I hereby give notice that an ordinary meeting of the Finance and Performance Committee will be held on:

**Date:** Tuesday, 20 November 2018  
**Time:** 9.30am  
**Meeting Room:** Reception Lounge  
**Venue:** Auckland Town Hall  
301-305 Queen Street  
Auckland

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**Komiti ā Pūtea, ā Mahi Hoki / Finance and Performance Committee**

**OPEN ADDENDUM AGENDA**

### MEMBERSHIP

<table>
<thead>
<tr>
<th>Chairperson</th>
<th>Cr Ross Clow</th>
</tr>
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<tr>
<td>Deputy Chairperson</td>
<td>Cr Desley Simpson, JP</td>
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<tr>
<td>Members</td>
<td>Cr Josephine Bartley</td>
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<td>Cr Dr Cathy Casey</td>
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<td>Deputy Mayor Cr Bill Cashmore</td>
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<td>Cr Fa’anana Efeso Collins</td>
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<td>Cr Linda Cooper, JP</td>
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<td>Cr Chris Darby</td>
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<td>Cr Alf Filipaina</td>
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<td>Cr Hon Christine Fletcher, QSO</td>
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<td>Mayor Hon Phil Goff, CNZM, JP</td>
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<td>Cr Richard Hills</td>
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<td>IMSB Member Terrence Hohneck</td>
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</table>

(Quorum 11 members)

**Sandra Gordon**  
Senior Governance Advisor

16 November 2018

Contact Telephone: (09) 890 8150  
Email: sandra.gordon@aucklandcouncil.govt.nz  
Website: www.aucklandcouncil.govt.nz

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**Note:** The reports contained within this agenda are for consideration and should not be construed as Council policy unless and until adopted. Should Members require further information relating to any reports, please contact the relevant manager, Chairperson or Deputy Chairperson.
<table>
<thead>
<tr>
<th>ITEM</th>
<th>TABLE OF CONTENTS</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>Transfers of land within the Council Group</td>
<td>5</td>
</tr>
</tbody>
</table>
Transfers of land within the Council Group

File No.: CP2018/21037

Te take mō te pūrongo / Purpose of the report

1. To provide advice on issues related to the ownership of waterfront land and related assets and the implications of any potential transfers of ownership within the council group.

Whakarāpopototanga matua / Executive summary

2. The legal ownership of waterfront land and related assets such as wharf structures, marinas, and investment properties currently sit with Panuku Development Auckland (a CCO) and Ports of Auckland (a Council Organisation or CO) rather than at parent (Auckland Council) level.

3. The issue of legal ownership is a separate issue to the management and operational use of the land. For example, roading assets are legally owned by Auckland Council but managed and accounted for by Auckland Transport.

4. The current ownership arrangements were put in place when Auckland Council was established in 2010 and have not been reviewed since. These landholdings are of high importance to the council for both financial and strategic reasons. These landholdings are intended to play a key role in council progressing key Auckland Plan 2050 outcomes in areas such as spatial development, planning, environmental management and stakeholder relationships.

5. Although not necessarily affecting day-to-day operations, direct legal ownership of these landholdings by the council parent would provide another layer of control over the medium to long-term use of these assets. On the other hand, direct ownership means that any long-term risks or obligations in respect of these landholdings also transfer to the council parent.

6. Tax law is changing on 1 July 2019. One implication of this change is that after 1 July any transfer of land holdings from subsidiaries to parent cannot be made without creating a substantial tax liability. While leaving the land holdings unchanged for the foreseeable future is certainly an option, if there is an appetite to transfer land to parent ownership for governance or strategic reasons, then this should be considered before the new tax laws come into effect.

7. Because these land holdings are strategic assets, a transfer of ownership from CCO or CO to the council parent can only be done via a Long-term Plan (LTP) amendment and using the Special Consultative Procedure. As an LTP amendment this process would require audit review and an audit opinion from the Auditor-General. To enable transfers to be executed before 1 July 2019, practically speaking any decision to undertake consultation on a proposal to transfer ownership would need to be made by the end of this calendar year.

8. The changing tax law is not a reason in and of itself to change legal ownership. Rather, if the council considers that there may be good governance or strategic benefits to hold these assets more centrally in the future, then acting now is important to enable land to be transferred before 30 June 2019 to keep the council’s long-term strategic options open.

Ngā tūtohunga / Recommendation/s

That the Finance and Performance Committee:

a) request that the boards of Panuku Development Auckland and Ports of Auckland consider the potential transfer of legal ownership of waterfront land and related assets to the council parent

b) request that staff include the respective positions of the Panuku Development Auckland and Ports of Auckland Boards in a final report back to council in December to enable a decision on whether to proceed to formal public consultation.
Horopaki / Context

9. The waterfront land in Auckland’s city centre has long been identified as an area of high strategic importance. In 2012, The Waterfront Plan defined a vision for the waterfront as “a world-class destination that excites the senses and celebrates our sea-loving Pacific culture and maritime history. It supports commercially successful and innovative businesses and is a place for all people, an area rich in character and activities that link people to the city and the sea.”

10. The legal ownership of waterfront land and related assets such as marinas, wharf structures and investment properties currently sit with Panuku Development Auckland (a CCO) and Ports of Auckland (a Council Organisation or CO) rather than parent (Auckland Council) level.

11. The issue of legal ownership is a separate issue to the management and operational use of the land. For example, roading assets are legally owned by Auckland Council but managed and accounted for by Auckland Transport. The current ownership arrangements were put in place through the establishment legislation when Auckland Council was formed in 2010 and have not been reviewed since. The legislation did not provide any simple mechanism to change ownership arrangements, so unless further legislative intervention is sought, any change to subsidiary structures or asset holdings initiated by Auckland Council would require a commercial transaction between legal entities in a similar way to the private sector.

12. Under these current arrangements, key decisions concerning waterfront and ports land are not made directly by elected members of Auckland Council. The accountability chain is provided by indirect measures such as:
   (a) Shareholder approvals of “major [financial] transactions” (Companies Act).
   (b) Council approval rights for strategic land / assets disposal (Significance and Engagement Policy, and the Substantive CCO Accountability Policy).
   (c) CCO / POAL board appointments and removals.
   (d) Statements of Intent (or in the case of POAL, Statements of Corporate Intent).

13. The specific assets that could potentially transfer are listed in the following table and are located within the area shown in the map below.

<table>
<thead>
<tr>
<th>Current legal owner</th>
<th>Asset</th>
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<tbody>
<tr>
<td>Panuku Development Auckland</td>
<td>Panuku waterfront land, including investment properties</td>
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<td></td>
<td>Panuku wharf structures</td>
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<td></td>
<td>Panuku water rights</td>
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<tr>
<td></td>
<td>Westhaven marina</td>
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<td></td>
<td>Other marina assets</td>
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<tr>
<td>Ports of Auckland</td>
<td>Ports of Auckland Land</td>
</tr>
<tr>
<td></td>
<td>Ports of Auckland Wharf Structures</td>
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<tr>
<td></td>
<td>Ports of Auckland water rights</td>
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Transfers of land within the Council Group
The Ports of Auckland land and wharf holdings have a current book valuation of $658 million and Panuku’s land, wharves, marina assets and investment properties have book values of $740 million.

Tātaritanga me ngā tohutohu / Analysis and advice

14. While a change of legal ownership within the group would not necessarily affect day-to-day operations and would not change the level of public ownership, it does present a range of implications which require careful consideration.

15. A transfer of legal ownership of Ports of Auckland land holdings would involve a lease arrangement between the council and Ports of Auckland to enable the port to continue its operations. A transfer of legal ownership of Panuku Development Auckland land holdings would involve a change in Panuku’s mandate to allow them to manage these assets on the council’s behalf.

16. The principal options here are to do nothing, transfer all of the assets referred to in this report, or to transfer only some of these assets.

Governance implications

17. The waterfront landholdings of Panuku and Ports of Auckland are of high importance to the council for both financial and strategic reasons. These landholdings are intended to play a key role in council progressing key Auckland Plan 2050 outcomes in areas such as spatial development, planning, environmental management and stakeholder relationships.

18. Although not necessarily affecting day-to-day operations, direct legal ownership of these landholdings by the council parent would provide another layer of control over the medium to long-term use of these assets. On the other hand, direct ownership means that any long-term risks or obligations in respect of these landholdings also transfer to the council parent.

19. Implementing the change would require engagement with and approval of the boards of Panuku and Ports of Auckland. Some minor consequential changes would also need to be made to CCO and CO accountability policies and documents, including statements of intent and corporate intent. For example, in the case of Panuku these documents should make it clear that their role in managing property development at the waterfront on council’s behalf would then become the same as their role in the other Panuku development areas. There would also need to be some changes to delegations to enable Panuku to carry out this role on council’s behalf.

20. For the purpose of preparing this report, council staff have engaged with the staff of Panuku and Ports of Auckland. Staff and advisers of both organisations have responded in an open and constructive manner. At the time of writing formal engagement with their boards has not yet occurred, although we understand that the board of Ports of Auckland are expected to discuss this matter at a meeting on 19 November.
21. The use of lease arrangements could lead to greater transparency and efficiency in the use of land, as the subsidiaries would have an incentive to only use land that they are willing to pay for.

**Tax implications**

22. Tax law is changing on 1 July 2019. One implication of this change is that after 1 July any transfer of land holdings from a CCO or CO to parent cannot be made without creating a substantial tax liability. While leaving the land holdings unchanged for the foreseeable future is certainly an option, if there is an appetite to transfer land to parent ownership for governance or strategic reasons, then this should be considered before the new tax laws come into effect.

23. Indicatively, if all the land holdings referred to in this report were transferred at the current book value of $1,398 million after 1 July 2019, then the potential tax liability would be 28% percent of this value or $391 million.

24. External tax advice on this matter has been obtained from PwC and is included as Attachment A. To provide certainty of the actual tax treatment that Inland Revenue will apply to any asset transfer, PwC recommend the council seeks a binding ruling from Inland Revenue before executing any transfer.

**Public consultation implications**

25. Because these land holdings are strategic assets, a transfer of ownership from CCO or CO to the council parent can only be done via an LTP amendment and using the Special Consultative Procedure. As an LTP amendment, this process would require audit review and an audit opinion from the Auditor-General. To enable transfers to be executed before 1 July 2019, practically speaking any decision to undertake consultation on a proposal to transfer ownership would need to be made by the end of this calendar year.

26. Once waterfront landholdings are transferred to the council parent, under the council’s current policies, the council could only make a decision on any further changes to ownership and control of these assets by way of another LTP amendment and using the Special Consultative Procedure. This provides for additional political and public scrutiny over any future proposals to change ownership or control of these strategic assets.

**Implementation implications**

27. Execution of a potential transfer of legal ownership would require significant work, including due diligence, transaction implementation, lease negotiations with Ports of Auckland and engagement with the boards of Panuku and Ports of Auckland.

28. The legal due diligence would need to review the title of each asset and identify any potential challenges to the proposal or any underlying land ownership issues. Financial due diligence would include working with an external tax adviser to seek a binding ruling from Inland Revenue.

29. While some work will be done in-house, external legal, tax, audit, accounting and valuation costs are likely to exceed $1 million if all of the assets discussed in this report were transferred.

30. Given the tight timelines, strong project management disciplines will need to be employed to meet the deadline and manage delivery risks.

**Financial and accounting implications**

31. Because any potential land transfers would occur within the council group, there should not be any material financial implications at an overall group level, aside from the transaction costs discussed above.
32. However, there would be a range of accounting issues to be worked through for each entity within the group. This would include a range of valuation and technical accounting issues, including working through the impact the lower asset values would have on the subsidiaries’ balance sheets.

**Ngā whakaaweawe ā-rohe me ngā tirohanga a te poari ā-rohe / Local impacts and local board views**

33. Despite any potential transaction being internal to the council group the Waitematā Local Board is likely to have views on the governance of these assets within their board area.

34. If a decision is made to proceed with consultation on ownership transfer, views of all local boards will be sought to inform final decision-making.

**Tauākī whakaaweawe Māori / Māori impact statement**

35. Despite any potential transaction being internal to the council group the nature of the assets involved will mean that local iwi groups have a particular focus on any decision.

36. If a decision is made to proceed with consultation on ownership transfer, engagement with relevant groups will take place alongside other consultation activities early in 2019.

**Ngā ritenga ā-pūtea / Financial implications**

37. The financial implications are addressed in the body of the report.

**Ngā raru tūpono / Risks**

38. The key risks are addressed in the body of the report. In general, transferring legal ownership of assets within the group will not materially change the risk profile of the group overall. It may however change the allocation of some risk between specific entities within the group.

39. Given the tight timelines, there are implementation risks that will need to be carefully managed. There is a risk that a favourable binding ruling is not received from Inland Revenue within the necessary timeframe. To some extent this can be mitigated through good ongoing dialogue with Inland Revenue throughout the process.

**Ngā koringa ā-muri / Next steps**

40. If the recommendations of this report are agreed, staff will engage through Panuku Development Auckland and Ports of Auckland executives to establish the positions of their respective boards. Staff will report in December 2018 on the positions of the boards and provide advice to support decisions on whether to proceed to formal public consultation.

**Ngā tāpirihanga / Attachments**

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<thead>
<tr>
<th>No.</th>
<th>Title</th>
<th>Page</th>
</tr>
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<tbody>
<tr>
<td>A</td>
<td>Ownership of Strategic Land Assets - PwC Tax Considerations Letter</td>
<td>11</td>
</tr>
</tbody>
</table>

**Ngā kaihaina / Signatories**

| Authors | Ross Tucker - Acting General Manager, Financial Strategy and Planning  
|         | Kevin Ramsay - General Manager Corporate Finance and Property  
|         | Bram VanMelle - Manager Property and Commercial  
|         | Hinewairere Warren - Project Manager  |
| Authoriser | Matthew Walker - Group Chief Financial Officer |
Ownership of strategic land holdings – tax considerations

Dear Francis,

As requested, we have considered the tax implications of the proposal to transfer the ownership of strategic land assets currently owned by Panuku Development Auckland Limited ("Panuku") and Ports of Auckland Limited ("POAL") to Auckland Council prior to 1 July 2019.

Based on the analysis set out in the appendices to this letter, it is our view that no tax should arise on the contemplated transfer of land, irrespective of the transfer mechanism employed. But, due to the impending tax law change and the amounts involved, we strongly recommend seeking a binding ruling from Inland Revenue to confirm this expected tax outcome prior to proceeding with any land transfer.

Further work is needed to determine the tax treatment of income derived by Auckland Council from transferred land. However, we are satisfied that there is no tax disadvantage with Auckland Council owning the land on a go-forward basis.

This letter and associated appendices should be read in conjunction with other relevant briefing documents addressing the key non-tax considerations and drivers of the proposed pre 1 July 2019 land transfers. Tax comments are based on the existing abridged group structure and relevant tax groupings as set out at Appendix 2, and on current tax legislation and information available at the time of drafting.

Yours sincerely,

Leigh Tomei
Partner

Brendan Catchpole
Partner
Appendix 1: Detailed analysis

Executive Summary

- Recent amendments to the Income Tax Act 2007, effective from 1 July 2019, will change the way that Auckland Council is taxed.

- From 1 July 2019, all dividends received by Auckland Council from all council controlled organisations and port companies (for ease of reference, both referred to as “CCOs” in this document) will once again be taxable. This has not been the case since 1 July 2014 with the formation of the Auckland Council consolidated income tax group (“ACCG”).

- This means that from 1 July 2019;
  - Unlike other corporate groups, income derived from land held by CCOs will be subject to tax at the CCO level, and then again at the Auckland Council level when it is distributed. This requires Watercare Services Limited (“Watercare”) to be effectively paid twice for tax losses covering the same income stream.
  - Income derived from land held by Auckland Council may not be subject to tax. Where it is subject to tax, as is currently the case, Watercare will only need to be paid once for tax losses.
  - The ways in which land can be transferred from a CCO to Auckland Council tax neutrally will be severely restricted. Any options which involve an actual or deemed dividend will have a substantial, and likely prohibitive, tax cost estimated to be c. $339m-391m².

- No tax should arise on the transfer of land from a CCO to Auckland Council prior to 1 July 2019, irrespective of the transfer mechanism. But, due to the impending tax law change and the quantum involved, we strongly recommend seeking a binding ruling from Inland Revenue to confirm this expected tax outcome prior to proceeding with any land transfer.

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1 New section 89(3)(d) Income Tax Act 2007 brings into tax dividends derived by a local authority from an entity referred to in section CW 10(3) Income Tax Act 2007, being both a CCO, and a port company (including a subsidiary of a port company) that would be a CCO in the absence of section 65(3) of the Local Government Act 2002.

2 Note that a lower tax cost on a transfer of land is driven by use of FGA imputation credits to impute an actual or deemed dividend. Where the imputation credits are used in this way, they will not be available for future “normal” distributions of profit to Auckland Council - essentially creating a deferral of the cost rather than an elimination i.e. $3.333m (total dividend) - $1.83m (imputed dividend) x $1.308m (unimputed dividend) x 28% (company tax rate) = $1.39m vs. $2.308m (total dividend) x 28% (company tax rate) = $391m
Further Detail

1. What is the current tax position?

- As a local authority, Auckland Council is generally exempt from income tax.\(^3\) The exception to this is where Auckland Council derives income from CCOs, port companies or PRCUs.\(^4\) Unless otherwise directed, income from these sources will be treated as taxable.\(^5\)

- POAL and Panuku are both liable to income tax on the same basis as any other corporate taxpayer (i.e. taxed on all taxable income).

- Auckland Council is a member of the ACCG along with a number of other Auckland Council group entities, including POAL and Panuku. A list of all current members of the ACCG has been included in Appendix 3. Watercare is not a member of the ACCG.

- The tax consolidation rules broadly provide that transactions between consolidated group members should be disregarded for income tax purposes. This is on the basis that members of a consolidated tax group are essentially treated as the same entity. As such CCO income derived by Auckland Council from a CCO within the ACCG (such as rents, dividends etc. from POAL and Panuku) is currently ignored for income tax purposes. This is despite the basic tax policy setting for local authorities which requires CCO income to be taxed (as noted above).

- Since its formation on 1 July 2014, the ACCG has generated net taxable income. This is mostly attributable to profits arising in POAL. This taxable income is offset by tax losses which are purchased by the ACCG from Watercare at a cost of 12.6\(^6\) cents in the dollar. Watercare has a significant tax losses balance (both historic and new) due to the nature of its activities. Whilst the tax losses of one group entity can be made available to another group entity at no cost, the tax loss sharing arrangement with Watercare is the result of extensive negotiation as to the value of those losses for both parties and the legal prohibition.\(^7\) Watercare paying any dividend to Auckland Council.

- No tax is paid directly to Inland Revenue by the ACCG, and so no imputation credits ("ICs") are generated.\(^8\)

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\(^{4}\) The terms "port operator" and PRCU have been explained further in Appendix 3.

\(^{5}\) Sections CW 39(a) & (j), Income Tax Act 2007.

\(^{6}\) Calculated by tax offsetting (at 18.8%) the agreement to pay 45 cents in the dollar for Watercare tax losses.


\(^{8}\) Section 57, Local Government (Auckland Council) Act 2009.

\(^{9}\) An overview of the imputation credit regime has been included in Appendix 5 for reference.
2. What has changed?

- The Taxation (Annual Rates for 2017-18, Employment and Investment Income and Remedial Matters) Act 2018 was enacted on 29 March 2018. This legislation included an amendment to the consolidated income tax group rules, as they apply to local authorities.

- Effective from the 2019/2020 income tax year, dividends from a CCO to a local authority within the same consolidated tax group will be taxable. This law change has been made to address the conflict between the local authority taxing provisions (which treat income derived by local authorities from CCOs as taxable) and the consolidated income tax group rules (which instruct taxpayers to ignore transactions between consolidated group members).

- At a practical level, this means that from 1 July 2019, Auckland Council will be subject to tax on the receipt of unimputed\(^{10}\) dividends from all CCOs, including those paid within the ACCG. This tax can be mitigated by Auckland Council where tax losses are purchased from Watercare, although there is a cost to this (as noted above).

- There is no practical likelihood that Watercare tax losses will be made available to the ACCG free of charge (or at a lower cost). As such, Watercare will need to effectively be paid twice by the ACCG to access tax losses—once at the CCO level to cover any taxable profits arising on CCO owned land, and once at the Auckland Council level to cover taxable distributions of these profits. We set out some illustrative numerical examples in Appendix 5 to demonstrate the differences between the current position and the post 1 July 2019 position.

- The ways that a transfer of land can be effected tax neutrally after 1 July 2019 will be severely restricted. Most mechanisms for transferring the land involve an actual or deemed dividend (equal to the fair market value of the land being transferred) from POAL and/or Panuku to Auckland Council. And, from 1 July 2019, Auckland Council will be subject to tax on receipt of such dividends.

- Based on the current market value of land held by POAL and Panuku, we understand that such a dividend is estimated to be $1.398bn\(^{11}\), translating to a tax cost of $859m\(^{12}\). Where ACCG is able to access Watercare tax losses to partially offset this taxable income, the cost for the ACCG should reduce but will still be sizeable (e.g. if sufficient tax losses existed to fully offset this income—which is not understood to be the case\(^{13}\) - the estimated cost to fully access these losses is $176m\(^{14}\)).

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\(^{10}\) Being distributions which have no imputation credits attached.

\(^{11}\) Calculated as the carrying amount at 30 June 2018 of PPE ($364m) and investment property ($444m) as per the Panuku Annual Report 2017-18, and the book value of Freehold Land ($342m) and Wharves ($315m) as per the Ports of Auckland Annual Report 2018.

\(^{12}\) $1.398bn (amount of the dividend) x 18% (company tax rate) = $859m

\(^{13}\) Watercare tax losses are stated as being $537m per the Watercare Annual Report for the year ended 30 June 2018.
We understand that POAL has c. $71.5m\textsuperscript{16} of ICs available. These ICs were generated by POAL prior to the current arrangement which sees POAL offset its taxable income by purchasing tax losses from Watercare. Whilst these ICs can be attached to any deemed or actual dividend arising on the transfer of land from POAL to Auckland Council. The available ICs can only impute a dividend of c. $19.5m\textsuperscript{16} and so are insufficient to fully eliminate the cost for the ACCG. Also, once these ICs are used, they cannot be used again to offset any other taxable distributions from POAL to Auckland Council. Since 2014, POAL has distributed between c. $42m - 55m of untaxed profits per year to Auckland Council. Where this trend continues, the cost "saved" by using the ICs on a transfer of land will only be incurred later on the payment of an unimputed dividend by POAL.

Any transfer mechanism after 1 July 2019 which does not involve either a deemed or actual dividend flow from POAL and/or Panuku to Auckland Council is likely to be challenged by Inland Revenue. If successful, Inland Revenue would be able to re-characterise the transaction to impose not only the original unpaid, but also to levy interest and 100% penalties.

Where land is transferred to Auckland Council, income derived by Auckland Council from that land (e.g. rent) may not be taxable going forwards. This is due to the broad income tax exemption afforded to local authorities and the existence of the ACCG (which, from 1 July 2019, continues to require all intra-group transactions to be disregarded other than CCO-local authority dividends).

In order to conclude on this, further work is required to consider:
- whether income from waterfront land represents income derived from a PRCU carried on by Auckland Council;
- whether the income is derived from a CCO; and
- whether the local authority taxing provisions or the consolidated income tax group rules take precedence.

Where this analysis supports the income as not being subject to tax, we recommend that this outcome is tested with Inland Revenue before being relied upon. Given the recent tax law change concerning dividends paid to a local authority within a consolidated income tax group, it is quite possible that Inland Revenue may also seek to address other similar anomalies through another (similar) law change; or seek to challenge the result.

\textsuperscript{14} $1.398\text{bn} \times 0.526 = $0.76\text{bn}$ (being the cost to access Watercare tax losses of 45 cents in the dollar, tax effected at 28%)

\textsuperscript{15} Note A3, Ports of Auckland Annual Report 2018.

\textsuperscript{16} For example, $71.5m (IC balance) \times 72/28 (imputation ratio) = $18.4m (dividend).
3. Inland Revenue view

- Inland Revenue are permitted to challenge and re-characterise arrangements which have a main purpose or effect of altering the incidence of tax in an advantageous manner\(^\text{17}\).

- There is a wide body of case law which has considered this power. The leading authority is the majority judgment of the Supreme Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*.\(^\text{18}\) In terms of *Ben Nevis*, whether the tax outcomes of a particular arrangement are appropriate will turn on whether the use of the specific taxing provisions is in line with how Parliament intended those rules to be used.

- The Inland Revenue (drawing heavily from the decision in *Ben Nevis*) has also identified\(^\text{19}\) a number of factors as being relevant for these purposes. They include:
  - the manner in which the arrangement is carried out;
  - the role of the relevant parties and their relationships;
  - the economic and commercial effect of documents and transactions;
  - the duration of the arrangement;
  - the nature and extent of the financial consequences;
  - the presence of artificiality, contrivance, pretence or circularity;
  - the presence of inflated expenditure or reduced levels of income, and
  - the undertaking of real risks by the parties.

- Where there are clear strategic and commercial reasons for transferring the land to Auckland Council, the tax neutrality of a pre-1 July 2019 land transfer prior to 1 July 2019 should be respected by Inland Revenue. However, given (i) Inland Revenue’s power to challenge, (ii) the recent tax law change (which brings into tax any post 1 July 2019 dividends received by local authorities from CCOs) and (iii) the quantum involved, we recommend seeking a binding ruling from Inland Revenue to confirm the expected tax outcomes prior to proceeding with a transaction.

- The binding ruling process involves a taxpayer preparing an application that sets out the facts of their arrangement/proposed arrangement, and their interpretation of how the law applies to that arrangement. Inland Revenue (generally led by Inland Revenue’s Office of the Chief Tax Counsel) consider whether they agree with the taxpayer’s interpretation of the law, and issue either a binding ruling (if they agree) or a contrary view letter (if they do not).

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\(^{17}\) Sections BG 1 and GA 1, Income Tax Act 2007.

\(^{18}\) *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115.

\(^{19}\) IS 15/04 “Tax avoidance and the interpretation of sections BG1 and GA 1 of the Income Tax Act 2007”
The ruling will be binding on the Commissioner, unless conditions or assumptions set out in the binding ruling are not satisfied, or if the facts of the actual arrangement entered into are materially different to those described in the binding ruling application. It is therefore of critical importance that the facts of the proposed arrangement are clearly articulated, and do not materially change after the ruling application has been lodged. If this is not the case, the arrangement will be open to challenge despite the binding ruling.

The timeframe for securing a binding ruling will generally depend on the complexity of the matter being considered. We recommend allowing at least three months from the date that the completed binding ruling application is lodged with Inland Revenue. It is possible that a shorter timeframe could be agreed if Inland Revenue appreciate that there is genuine urgency, but that is not guaranteed. Equally, if they determine that the issues are complex or numerous, the timeframe could range up to six months.

4. **What are the options?**

- Given the tax commentary set out above, please refer to Appendix 4 which compares and contrasts the key tax implications for (i) maintaining the existing structure, and (ii) transferring land.
Appendix 3: Auckland Council Consolidated Income Tax Group Members

- Auckland Council
- Auckland Transport
- Panuku Development Auckland Limited
- Ports of Auckland Limited
- Bunker Shipz Limited
- Seafuels Limited
- Waikato Freight Hub Limited
- Conlinxx Limited
- Nexus Logistics Limited
- Auckland Tourism, Events & Economic Development Limited
- Downtown Marinas Limited
- Westhaven Marina Limited
- Westhaven Marina (Unit Trusts)
## Appendix 4: Summary of Tax Implications

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<thead>
<tr>
<th>Item</th>
<th>Maintain existing structure (land remains in CCOs)</th>
<th>Transfer land to Auckland Council</th>
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<tbody>
<tr>
<td>Income from land use (e.g., rental income)</td>
<td>Subject to tax in CCOs (unless derived within the ACCG)</td>
<td>Subject to tax (in circumstances where it is derived from a PRCU or CCO – further consideration of the impact of POAL/Panuku being members of the ACCG is required)</td>
</tr>
<tr>
<td>Income from the sale of land</td>
<td>Subject to tax in CCOs (unless held on capital account or sold within the ACCG)</td>
<td>Tax exempt (unless sold to a non-ACCG CCO)</td>
</tr>
<tr>
<td>Use of Watercare tax losses</td>
<td>Tax losses required to offset the same income twice (once at the CCO level and once at the Auckland Council level as a taxable dividend)</td>
<td>Required once at Auckland Council level (if at all).</td>
</tr>
<tr>
<td>Dividends from CCOs</td>
<td>Taxable to Auckland Council</td>
<td>Taxable to Auckland Council, but the dividend amount may be lower (i.e., as income from land assets arises at the Auckland Council level, not the CCO level).</td>
</tr>
<tr>
<td>Transfer of land involving a deemed /actual dividend</td>
<td>N/A</td>
<td>Tax neutral, subject to confirmation from Inland Revenue (via a binding ruling application prior to transfer).</td>
</tr>
</tbody>
</table>
Appendix 5: Illustrative examples

The illustrative examples below assumes that the CCO entity is a taxable entity and member of the ACCG. It is also assumed that the CCO entity will not have sufficient imputation credits available to fully impute the dividend being paid. This is on the basis that generally speaking, CCO entities within the ACCG are able to pay tax losses to offset their taxable income, and so do not generate imputation credits.

(i) Current position

<table>
<thead>
<tr>
<th></th>
<th>Auckland Council:</th>
<th>($)</th>
<th>Cash paid</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Taxable dividend</td>
<td>nil</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax losses</td>
<td>N/A</td>
<td>nil</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>CCO entity:</th>
<th>($)</th>
<th>Cash paid</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Taxable income</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax losses</td>
<td>(100)</td>
<td>12.60</td>
</tr>
<tr>
<td></td>
<td>Available to distribute</td>
<td>87.40</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total cash paid to Watercare</td>
<td>$12.60</td>
<td></td>
</tr>
</tbody>
</table>

(ii) On/after 1 July 2019 – land remains in CCO

<table>
<thead>
<tr>
<th></th>
<th>Auckland Council:</th>
<th>($)</th>
<th>Cash paid</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Taxable dividend</td>
<td>87.40</td>
<td>$11.01</td>
</tr>
<tr>
<td></td>
<td>Tax losses</td>
<td>(87.40)</td>
<td>$11.01</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>CCO entity:</th>
<th>($)</th>
<th>Cash paid</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Taxable income</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax losses</td>
<td>(100)</td>
<td>12.60</td>
</tr>
<tr>
<td></td>
<td>Available to distribute</td>
<td>87.40</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total cash paid to Watercare</td>
<td>$23.61</td>
<td></td>
</tr>
</tbody>
</table>
(iii) **On/after 1 July 2019 – land transferred to Auckland Council & income from land taxable**

<table>
<thead>
<tr>
<th></th>
<th>Auckland Council</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income</td>
<td>($)</td>
<td>Cash paid</td>
</tr>
<tr>
<td>Taxable dividend</td>
<td>43.70</td>
<td></td>
</tr>
<tr>
<td>Tax losses</td>
<td>($93.70)</td>
<td>$11.81</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$93.70 @ 12.6 cents - Watercare</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>CCO entity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Rent expense</td>
<td>(50)</td>
<td></td>
</tr>
<tr>
<td>Taxable income</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Tax losses</td>
<td>(50)</td>
<td>$6.30</td>
</tr>
<tr>
<td>Available to distribute</td>
<td>43.70</td>
<td></td>
</tr>
</tbody>
</table>

**Total cash paid to Watercare** $18.11

(iv) **On/after 1 July 2019 – land transferred to Auckland Council & income from land not taxable**

<table>
<thead>
<tr>
<th></th>
<th>Auckland Council</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental income</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Taxable dividend</td>
<td>43.70</td>
<td></td>
</tr>
<tr>
<td>Tax losses</td>
<td>(43.70)</td>
<td>$5.51</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$43.70 @ 12.6 cents - Watercare</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>CCO entity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Rent expense</td>
<td>(50)</td>
<td></td>
</tr>
<tr>
<td>Taxable income</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Tax losses</td>
<td>(50)</td>
<td>$6.30</td>
</tr>
<tr>
<td>Available to distribute</td>
<td>43.70</td>
<td></td>
</tr>
</tbody>
</table>

**Total cash paid to Watercare** $11.81
Appendix 6

Imputation credits

The imputation credit regime operates to eliminate double taxation. A company generates imputation credits when it pays tax, and may attach these credits to dividends it pays to its shareholders. Fully imputed dividends are not taxable in the hands of the recipient (i.e. on the basis that the imputation credits attached show the amount has already been taxed in the underlying company.

Port operator, PRCU

The Port Companies Act 1988 defines a port operator as "any local authority which operates a port related commercial undertaking".

A port related commercial undertaking ("PRCU") is defined as "the property and rights of the Harbour Board that:

(i) relate to the activities of commercial ships and other commercial vessels, and commercial hovercraft and commercial aircraft, or to the operation of facilities on a commercial basis for ships, vessels, hovercraft, and aircraft of any kind; or

(ii) facilitate the shipping or un-shipping of goods or passengers."

This broad definition includes the provision of any building or facility wherever situated for use in connection with the handling, packing, or unpacking of goods for shipping or unshipping through any port.

Case law has established that there needs to be a real and substantial link with commercial shipping in order for an activity to be a PRCU. A tenuous/remote link is not sufficient.

Close proximity to shipping facilities coupled with a degree of port related use may be enough to create a PRCU; although a relatively minor association with a main focus elsewhere would not be.
Appendix 7: Glossary of terms

- ACCG  Auckland Council consolidated income tax group
- CCO  Council-controlled organisation
- IC  Imputation credit
- Panuku  Panuku Development Auckland Limited
- POAL  Ports of Auckland Limited
- Watercare  Watercare Services Limited