PRODUCT RULING - BR Prd 14/04

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 Scales Consolidated Tax Group
- Scales Corporation Ltd

Taxation Laws

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

This Ruling applies in respect of s CD 22 and s BG 1.

This Ruling does not consider or rule on the tax effects set out in paragraph 60.

The Arrangement to which this Ruling applies

The Arrangement is an intra-group restructure of the Scales Consolidated Tax Group (Scales Group). The Arrangement involves a transfer of certain property-owning companies to a new holding company, George H Investments Ltd (GHI). Scales Corporation Ltd (SCL) will then distribute the shares in GHI, along with surplus cash, to its shareholders in an off-market share repurchase and cancellation (so that GHI is a sister company to the existing holding company).

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

1. SCL has identified property assets and shares that are considered surplus to the ongoing requirements of the Scales Group. The Arrangement has the following 3 purposes:
    - The Arrangement will be undertaken to allow the capital represented by these surplus property assets and shares to be returned to current SCL shareholders. The assets identified are various land and buildings and a 10.3% shareholding in Turners & Growers Ltd (T&G).
    - The Arrangement will be undertaken because the Scales Group considers that the risk of ownership of these surplus property assets and shares could complicate a possible initial public offering (IPO).
    - The Arrangement will be undertaken because separating the core operating divisions of the Scales Group from other property and investment interests (not required in the operating divisions) will enable SCL to focus on the growth and development of the core operating divisions while GHI focuses on managing its property and other investments. The Scales Group considers this will maximise value, with any proceeds from asset realisations by GHI and GHI's newly acquired subsidiaries expected to be returned to shareholders as the relevant assets are realised.

Current Scales Group structure

2. Figure 1 in the Appendix sets out the current structure of the Scales Group.

3. All of the wholly-owned New Zealand companies, in Figure 1 in Appendix 1, are members of the Scales Group, except for Scales Property Development Ltd (SPDL) and Cashreal Properties Ltd (in liquidation). However, SPDL is wholly owned by Scales Holdings Ltd (SHL), which is a member of the Scales Group.

Summary of Arrangement

4. The following will occur before the distribution of GHI shares by SCL to its shareholders:
   - Some of the assets (being real property) that are surplus to the ongoing requirements of the Scales Group have been, or will be, sold to third parties. These sales are expected to raise about \$9.3 million. Two further properties will be sold to other Scales Group companies.
   - Several options have been entered into to enable members of the Scales Group to acquire properties from GHI's newly acquired subsidiaries (for a fixed price based on their market value), until 31 December 2015.
   - GHI will purchase:
     - various intra-group loans; and
     - the shares in Tiger Ventures Ltd (TVL), SPDL, Silverstream Industrial Park Ltd (SIPL), and Whakatu Property Management Ltd (WPML).
   - The proceeds from the above transactions will be paid between Scales Group members as dividends or loan repayments.
   - There will be a 2 to 1 share split of all SCL shares issued (currently 39,864,002 shares).

5. The above share split will be followed by an off-market pro rata repurchase and cancellation of 50% of SCL's shares on issue in exchange for cash consideration (27 cents per share and \$10.8 million in total) and one share in GHI for each SCL share (the demerger). The cash paid to shareholders will be sourced from the sales of the surplus properties.

6. The restructuring referred to above and how the demerger will occur are explained in more detail in paragraphs 7 to 57.

Pre demerger restructuring

George H Investments Ltd

7. GHI was incorporated on 5 December 2013. GHI will be part of the Scales Group from that date (although it may leave the Scales Group on an IPO). SCL will hold 100% of the shares in GHI until the demerger.

8. SCL will capitalise GHI with up to $52.6 million of new capital. SCL will fund the capitalisation of GHI by issuing GHI with assignable promissory notes for the amount of the capital. The capital may be less than $52.6 million, with GHI obtaining external debt funding to cover the difference, if it should be necessary to reduce the value of GHI so the total distribution to shareholders, on the share repurchase and cancellation, does not exceed the available subscribed capital of SCL. In this event, SCL expects to repay its borrowings (being working capital facilities provided by a third-party bank) by an equivalent amount. The Scales Group does not expect GHI's external debt funding, used to reduce the value of GHI, will exceed $4 million.

Whakatu Property Management Ltd

9. WPML owns land in Hawke's Bay (the Whakatu Industrial Park), one lot of which it is planning to subdivide into seven sections during 2014. WPML expects to apply for resource consent, to subdivide this land, in April 2014 and to complete this subdivision by December 2014.

10. WPML's parent entity Whakatu Coldstores Ltd (WCS) uses part of the Whakatu Industrial Park as part of its cold store business (lot 3). WPML will sell lot 3 to WCS at its market value (about $2.1 million) before the demerger. Title in that land will transfer to WCS in 2014 immediately on the completion of the subdivision. WCS will fund this purchase from its available working capital, including (as necessary) its bank working capital facility.

11. Until 31 December 2015, WCS will hold an option to acquire a second lot in the Whakatu Industrial Park (lot 12) from WPML for $370,000 (which is the market value of this lot). The option ensures WCS can acquire this land if it becomes required for its business before 31 December 2015.

12. WPML sold three further sections (Wool Scours) to a third party in December 2013 for a total of $2.2 million. The sale proceeds are being held in a trust account until title to these sections is issued.

13. The balance of the land in Whakatu Industrial Park is considered surplus to the Scales Group ownership requirements and will be retained in WPML when that entity is sold to GHI. The value of this land is expected to be about $9.6 million.

14. WPML has already sold a property in Dunedin to a third party. The property is leased to a Scales Group entity, Meateor Foods Ltd, for use in its business activities. This land was sold at market value ($1.7 million).

15. The above transactions and land holdings of WPML are summarised in the following table:

	Value ($m)	Status
WCS lot 3	2.1	To be sold
Meateor, Dunedin	1.7	Sold
Wool Scours	2.2	Sold
Residual land	9.6	Holding

16. WPML's parent entity, WCS, has an outstanding intercompany balance with WPML for about $5.5 million. After the above transactions, WCS will repay this amount to WPML. This outstanding intercompany balance is money lent after WPML and WCS were both part of the Scales Group. Further, WPML and WCS will remain in the Scales Group when WCS repays this loan to WPML.

17. The funds received from these land sales (about $4.3 million), along with the funds received from WCS (about $5.5 million, being repayment of the intercompany loan), plus some accumulated gains of about $0.5 million will be paid as a dividend (about $10.3 million), to WCS, before the demerger.

Scales Property Development Ltd

18. SPDL owns land in Hawke's Bay (Groome Place), part of which a Scales Group entity, Mr Apple Ltd, uses as part of its business activities.

19. In 2014, SPDL is planning to subdivide lot 5 Groome Place into five sections. SPDL expects to apply for resource consent, to subdivide this land, in March 2014. SPDL expects that the subdivision will be complete by December 2014. Until 31 December 2015, Mr Apple Ltd will lease two of these sections from SPDL on market terms. During this period, Mr Apple Ltd will also have an option to acquire either or both of these sections for $760,000 and $635,000 (the respective current market values of each section).

20. SPDL will retain the land SPDL owns when the entity is sold to GHI. This residual land's value will be about $5.2 million.

21. The above land holdings, by SPDL, are summarised in the following table:

	Value ($m)	Status
Residual land	5.2	Holding

Silverstream Industrial Park Ltd

22. SIPL owns industrial land and buildings in Mosgiel (Silverstream Industrial Park).

23. This land is considered surplus to the Scales Group's requirements. SIPL has subdivided and sold a portion of this land to a third party for $5.4 million. The settlement proceeds were temporarily advanced to another Scales Group entity, Polarcold Stores Ltd (PCL), which will repay them to SIPL.

24. The balance of the land in Silverstream Industrial Park will be retained by SIPL and held for future sale. This residual land's value will be about $12.5 million.

25. PCL owns a piece of bare land in Hornby, Christchurch (Canada Crescent), that is considered surplus to the Scales Group's requirements. SIPL will purchase this land before the demerger at the land's current market value (about $2.3 million). Until 31 December 2015, PCL will hold an option to reacquire this land from SIPL for $2.3 million (which is the market value of this land). This option ensures PCL can reacquire this land if it becomes required for its business before 31 December 2015.

26. The above transactions and land holdings by SIPL are summarised in the following table:

	Value ($m)	Status
Mosgiel	5.4	Sold
Canada Crescent	2.3	To be purchased
Residual land (excluding above)	12.5	Holding

27. The net funds received from the above transactions (about $3.1 million), plus some accumulated gains of about $0.4 million, will be paid as a dividend (about $3.5 million), to PCL before the demerger.

Tiger Ventures Ltd

28. TVL is a wholly-owned subsidiary of SCL. TVL was incorporated for the purpose of purchasing shares in Turners and Growers Ltd (T&G). TVL owns a 10.3% shareholding in T&G. These shares are the only asset TVL holds. TVL funded the purchase of shares in T&G through a loan from SCL. This loan is TVL's only liability.

29. The market value of TVL's shares in T&G (based on T&G's NZX trading price) is now less than the amount of the loan SCL advanced to TVL to fund the purchase. However, the combined shareholding may have an additional strategic value (which is difficult to value). As explained in paragraph 30, the consideration for the transfer of this loan, from SCL to GHI, will be the face value of the loan (the amount owing, which is about $22.9 million).

George H Investments Ltd purchases shares in various companies, and loans, from members of the Scales Group

30. Following the above transactions, GHI will acquire the following assets from the Scales Group:

- In relation to TVL:
  - the shares in TVL, from SCL, for $1; and
  - a loan TVL owes to SCL, from SCL, for the amount owing of about $22.9 million.
- In relation to SPDL:
  - the shares in SPDL, from SHL, for about $0.5 million; and
  - a loan SPDL owes to WCS, from WCS, for the amount owing of about $4.9 million.
- In relation to SIPL:

    - the shares in SIPL, from PCL, for about $0.2 million; and
    - a loan SIPL owes to PCL, from PCL, for the amount owing of about $13.3 million.
- In relation to WPML:
    - the shares in WPML, from WCS, for about $8.7 million.

31. All of the above loans are interest free, repayable on demand, and in New Zealand currency. Further, after the sale of the above loans to GHI, their terms will not change and these loans will remain fully repayable. No portion of these loans will be remitted either before or after GHI acquires these loans.

32. GHI will fund the above purchases by assigning the promissory notes SCL issued to it (up to $52.6 million in total). The recipients of these notes will use them to fund their transactions under the Arrangement (together with funds raised from selling properties to third parties and available working capital). The promissory notes are all finally paid or distributed to SCL under the Arrangement, at which point they will be cancelled (because SCL will be both the holder and the issuer of the notes).

Cash used to pay further dividends and repay another intra-group loan

33. After the above transactions, the Scales Group will pay further dividends and repay another intra-group loan with the cash received from the above transactions and the previous dividends (as detailed above).

Whakatu Coldstores Ltd

34. WCS will pay a dividend to PCL of approximately $16.3 million funded by the dividend received from WPML ($10.3 million), the sale of WPML shares ($8.7 million) and the SPDL loan ($4.9 million).

Polarcold Stores Ltd

35. PCL has a loan liability to SCL of $32.8 million as the result of various advances. PCL will repay this loan and pay a dividend of $2.8 million to SHL, a total of $35.6 million, which the above transactions will fund.

36. PCL (the borrower) and SCL (the lender) have been in the Scales Group for the whole term of the above loan. PCL and SCL will remain in the Scales Group when PCL repays this loan to SCL.

Scales Holdings Ltd

37. SHL will pay a dividend to its parent SCL of about $3.3 million funded by the sale of SPDL shares ($0.5 million) and the dividend from PCL ($2.8 million).

38. Figure 2 in the Appendix summarises the funding flows under the Arrangement.

Scales Corporation Ltd undertakes a demerger of the GHI group

39. SCL will then undertake the demerger of the new GHI group, from SCL, as explained below.

40. Before the return of capital, under the demerger, SCL will carry out a 2 to 1 share split of all SCL shares issued (currently 39,864,002 shares).

41. The demerger of the GHI group will then occur by way of a mandatory pro-rata buy back and cancellation by SCL of 50% of its shares. The shares will be cancelled wholly and not in part.

42. For every one SCL share cancelled, SCL shareholders will receive one GHI share (estimated value $1.36) and $0.27 cash (being solely the proceeds of the sale of assets identified as surplus to the Scales Group's requirements under the Arrangement).

43. The share repurchase and cancellation will allow capital represented by assets identified as surplus to requirements to be returned to SCL shareholders ahead of a possible IPO of SCL. If an IPO occurs, its primary purpose will be to allow existing shareholders access to an easily accessible market to increase the transferability of their shares. No plans exist to issue new shares if an IPO does not proceed. Any such potential share issue is not part of the Arrangement.

44. The return of capital is not intended to be a substitute for, or to replace, the payment of a dividend.

45. The total cash payment to SCL's shareholders on the share repurchase will be about $10.9 million and the total value of the GHI shares will be not more than $52.7 million.

46. Initially, SCL's and GHI's shares will be stapled. No decision has been made about when the shares might be de-stapled, except that if an IPO occurs, a de-stapling would occur at that point.

Structure of the Scales Group after Arrangement

47. Figure 3 in the Appendix shows the structure of the Scales Group after the Arrangement.

Available subscribed capital of Scales Corporation Ltd

48. The available subscribed capital of SCL was $63.6 million as at 31 March 2013 (at a minimum) and will be maintained at least at that level until the demerger.

Dividend history of Scales Corporation Ltd

49. Previous dividends SCL paid are shown in the following table:

Date	**Amount of dividend ($)**
December 2007	1,885,637
December 2008	2,157,025
November 2009	3,370,352
June 2013	8,107,668

50. Dividends were not paid between 2010 and 2012 because of financial pressure in this period. Instead profit was used to retire debt.

51. The Scales Group was sold to its current ownership group on 21 July 2011. Since then the group's financial position has improved such that the group could pay its first dividend since 2009 in June 2013.

52. The Scales Group does not have a formal dividend policy. However the Scales Group intends to pay the following dividends:

- a final dividend for the 2013 calendar year of $8 million; and
- a further dividend in the following year subject to the financial position of the Scales Group.

53. The company has historically maintained and is committed to re-establishing consistent dividend payments in the future.

Retained earnings balances of Scales Corporation Ltd and the Scales Group

54. The balances of retained earnings for SCL, SPDL and the Scales Group are set in paragraphs 55 to 57.

55. The balance of retained earnings of SCL are shown in the following table (brackets indicate negative balances):

Date	**Level of retained earnings ($)**
30 June 2009	(29,446,704)
30 June 2010	(23,168,048)
30 June 2011	(18,553,390)
31 December 2011	(22,988,518)
31 December 2012	(34,179,727)

56. The balance of the retained earnings of SPDL is shown in the following table (brackets indicate negative balances):

Date	**Level of retained earnings ($)**
30 June 2010	0
30 June 2011	(6)
31 December 2011	141,631
31 December 2012	(386,308)

57. The balance of the retained earnings of the Scales Group (on a consolidated basis) is shown in the following table:

Date	**Level of retained earnings ($)**
30 June 2009	53,065,421
30 June 2010	50,752,877
30 June 2011	66,604,876
31 December 2011	59,993,342 (restated)
31 December 2012	71,022,206

Subsequent plans after the demerger

58. Initially, none of the companies will leave the Scales Group.

59. GHI and GHI's subsidiaries (after the demerger) will progressively dispose of their assets to optimise value for the GHI shareholders. GHI's subsidiaries will repay the loans owed to GHI as funds are available and then be liquidated or amalgamated. These post-demerger transactions are not part of the Arrangement.

Tax effects of the Arrangement

60. The Applicants consider that the tax effects of the Arrangement are as follows:

a) All shares being transferred under the Arrangement are held on capital account by the transferors. They will also be held on capital account by the transferees. No income will arise, from the transfer of these shares, under s CA 1.

b) In relation to the subdivision of Whakatu Industrial Park into seven sections by WPML:

- The land (Whakatu Industrial Park Land) was purchased in 1995 and was not acquired for the purpose of disposal.
- The land is held on capital account and no income will arise, under s CA 1, from the sale of this land.
- Section CB 12 does not apply to the disposal of any of this land, because the land has been held for more than 10 years.
- Section CB 13 does not apply to the disposal of any of this land, because the subdivision of land will not involve significant expenditure.

c) In relation to the sale, of lot 3 Whakatu Industrial Park, by WPML to WCS:

- The sale price will be at market value.
- WPML will derive depreciation recovery income, of about $188,000, from the sale under subpart EE. This income will be excluded income under ss FM 8 and CX 60.
- WCS will be treated as having acquired the property on the date it was acquired by WPML for its cost to WPML and to have been allowed deductions of the depreciation loss that WPML has been allowed for the property under s FM 15.
- The expected sale price of $2.054 million will generate an associated party capital gain of $1.020 million. Under s CD 44(10B), this amount will not be included in WPML's capital gain amount for the purposes of the "available capital distribution" formula in s CD 44.
- Any income derived from the sale of lot 3 to WCS would be excluded income to WPML under ss FM 8 and CX 60.

d) In relation to the sale of the three sections (referred to in the Arrangement as the Wool Scours) by WPML, to unrelated parties, WPML will derive depreciation recovery income, of about $10,000, under subpart EE. This land is held on capital account, and no other income will arise from the sale of this land.

e) In relation to the sale of the Meateor, Dunedin, site by WPML to a third party:

- The sale is complete and settlement occurred on 31 October 2013.
- This land was held on capital account and no income arose under s CA 1.
- WPML derived depreciation recovery income of about $180,000 under subpart EE.

f) In relation to the land, held by SPDL, at Groome Place, Hawke's Bay:

- This land was acquired in June 2011 (from Mr Apple Ltd and WCS).
- This land is held on revenue account, because SPDL carried on a business of property development when this land was acquired (and the land has been held for less than 10 years). Therefore, income will arise under s CA 1 for SIPL from any sale of this land.
- The sale proceeds of any of this land in the future will be income under s CB 10(1).
- Mr Apple Ltd has options, which will expire on 31 December 2015, to acquire either or both of two sections. If these options are exercised, the amount SPDL receives will be income under s CB 10(1).

g) In relation to the sale of the land and buildings in Mosgiel (Silverstream Industrial Park) by SIPL to third parties:

- This land was acquired in August 2008.
- This land is held on revenue account because SIPL was associated with a property developer when the land was acquired. Therefore, income will arise under s CA 1 for SIPL from any sale of this land.
- The gain on sale of this land will be about $500,000. This gain on sale will be taxable under s CB 10(2).
- SIPL will derive depreciation recovery income of about $80,000 under subpart EE.

h) In relation to the sale of land at Canada Crescent, Christchurch, by PCL to SIPL:

- The sale price will be at market value.
- This land is, and will continue to be, held on capital account. Therefore, any sale proceeds will not be income under s CA 1.
- There are no buildings or other depreciable property. Therefore, PCL will not derive any depreciation recovery income on the disposal of this land under subpart EE.
- PCL will have an option, which will expire on 31 December 2015, to buy back the land for $2.3 million (which is its market value).

i) The loans GHI will purchase are excepted financial arrangements for the lenders under s EW 5(10). Therefore, on the purchase of the loans by GHI, the lenders are not required to calculate a base price adjustment under s EW 29. The borrowers remain liable under those loans, so are not required to calculate a base price adjustment under s EW 29.

j) The sale of shares (in SIPL, WPML, TVL and SPDL) to GHI is on capital account. Therefore, no income arises from the disposal of those shares under s CA 1. If any income were to arise, then that income would be excluded income under ss FM 8 and CX 60.

k) SCL's shareholders will be treated as disposing of their shares when SCL repurchases them under its pro rata buy back and cancellation. Consequently, any shareholder who hold their SCL shares on revenue account will derive net income from the repurchase equal to the difference between the repurchase proceeds they receive and the cost of the shares that are repurchased from them.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) All SCL shares cancelled as part of the Arrangement will be ordinary shares of the same class issued by SCL, and the shares will each be cancelled in whole, not in part.

b) A "market value circumstance" (as defined in s YA 1) will not exist at the time of the share cancellation.

c) The aggregate of the amount payable, plus the market value of the GHI shares distributable, by SCL to its shareholders on account of the share cancellation will be less than the available subscribed capital of SCL.

d) The aggregate of the amount payable, plus the verifiable market value of the GHI shares distributable by SCL to its shareholders on account of the share cancellation will be at least 15% of the market value of all ordinary shares SCL issues at the time of the share cancellation being notified to SCL's shareholders.

e) SCL will continue to pay dividends after the capital reduction provided the financial performance of the Scales Group allows this.

f) All transactions in the Arrangement will be for market value and on arm's length terms with the possible exception of the purchase, by GHI, of the loan owned by TVL to SCL. In particular, any amount paid for or allocated to the sale of depreciable property under the Arrangement is equal to the market value of that depreciable property on the date of sale.

g) All of the companies in the Scales Group and SPDL are solvent, both in terms of their liquidity and balance sheet, except for TVL, which may be insolvent.

h) No material tax effects arise from the Arrangement other than those described in paragraph 60.

i) The Scales Group and SPDL will file its tax returns materially in accordance with the tax effects described in paragraph 60.

How the Taxation Laws apply to the Arrangement

Subject in all respects to the conditions stated above and the qualification set out under "Taxation Laws", the Taxation Laws apply to the Arrangement as follows:

a) The entire amount distributed to SCL shareholders upon the pro-rata buy-back and cancellation of shares by SCL under the Arrangement is excluded from being a "dividend" (as defined in subpart CD) by s CD 22 of the Income Tax Act 2007.

b) 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 January 2014 and ending on 31 December 2015.

This Ruling is signed by me on the 31st day of March 2014.

Dinesh Gupta
Director (Taxpayer Rulings)

Appendix: Diagrams of Scales Group and flow of funds under the Arrangement

Figure 1**: Existing Scales Group structure**

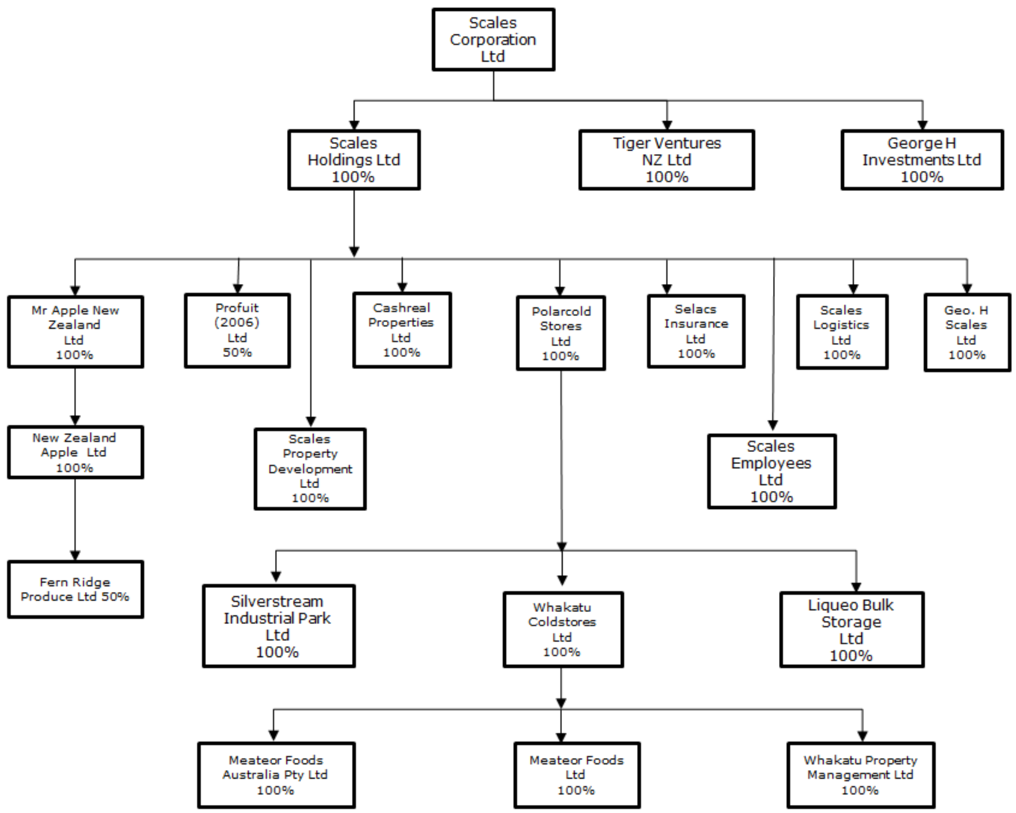

Figure 2: **Flow of funds under the Arrangement** (the numbers in **bold** indicated the order in which the transactions occur)

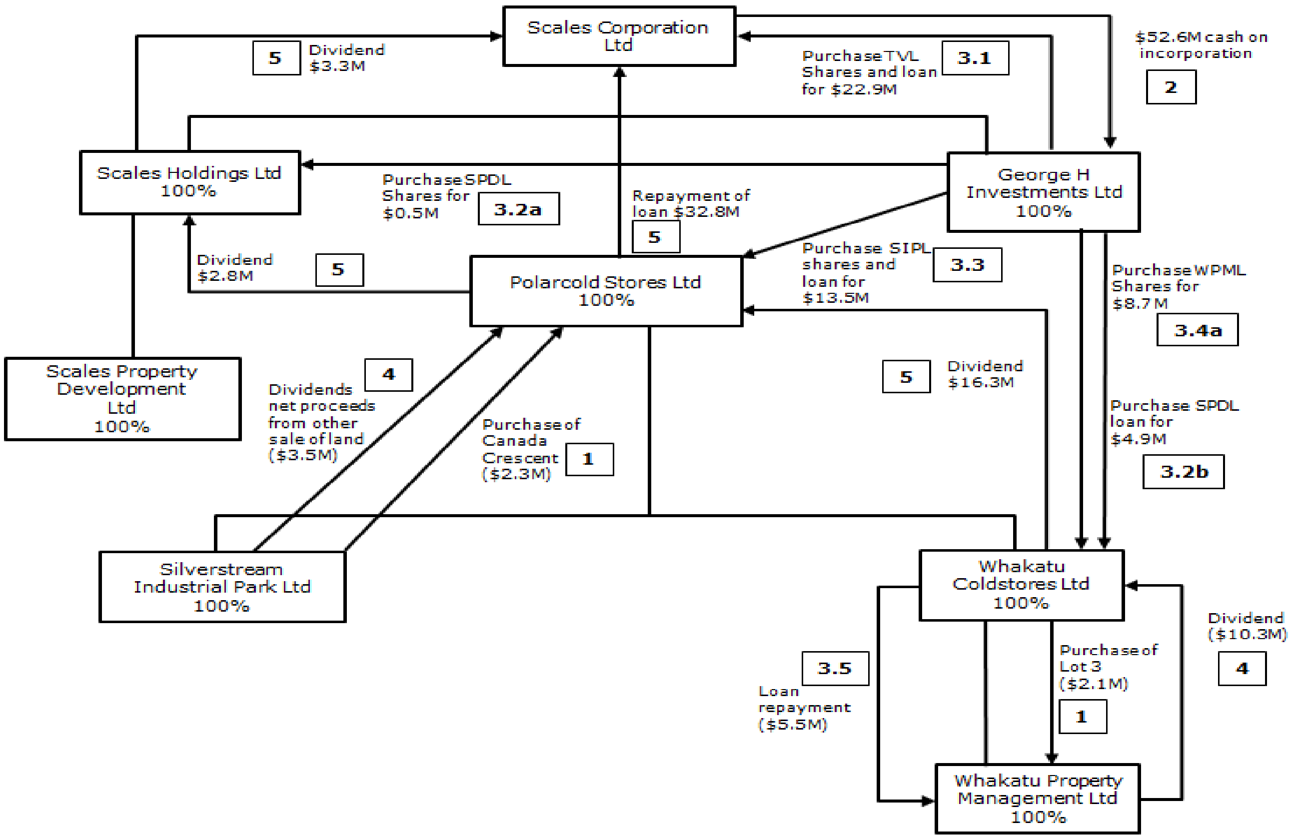

Figure 3: **Scales Group and GHI (and subsidiaries) structure after the Arrangement**