

PRODUCT RULING – BR PRD 19/01

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 Milldale Infrastructure LP.

Taxation Laws

Legislative references are to the Income Tax Act 2007 (ITA) and the Goods and Services Tax Act 1985 (GSTA).

This Ruling applies in respect of:

- Sections DA 1, DA 2, DB 6, DB 7, EW 3, EW 5, EW 14, EW 15, EW 29 and EW 31, and subpart RE of the ITA.
- Sections 8 and 10 of the GSTA.

The Arrangement to which this Ruling applies

The Arrangement is a funding arrangement that includes:

- the advancement of an amount by Milldale Infrastructure LP (the Applicant) to the Developer for the Bulk Infrastructure required for a proposed housing development in Milldale (the Developer Loan);
- **the satisfaction of the Developer's obligation to repay** part of the Developer Loan by registration of an encumbrance (the Final Encumbrance) over each subdivided section when title is issued; and
- the payment by future landowners of amounts (Infrastructure Payments) over the term of the Final Encumbrance.

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

Background

1. The Developer (and its associated companies) are, or will be, the registered proprietors of land in Milldale, Wainui, Auckland, which will be subdivided to deliver approximately 3,860 new build houses, apartments and commercial premises. As part of the development of that land, the Developer is responsible for building bulk infrastructure (including storm water, drinking water, waste water and roading) (Bulk Infrastructure). The Bulk Infrastructure will be owned, operated and maintained by the local Council or other appropriate entity.
2. The Arrangement relates to a portion of the overall funding of the Bulk Infrastructure, and involves the recovery of amounts from the Developer and future landowners of the subdivided sections (the Landowners) as repayment of the funding.

3. The relevant funding (the Developer Loan) was provided to the Developer by the Applicant on the terms and conditions set out in the Developer Project Agreement. The Developer is using the funding to assist the build of the Bulk Infrastructure required for the development. The Developer Loan is secured by way of a first ranking mortgage over all the land in the development (the Developer Mortgage).

The Final Encumbrance

4. As titles are issued in respect of the subdivided sections the Developer will be treated as having repaid part of the Developer Loan by registering an encumbrance against the title of each subdivided section (the Final Encumbrance). The Background to the Final Encumbrance states:
 - A. The Encumbrancee has helped fund bulk infrastructure projects (roading and wastewater) in the Wainui East area necessary to enable housing in the area to proceed including within the Milldale development.
 - B. A portion of the overall bulk infrastructure project costs are to be recovered from the benefiting land owners as the repayment of, and return on, funding that related to the construction of the bulk infrastructure projects referred to above.
 - C. As a condition of the Encumbrancee funding the bulk infrastructure projects described above the Encumbrancer or, from the time of sale, any subsequent purchaser of the Land is bound to pay the Infrastructure Payments to the Encumbrancee on the terms set out in this Encumbrance.
5. The Developer will sell the subdivided sections to third party purchasers (the Landowners). The titles will be transferred subject to the Final Encumbrance, such that the new Landowners will take on the obligation to make payments under the Final Encumbrance. No consideration will be paid for the transfer of the Final Encumbrance (clause 17 of the Final Encumbrance).
6. The Final Encumbrance requires the owner of each subdivided section (the Landowner) to make payments (Infrastructure Payments) to the Applicant over the term of the Final Encumbrance (30 years). Each Infrastructure Payment will fall due for payment in four equal quarterly instalments (clause 2 of the Final Encumbrance), on the same payment dates that apply for Auckland Council general rates. The payments under the Final Encumbrance will be made by Landowners to the Council as collection agent on behalf of the Applicant.
7. The full amount of Infrastructure Payments owing or that would become owing under a Final Encumbrance can be prepaid by a Landowner in a single lump sum payment (clause 7 of the Final Encumbrance). A Landowner is not entitled to make a partial prepayment of Infrastructure Payments (clause 8).
8. Once the final Infrastructure Payment has been made in relation to a specific section (and no arrears or enforcement costs are outstanding), the Applicant will remove the Final Encumbrance from the title.

Future sales of the sections

9. Any future sale of the subdivided sections will also be subject to the Final Encumbrance until all of the required payments have been made and the Final Encumbrance has been removed from the title. Any subsequent purchaser is also

a Landowner for the purposes of this Ruling. No consideration will be paid for the transfer of the Final Encumbrance to any subsequent purchaser of the land (clause 17 of the Final Encumbrance).

10. Where an Infrastructure Payment has accrued for a period but is not yet due on the date that a section is sold, the Vendor may pay an amount as 'outgoings' to the purchaser on settlement for their share of the Infrastructure Payment. Similarly, if the Vendor has prepaid an amount of Infrastructure Payment for a period, the purchaser may pay an amount of 'outgoings' to the Vendor for their share of the Infrastructure Payment for the period.
11. The following example demonstrates the apportionment referred to above:

Example

A GST registered Landowner owns a section with a Final Encumbrance attached. Infrastructure Payments are \$300 per quarter and are due for payment on the same payment dates that apply for quarterly payments of Auckland Council general rates, being:

- 31 August, for the period 1 July - 30 September
- 30 November, for the period 1 October - 31 December
- 28 February, for the period 1 January - 31 March
- 31 May, for the period 1 April - 30 June

The Landowner sells the property for \$500,000 plus GST, with settlement on 31 July. The Landowner has not paid the Infrastructure Payment for the period 1 July - 30 September.

On settlement, there will be an apportionment of the accrued but unpaid Infrastructure Payment on settlement date, calculated on a number of days basis:

$$31 \text{ days} / 92 \text{ days in the quarter} * \$300 = \$101.10$$

The 'outgoings' adjustment on settlement that the vendor will pay the purchaser for their apportioned share of the accrued but unpaid Infrastructure Payments will not be subject to GST.

The settlement statement on 31 July will include:

Purchase price as per Agreement for Sale and Purchase	\$500,000.00	Plus GST
Less: credit for vendor's proportion of Infrastructure Payments from 1 July to 31 July (31 days) at \$300 per quarter	(\$101.10)	GST exempt
GST (15% x \$500,000.00)	\$75,000.00	
Amount required to complete settlement as at 31 July	\$574,898.90	

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:

- a) This Ruling does not apply to:
- The Developer;

- Any Landowner who holds the property for private purposes and to whom the private limitation in s DA 2(2) applies;
- Any Landowner who holds the property for the purposes of deriving exempt income, and to whom the exempt income limitation in s DA 2(3) applies; or
- A non-resident, unless the Landowner carries on business through a “fixed establishment” (as defined in s YA 1) in New Zealand and the property is used as part of carrying on that business.

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:

ITA

- a) The Final Encumbrance is a “financial arrangement” under s EW 3 and not an “excepted financial arrangement” under s EW 5.
- b) For the purposes of ss EW 15(1) and EW 31(7), the only amounts that are “consideration” under the Final Encumbrance are:
 - The Infrastructure Payments (including any lump sum prepayment of the amounts owing); and
 - Any amount paid to or by the Landowner as an adjustment of the purchase price for the accrued or prepaid portion of the Infrastructure Payment when a section is purchased or sold.
- c) Provided that the Landowner applies *Determination S62* (which applies to allocate the consideration under the Final Encumbrance to an income year), the amounts allocated will be expenditure incurred by the person under s EW 14(3).
- d) Provided that the Landowner applies *Determination S62*, when the property is sold, or the final Infrastructure Payment is made, the Landowner will be required to calculate a base price adjustment (BPA) under s EW 29. The BPA calculation under s EW 31(5) must:
 - Add the aggregate of all Infrastructure Payments made over the period for which they held the property;
 - Add or subtract (as relevant) any adjustment made to the purchase price for the accrued or prepaid portion of the Infrastructure Payments when the property was purchased (the adjustments);
 - Add or subtract (as relevant) any adjustment made to the sale price for the accrued or prepaid portion of the Infrastructure Payments when the property was sold (the adjustments);
 - Subtract the aggregate of all Infrastructure Payments (plus or minus any adjustments) made over the period for which they held the property where a deduction was taken under subpart D.

The BPA amount will equal the total Infrastructure Payments made in the BPA year (plus or minus any adjustments) and will be a negative amount.

- e) Expenditure incurred by Landowners under the financial arrangements rules (including the amount determined under *Determination S62* and calculated under the BPA) will be deductible under ss DA 1 and DB 6 or DB 7, provided that no provision in subparts DB to DZ applies to deny a deduction. None of the general limitations in s DA 2 apply in respect of the expenditure.
- f) Provided that the Applicant holds a valid RWT exemption certificate under s RE 27, any Infrastructure Payment made by a Landowner under the Final Encumbrance (including any lump sum prepayment of the amount owing) will not be subject to resident withholding tax under subpart RE.

GSTA

- g) **Where a section is sold by a GST registered vendor as part of their “taxable activity” (as defined in s 6), the “value of the supply” (under s 10) is equal to the amount paid for the land as set out in the sale and purchase agreement for the property. The value under s 10 does not include any non-cash consideration for the transfer of the Final Encumbrance.**
- h) Infrastructure Payments made by a landowner under the Final Encumbrance (including any lump sum prepayment of the amount owing) will not be subject to GST under s 8.
- i) On the sale and purchase of property, where the Infrastructure Payment for the period is prepaid beyond the date of settlement of the transaction, the payment by the purchaser for their apportioned share of the prepaid Infrastructure Payments is not subject to GST under s 8.
- j) On the sale and purchase of property, where the Infrastructure Payment for the period is accrued but unpaid on the settlement date, the credit allowed by the vendor for their apportioned share of the accrued but unpaid Infrastructure Payments is not subject to GST under s 8.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 October 2018 and ending on 30 June 2056.

This Ruling is signed by me on the 7th day of March 2019.

Howard Davis
Director (Taxpayer Rulings)