
- i) The Residual Value of the bloodstock is a reasonable, and the parties’ best, estimate of the likely market value of the bloodstock at the Lease Termination Date.
- j) The bloodstock becomes the property of the customer only when the customer makes payment of the Residual Value after the Lease Termination Date.
- k) No consideration is paid for the option to purchase the bloodstock at the Lease Termination Date.
- l) The customer is not in the business, as defined in section YA 1, of selling or exchanging leases.
- m) At the time of entering into the Bloodstock Agreement, the customer does not intend to dispose of the lease.
- n) The customer is not carrying on or carrying out an undertaking or scheme of trading leases entered into or devised for the purpose of making a profit.

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:

- a) The bloodstock lease payments are deductible under section DA 1(1) and none of the general limitations in section DA 2 apply, 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.
- b) 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.

- c) The valuation and specified write-down provisions in sections EC 38 to EC 48 apply to the customer when the bloodstock is purchased by payment of the Residual Value after the Lease Termination Date.
- d) The "cost price" of the bloodstock for the purposes of sections EC 38 to EC 48 is the Residual Value stated in the Bloodstock Agreement.
- e) The financial arrangements rules in subpart EW do not apply to the Arrangement.
- f) Section EJ 10 does not apply to the Arrangement as the lease is not an operating lease.
- g) Sections FA 6 to FA 11 do not apply to the Arrangement as the lease is not a finance lease.
- h) Section FA 12 does not apply to the Arrangement as the lease is not a hire purchase agreement.
- i) 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 6 December 2012 and ending on 6 December 2017.

This Ruling is signed by me on the 6th day of May 2013

Chris Springett
Investigation Manager, Investigations and Advice