

## **PRODUCT RULING – BR PRD 17/03**

---

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

### **Name of the Person who applied for the Ruling**

This Ruling has been applied for by Westpac New Zealand Limited (Westpac).

### **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 4, CC 7, EW 15, EW 31, GB 21, RE 1 to RE 6, RE 10, RF 2 to RF 4, RF 12, RF 12I and YA 1;
- (b) part VIB of the Stamp and Cheque Duties Act 1971.

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

The Arrangement is a mortgage offset arrangement pursuant to which Westpac customers can elect to use the balance of eligible Westpac transaction and savings accounts to offset against home loan accounts in order to reduce interest payable on those home loan accounts (Choices Offset Arrangement).

The Choices Offset Arrangement allows a customer to link several deposit accounts (known as Linked Deposit Accounts) to one of a variety of home loan accounts (known as a Choices Offset Loan), notionally offsetting the balances of the deposit accounts against the loan account balance. Interest is calculated on the loan account balance after the notional offset. Interest is not paid or payable on any Linked Deposit Accounts for as long as the account is linked to a Choices Offset Loan.

This Ruling does not consider the tax consequences of any arrangement under which a Linked Deposit Account holder agrees to offset their deposit account credit balance against another person's Choices Offset Loan account debit balance in return for valuable consideration (whether in monetary or non-monetary form).

Further details of the Arrangement are set out below.

### **Background**

1. The Choices Offset Arrangement is a "mortgage offset" arrangement. The customers who may participate are classified as either Restricted Entities or Non-

restricted Entities. Special rules apply to each of the two participant entities as discussed below.

2. The Choices Offset Arrangement allows Westpac customers to "link" up to 10 Linked Deposit Accounts to a single loan account such that the balances of the home loan and deposit account(s) will be notionally aggregated (thereby notionally reducing the debit balance of the loan) for the purposes of calculating the amount of interest that accrues on the loan. Westpac will pay no credit interest on the Linked Deposit Accounts during the period they are so linked, even where the deposit balances exceed the loan balance.
3. The Choices Offset Arrangement is not a separate loan product; it is an arrangement that can be used with an existing home loan product and deposit accounts. Further details of the Choices Offset Arrangement, particularly in relation to the eligible home loans and deposit accounts, interest calculations, interest rates, eligibility requirements of participants and relevant documentation are set out in the following paragraphs.

### ***Eligible home loans that can be offset***

4. Westpac offers its retail and business customers several loan products, including Choices Home Loans, which may have a fixed, floating or capped interest rate.
5. Westpac will determine from time to time which loan products may be included in a Choices Offset Arrangement (Qualifying Loans). Currently, only floating-rate Choices Home Loans may be included in the Choices Offset Arrangement. Other Choices Home Loan types (excluding the Choices Everyday Loan) may be added in due course.
6. Qualifying Loans will have a variety of repayment options, including table, non-table and interest only. A Qualifying Loan included in a Choices Offset Arrangement is referred to as a Choices Offset Loan.
7. The effect of offsetting is that interest will be payable on the lower notional principal balance of the Choice Offset Loan. In the case of:
  - a. a table loan, the term of the loan will be reduced;
  - b. a non-table loan, the interest payments will be reduced. Any interest savings will result in either a reduction of interest payments or (if any minimum periodical payments are maintained) a reduction in the term of the loan;
  - c. an interest-only loan, interest payments will be reduced.

### ***Eligible deposit accounts that can be offset***

8. Westpac also offers its customers a variety of deposit accounts, including transaction accounts and savings accounts. Westpac determines, from time to time, which of these accounts may be included in a Choices Offset Arrangement.
9. Deposit accounts are not required to be new deposit accounts opened for the purpose of the Arrangement. Further, no new deposit account types have been (or will be) created as part of the Choices Offset Arrangement.
10. To participate in the Choices Offset Arrangement, the deposit account (or accounts) must be linked to a Choices Offset Loan. As noted above, a deposit account that has been linked to a Choices Offset Loan pursuant to the Choices Offset Arrangement is referred to as a Linked Deposit Account.

11. Only one Qualifying Loan and up to 10 Linked Deposit Accounts may be included in a Choices Offset Arrangement.

### ***Offsetting features***

12. The key feature of the Choices Offset Arrangement is the "offsetting" of the aggregate credit balance of the Linked Deposit Account(s) against the debit balance of a Choices Offset Loan. This offsetting occurs before interest is calculated.
13. A net notional balance will be calculated for the Choices Offset Loan. Interest then accrues on that net notional balance only. This is the case as a matter of both contract (as set out in the terms and conditions applying to the Choices Offset Arrangement, which are discussed in more detail below) and as a matter of practice (in terms of Westpac's internal systems and accounting).
14. There are no actual transfers of funds, no set-offs or netting of funds, and no transfer of any interest in, or entitlement to, funds between the Choices Offset Loan account and Linked Deposit Account (or Accounts).
15. The effect of offsetting is that interest will be payable on the lower notional principal balance of the Choices Offset Loan.
16. Financially, the consequences for a customer of linking one or more deposit accounts and a Choices Offset Loan in a Choices Offset Arrangement are similar in terms of reduced interest costs that may arise from the use of Westpac's revolving home loan product (Choices Everyday Loan). Under the revolving home loan product, the balance on which interest is calculated is reduced, resulting in a reduced term of the loan for table mortgages and reduced periodic payments for non-table mortgages.

### ***Interest calculations under a Choices Offset Loan***

17. The balance on which interest accrues on any day under a Choices Offset Loan will be calculated by notionally reducing the debit balance of the Choices Offset Loan at the end of that day by an amount equal to the aggregate of the credit balances of each Linked Deposit Account at the end of that day.
18. If the aggregate of the credit balances of all Linked Deposit Accounts equals or exceeds the debit balance of the relevant Choices Offset Loan, no interest will accrue on the Choices Offset Loan.
19. No interest will accrue or be paid on the credit balance of a Linked Deposit Account for so long as it is linked to a Choices Offset Loan. This is the case irrespective of whether, on any given day, the aggregate of the credit balances of all Linked Deposit Accounts at the end of that day exceeds the debit balance of the Choices Offset Loan to which they are linked.
20. Interest will accrue on any Linked Deposit Account for any period that it is not linked to a Qualifying Loan. Clause 3 of the Offset Arrangement Agreement and Clause 2 of the Offset Arrangement Contributor Agreement make it clear that interest is suspended on Linked Deposit Accounts only for so long as they are linked to a Choices Offset Loan under those agreements.
21. Default interest will not be subject to the offsetting arrangement. It will continue to accrue in accordance with the standard terms and conditions that apply to any Choices Offset Loan.

## ***Interest rate***

22. The rate of interest applicable to a Choices Offset Loan will be a market rate that Westpac determines.

## ***Eligible persons and entities***

23. Under a Choices Offset Arrangement, deposit accounts held by the following persons may be linked to a Choices Offset Loan:
- a. the Borrower, that is, the person (or persons acting jointly) who has (have) taken out the Qualifying Loan to be included in the Choices Offset Arrangement;
  - b. in limited circumstances (as discussed below), persons other than the Borrower (known as a Contributor).
24. **The Offset Arrangement Agreement draws a distinction between "Restricted Entities" and "Non-Restricted Entities" for the purposes of determining what deposit accounts can be linked to a Choices Offset Loan.** These terms, and the consequences arising, are discussed below.

## ***Restricted Entities***

25. Where the Borrower is a Restricted Entity only the following deposit accounts may be linked to a Choices Offset Loan:
- a. A deposit account in respect of which the Borrower is the Account Holder; and
  - b. if the Borrower is party to this Agreement in its capacity as the trustee(s) of a trust or executor(s) of an estate, deposit accounts that are held by the Account Holder in its capacity as the trustee(s) of the same trust or executor(s) of the same estate.
26. A Restricted Entity is
- a. any body corporate or other person, including a body of persons acting jointly, other than a natural person or two natural person(s) jointly who are Partners; and
  - b. any person(s), including any natural person(s), who is/are acting in its/their capacity as the trustee(s) of a trust or executor(s) of an estate.
27. The effect of being a Restricted Entity is that only deposit accounts in respect of which the Borrower is the sole account holder can be linked to the Borrower's Choices Offset Loan.
28. In the case of a Borrower acting in its/their capacity as the trustee(s) of a trust or the executor(s) of an estate, deposit accounts held only by the Borrower in its/their capacity(ies) as the trustee(s) of the same trust or executor(s) of the same estate can be linked to its Choices Offset Loan.
29. By way of example, if ABC Limited has established a Choices Offset Arrangement in connection with its Qualifying Loan, deposit accounts held only by ABC Limited may be linked to that loan. Further, if ABC Limited is a party to the Choices Offset Loan as trustee of a trust, deposit accounts held only by ABC Limited in its capacity as trustee of the same trust may be linked to that loan.

## ***Non-Restricted Entities***

30. Where the Borrower is not a Restricted Entity, deposit accounts held either individually or jointly by the Borrower, their partner (spouse, civil union or de facto partner), any of their children (or a child together with his or her partner), or any of their parents (or a parent together with his or her partner) can be linked to the Borrower's Choices Offset Loan (on the condition that such persons are not themselves Restricted Entities). This can be done by:
- a. the Borrower where he or she (or they) can do so within the parameters of any linking rules determined by Westpac from time to time (which will require, among other things, that the Borrower has sufficient authority to operate the relevant deposit account);
  - b. the Borrower acting with the consent of the relevant Contributor, in circumstances where the linking rules determined by Westpac from time to time require the relevant Contributor's consent (which will be the case where the Borrower does not have sufficient authority to operate the relevant deposit account);
  - c. a Contributor, where the relevant deposit account is held by a Contributor and that Contributor has already provided consent in relation to another deposit account (and, therefore, has already signed up to the relevant terms and conditions under which the Borrower and the relevant Contributor agree that the Contributor may do so).
31. By way of example only, if Mr and Mrs Brown jointly establish a Choices Offset Loan:
- a. deposit accounts held by Mr and Mrs Brown jointly may be linked to that Choices Offset Loan;
  - b. subject to any further criteria set by Westpac from time to time, deposit accounts held by Mr Brown in his individual capacity may be linked to that Choices Offset Loan (most likely by Mr Brown himself);
  - c. subject to any further criteria set by Westpac from time to time, deposit accounts held by Mrs Brown's father may be linked to that Choices Offset Loan by:
    - i. Mr and Mrs Brown, as the Borrower, with the consent of Mrs Brown's father; or
    - ii. Mrs Brown's father, if Mrs Brown's father has already consented to another deposit account being linked to Mr and Mrs Brown's Choices Offset Loan;
  - d. deposit accounts held by Mr Brown's father or by Mr Brown's father and his de facto partner jointly may be linked to that Choices Offset Loan (in accordance with relevant linking criteria above); and
  - e. deposit accounts held by ABC Limited, or by Mr Brown in his capacity as a trustee, or any other Restricted Entity, cannot be linked to that Choices Offset Loan.

## **Offset Arrangement documentation**

32. The terms and conditions of the Choices Offset Arrangement are set out in the following documents provided to Inland Revenue on 29 March 2017:

- a. Choices Home Loan Summary (which forms part of the agreement pursuant to which Westpac advances home lending to a particular customer).
  - b. Choices Home Loan Terms & Conditions (which is a standard form master document that contains generic provisions applying to all Westpac loans of a particular type).
  - c. Offset Arrangement Agreement (being the principal agreement between the Choices Offset Loan customer and Westpac in relation to the Offset Arrangement).
  - d. Offset Arrangement Contributor Agreement (being the document that a Contributor signs in addition to Westpac and the Borrower to join an Offset Arrangement).
33. The Choices Offset Arrangement documentation will override certain of the terms and conditions that would otherwise apply to the relevant Qualifying Loan and Linked Deposit Accounts that are included in an Offset Arrangement.
34. In particular, the Choices Offset Arrangement Agreement sets out the interest calculation method to be used for the Choices Offset Loan, provides for no interest to accrue on Linked Deposit Accounts for as long as the account(s) are linked to a Choices Offset Loan, and sets out the eligibility criteria (in relation to loans, accounts and account holders).
35. Therefore, Westpac customers who wish to include a Qualifying Loan in a Choices Offset Arrangement would enter into the standard loan documentation applicable to the Qualifying Loan as well as the Choices Offset Arrangement documentation. A customer may not have a Choices Offset Arrangement without a Qualifying Loan.

### **Condition[s] stipulated by the Commissioner**

This Ruling is made subject to the following condition:

- a. All interest rates offered by Westpac in relation to an Offset Arrangement are at arm's length market rates.

### **How the Taxation Laws apply to the Arrangement**

Subject in all respects to any conditions stated above, the Taxation Laws apply to the Offset Arrangement as follows.

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

When, under the Choices Offset Arrangement, a credit balance of a Linked Deposit Account and a debit balance of a Choices Offset Loan account are offset, no amount of consideration is paid or payable by virtue of that offset for the purposes of calculating income or expenditure under ss EW 15 and EW 31 of the financial arrangements rules (as defined in s EW 1(2)). Therefore, offsetting does not, of itself, give rise to any income or expenditure under the financial arrangements rules. For the avoidance of doubt, fees payable by a Borrower to Westpac for the Choices Offset Arrangement constitute consideration for the purposes of the financial arrangements rules.

### **Withholding tax**

- There is no payment of, or entitlement to, interest (as defined in s YA 1) in relation to the credit balance(s) of Linked Deposit Account(s) in the Choices Offset Arrangement. Therefore, no holder of a Linked Deposit Account derives any interest income on such accounts for the purposes of s CC 4, and Westpac does not pay any interest and has no obligation to deduct resident withholding tax or non-resident withholding tax under the Act or pay approved issuer levy under part VIB of the Stamp and Cheque Duties Act 1971.
- The Choices Offset Arrangement is not an indirect associated funding arrangement as that term is defined in section RF 12I.

### **Section CC7**

- No income arises under s CC 7 for Westpac or its customers in relation to the Choices Offset Arrangement.

### **Tax avoidance**

- Sections BG 1 and GB 21 do not apply to the Choices Offset Arrangement.

### **The period or income year for which this Ruling applies**

This Ruling will apply for the period beginning on 1 April 2017 and ending on 31 March 2022.

This Ruling is signed by me on the 9<sup>th</sup> day of June 2017.



**Graham Poppelwell**

Investigations Manager, Investigation and Advice