

## PRODUCT RULING – BR PRD 17/06

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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 Finance and Leasing Limited.

### Taxation Laws

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

This Ruling applies in respect of ss BG 1, DA 1, EA 3, EC 39 to 48, EJ 10, FA 6 to FA 11B, 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 (Lease) to Purchase Agreement (Bloodstock Agreement) entered into by New Zealand Bloodstock Financing and Leasing Limited (NZBFLL) **and its customers, for use in the customers' "business" (as defined in s YA 1)** of breeding and selling the leased bloodstock's progeny.

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

### Background

1. NZBFLL is a wholly owned subsidiary of New Zealand Bloodstock Holdings Limited (NZB Holdings).
2. NZBFLL was, prior to 2 July 2014, known as New Zealand Bloodstock Leasing Limited (NZBLL). NZBLL had on 1 July 2014 amalgamated with New Zealand Bloodstock Finance Limited (NZBLL becoming the amalgamated company). New Zealand Bloodstock Leasing Ltd then changed its name to NZBFLL on 2 July 2014.

### Purpose of the Arrangement

3. NZB Holdings established NZBFLL 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. New **Zealand Bloodstock Limited ("NZB") is contractually entitled to** provide 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 **NZBFLL's right to receive the lease payments.**

4. The customer is in the business of leasing bloodstock to breed and sell its progeny. This business does not involve the sale and disposal of leases.

### **Sourcing of the Bloodstock**

5. NZBFLL acquires bloodstock from third party owners, and then leases this bloodstock to the customer. Alternatively, the customer purchases the bloodstock from the third party owner, sells it to NZBFLL, and then leases the bloodstock from NZBFLL. This helps protect NZBFLL from involvement in any subsequent contractual claims regarding the purchase of the bloodstock from the third party owner. In both cases the transaction as a whole (e.g., sale and lease-back) is contemplated by the parties at the outset. In either case, the customer sources the bloodstock, drawing on bloodstock consulting, freight, and insurance services provided by NZB.
6. NZBFLL 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")**. The proceeds or sale of the already owned bloodstock are used for **further investment in the customer's bloodstock breeding business.**
7. 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:

#### **"BACKGROUND**

A. At the request of the Lessee and the Guarantor (if any), the Owner has purchased the Bloodstock in order to lease the Bloodstock to the Lessee and the lessee has agreed to take on lease the Bloodstock with the right to purchase the Bloodstock at the expiration of the lease and otherwise upon the terms and conditions in this Lease.

B. The Lessee has entered into this Lease for the purpose of obtaining breeding stock to use in the Lessee's business of breeding bloodstock for sale..."

### **Lease Particulars**

8. 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.
9. The customer will make payments (Lease Payments) for the lease of the bloodstock, in the amount(s) set out in the Lease.

### **Residual Value**

10. 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 being a pre-estimate of the value of the Bloodstock upon the expiry of this Lease.**

11. Under clause 8(b) of the Lease, the Residual Value is exclusive of GST:

(b) **Liability for residual Value:** You are liable to pay the Residual Value exclusive of GST and to pay all other monies owing to Us notwithstanding any changes in circumstances or changes to the Bloodstock or its condition during the term of this Lease.

### **Lease Termination Date**

12. **The lease termination date (“Expiry Date”) is the date on which the lease ends.** The customer may purchase the bloodstock on the Expiry Date for the Residual Value. If the customer does exercise their option to purchase the bloodstock NZBFLL 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 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.
- b) Any racing undertaken by the leased bloodstock is only incidental to the actual use of the bloodstock for breeding during the lease term.
- c) **The Lease Payments are genuine, arm’s-length amounts for the possession and use of the bloodstock.**
- d) **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.
- e) The bloodstock becomes the property of the customer only when the customer makes payment of the Residual Value after the Lease Termination Date.
- f) No consideration is paid for the option to purchase the bloodstock at the Lease Termination Date.

### **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 s DA 1(1) and none of the general limitations in s DA 2 apply, provided that:

- No provision in subparts DB to DZ applies to prevent a deduction in s DA 1(1); and
  - **The customer is a "New Zealand resident" (as defined in s YA 1).**
- b) At the end of an income year, unless excused from this requirement pursuant to a determination issued by the Commissioner, s 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 s EC 39 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 s EC 39 to EC 48 is the Residual Value stated in the Bloodstock Lease to Purchase 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.
- g) Sections FA 6 to FA 11B do not apply to the Arrangement.
- h) Section FA 12 does not apply to the Arrangement.
- 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 7 December 2017 and ending on 7 December 2022.

This Ruling is signed by me on the 23<sup>rd</sup> day of November 2017.

### **Howard Davis**

Director (Taxpayer Rulings)