

## **PRODUCT RULING - BR Prd 14/03**

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 Bank of New Zealand (BNZ).

### **Taxation Laws**

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

This Ruling applies in respect of:

- (a) ss BG 1, CC 7, EW 15, EW 31, GA 1, RE 1 to RE 6, RE 10, RF 1, RF 2, RF 3 and RF 4; and
- (b) ss 86F and 86I of the Stamp and Cheque Duties Act 1971 (SCDA).

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

The Arrangement is a product (TotalMoney) that BNZ offers to its customers. These customers may only be 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 up to 10 of these new types of accounts (potentially increasing to 25 during 2014) into one or more groups to either "pool" or "offset" the account balances.

"Pooling" involves the aggregation of account credit balances to determine the tiered interest rate that will apply to the calculation and crediting of interest to each account balance. "Offsetting" involves the aggregation of account balances to calculate 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 13 December 2013:

- Terms and Conditions for your Bank of New Zealand TotalMoney Account for Personal and Sole Trader Customers;
- Terms and Conditions for your Bank of New Zealand TotalMoney Account for Companies and Trusts;
- Bank of New Zealand Home Loan Facility Master Agreement;

- Bank of New Zealand Facility Master Agreement;
- Letter of Advice - TotalMoney Home Loan;
- Letter of Advice - TotalMoney Business Term Loan; and
- Confirmation of New Terms and Conditions (for customers converting to TotalMoney).

Further details of the Arrangement are set out in paragraphs 1 to 30 below.

1. TotalMoney is a package of accounts and loans that BNZ offers to its customers. These customers may only be 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 only be 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, because of a "mortgage holiday". TotalMoney allows customers to group or aggregate these accounts to either "pool" or "offset" 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 several transaction accounts with credit balances exist. Interest on these credit balance accounts is calculated and paid based on the cumulative credit balance of all transaction accounts in the group that are nominated for the pooling feature. Interest-bearing accounts usually attract interest based on interest rate brackets that apply to the balance of each relevant individual account.
- (b) The cumulative credit balance is calculated so BNZ can 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 at 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 to calculate 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 applying to those accounts cease to apply and are replaced by the TotalMoney Terms and Conditions.
  7. For TotalMoney accounts, the customer can select either to "offset" or "pool" (and to change between) 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 applying to the total cumulative balance of all accounts being "pooled". Following usual business practice, BNZ makes a separate determination for 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 for 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 credit balance accounts when BNZ is calculating interest for those accounts.

### ***Offsetting - further detail***

11. Where one loan account is in the group, the interest payable on the loan account is calculated on 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 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. 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 (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 those 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 TotalMoney transaction account.

18. No arrangement must exist between the customers who have grouped their accounts that 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.

***Business purposes***

19. When TotalMoney was established, customers were contractually prohibited from using TotalMoney for business purposes. BNZ has now removed the prohibition on the business use of TotalMoney. BNZ extended the availability of TotalMoney to business customers to give them the same tools for managing their financial affairs as it gives to personal customers.
20. Under the terms and conditions applicable to TotalMoney, customers are able to use TotalMoney accounts for business purposes, which means that customers are able to group business and non-business product accounts. This means that a sole trader, for example, is able to group their business and non-business accounts.

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

21. Each of BNZ's home loans is explained in a collection of documents. These documents include primarily a Home Loan 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 for Home Loans (which contains particular and specific provisions for the home loan facility being made available to the customer and overrides the Loan Facility Master Agreement in case of any inconsistencies). 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.
22. The TotalMoney product home loans are also documented in a Home Loan Facility Master Agreement and Letter of Advice for Home Loans. 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 Home Loan Facility Master Agreement is the standard document that applies to all BNZ home loans. The Letter of Advice for Home Loans has only minor differences from 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 for the variable rate components of the home loan (to account for the "offset" feature of TotalMoney).
23. Table loans provide for regular payments and a set date when the loan 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.
24. 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. Under a non-table loan, any interest saving (whether as a result of a reduction in the applicable interest rate because of a general decrease in interest rates or because of the offset feature) would result in either a reduction of the interest repayment 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 only allowed in the loan term.

### ***Terms and conditions for TotalMoney business loan products***

25. Each of BNZ's business loans is also documented under a collection of documents. These include primarily the Loan Facility Master Agreement (a standard form "Master" document that contains primarily generic provisions that apply to BNZ's business loan facilities) and a Business Term Loan Letter of Advice (which contains particular and specific provisions for the loan facility that is being made available to a TotalMoney business customer and overrides the Loan Facility Master Agreement in case of any inconsistencies).
26. Any variations between the different versions of the Business Term Loan Letter of Advice and the Loan Facility Master Agreement primarily relate to branding (the name given by BNZ to this particular form of loan) and the interest calculation for the variable rate components of a business loan (to account for the "offset" feature of the product). Apart from these differences, the provisions are the standard provisions that apply to BNZ's other business loans; for example: table, non-table, tailored, interest only, and so on.

### ***Groups***

27. TotalMoney is based on a group of participating accounts. Groups can comprise only one of the following categories:
  - (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 of accounts.
    - (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, although the group may not include both residents and non-residents.
  - (b) One company or one trust:
    - (i) Multiple accounts of one company (including a qualifying company or look through company) or one trust may be combined as a group of accounts. 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.
28. Accounts may only be included in one group. An individual may have accounts in three groups, through membership in one as an individual customer, the second as a joint customer and in the third as a sole trader. A group may not include more than one sole trader's accounts.
29. 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 they do not have different tax residence 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.

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

30. BNZ's objectives in providing TotalMoney are to:
- (a) increase its market share, particularly for 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.

### **Condition 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 Applicant and the Arrangement as follows:

#### ***Financial arrangements rules***

- (a) 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 because of that "offset" for the calculation of income and expenditure under ss EW 15 and EW 31 of the "financial arrangements rules" (as defined in s EW 1(2)).

#### ***Resident Withholding Tax (RWT), Non-Resident Withholding Tax (NRWT) and Approved Issuer Levy (AIL)***

- (b) Under the "pooling" feature of TotalMoney:

- (i) RWT (as defined in s YA 1) and NRWT (as defined in s 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 ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1);
  - (ii) For an account that is a "registered security" (as defined in s 86F of the SCDA), "approved issuer levy" (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account pursuant to s 86I of the SCDA.
- (c) Under the "offsetting" feature of TotalMoney:
- (i) There is no payment of or entitlement to "interest" (as defined in s YA 1) for the credit balances of participating transaction accounts in a group, and no obligation to deduct RWT or NRWT or to pay AIL, except to the extent that the combined credit balance of those accounts exceeds the combined debit balance of the lending facility accounts.
  - (ii) To the extent that interest is credited to participating transaction accounts in a group:
    - o RWT (as defined in s YA 1) and NRWT (as defined in s 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 ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1);
    - o For an account that is a "registered security" (as defined in s 86F of the SCDA), "approved issuer levy" (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account pursuant to ss 86F and 86I of the SCDA.

***Section CC 7***

- (d) No income arises under s CC 7 for BNZ or its customers in relation to the Arrangement.

***Section BG 1***

- (e) 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 2014 and ending on 31 March 2018.

This Ruling is signed by me on the 31<sup>st</sup> day of March, 2014.

**Bill Acton**

Investigations Manager, Investigations and Advice