Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

Release Document

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

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30 April 2018

Tax Working Group Secretariat
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Dear Sirs

Tax Working Group

I refer to your letter dated 21 March 2018 to the Chief Executive of Housing New Zealand Corporation, Andrew McKenzie. As Chief Financial Officer, I am responding on behalf of Housing New Zealand Corporation.

The Housing New Zealand Corporation Group consists of the following entities:

- Housing New Zealand Corporation
- Housing New Zealand Limited
- HLC (2017) Limited

All entities in the Group are subject to income tax, GST and all other entity specific taxes.

As a consequence, any changes made to the tax system will impact on the HNZC group of companies

Housing New Zealand fully supports the objectives the Tax Working Group (TWG) has been asked to consider for the New Zealand tax system, including a tax system that promotes long-term sustainability and productivity of the economy, and treats all income and assets in a fair, balanced and efficient matter.

Housing New Zealand Corporation is pleased to provide input into the “Future of Tax” review by the TWG. We agree that the tax system plays a vital part in supporting the wellbeing of all New Zealanders and it is important that it functions fairly, efficiently and is sustainable (both politically over time and in raising the required amount of revenue to fund government spending).

I make comments in relation to the flowing taxation matters raised in the Future of Tax Submissions Background Paper:

- The introduction of a Capital Gains Tax;
- The introduction of a Land Tax.

Further, I make comments on the following issue that impacts the HNZC Groups taxation liability which, I believe, should be reviewed by the TWG:

- Tax depreciation on residential investment buildings;
- Tax deduction for earthquake strengthening costs.

Introduction of a Capital Gains Tax

If an exemption from a capital gains tax is provided to owner occupier properties the actual tax base for a capital gains tax is significantly eroded.

If original cost is used as the base, increases of valuation from date of acquisition to date of sale are taxed, even though amounts will have been gained when a capital gains tax was not in effect for assets purchased before its introduction. A capital gains tax being imposed on such gains would be inappropriate.

Therefore, on the introduction of a capital gains tax all assets should be valued at the date of introduction. This valuation then becomes the base price for calculating the amount of gain to be taxed in the future, rather than original cost for assets purchased before its introduction. This will mean that it will be some years in the future before significant amounts will be raised from a capital gains tax.

Realisation basis for taxation
A version of a capital gains tax supports taxing gains on an accrual (i.e. unrealised) basis. This is to address the so-called "lock-in" effect, which incentivises deferral of capital gains that are taxed on realisation.

The taxing of capital gains on an accrual basis can have significant cash and financial implications as businesses may not have the cash available to pay the tax at the time of accruing a significant value improvement or payment of the tax is made out of working capital.

Conclusion
A capital gains tax should be calculated on a realisation basis.

It will take some time, if at all, for significant amounts to be collected from such a tax due to the valuation of assets on introduction setting the base price for calculating the gain, and the limited tax base due to the exclusion of owner occupied houses.

Introduction of Land Tax

A land tax is another suggested way of raising significant revenue. However, that assumes a universal land tax base, at low rates which will not be the case as owner occupied housing is excluded from any potential tax base.

New Zealand's previous experience with a land tax suffered from a narrow base. The most recent version, introduced in the early 1980s, was abolished in 1992 due to various exemptions resulting in the tax being considered uneconomic and inefficient.

As at 30 June 2017 the Housing New Zealand Corporation Group held $16.3bn of investment land assets. Without a specific exemption, a land tax imposed on investment land holdings would be a significant cost to the Group, which would need to be paid out of working capital.

Otherwise, a separate appropriation from Government to pay the tax would be required which would just add to the "NZ Inc money go round". This would appear to be an inefficient use of scarce resources.

Conclusion
The introduction of a land tax is not seen as a means of gathering significant tax due to the likely exemption of owner occupied properties and therefore a very restricted tax base.

Tax Depreciation on Investment Property

One tax distortion, which significantly impacts the HNZC Group is the 2010 removal of tax depreciation on investment residential and non-residential buildings. That change has resulted in real economic costs for the HNZC Group and other building owners, as there is no tax recognition for economic depreciation on buildings (unlike other business assets) or for the cost of required capital upgrades to buildings such as earthquake strengthening to prevent the possible loss of life.

The removal of tax depreciation has eroded the integrity of the tax system and it was not a tax policy that was been followed by other countries ion the OECD.

Conclusion
The TWG should reconsider the current tax policy setting of no tax depreciation for investment buildings.

Tax Deduction for Earthquake Strengthening Expenditure

Given the events of Christchurch in 2011/12, which tragically led to loss of life, and more recently the earthquakes in the Kaikoura/greater Wellington region, there has been a drive to upgrade (i.e. earthquake strengthen) buildings. Such strengthening has occurred in both residential investment properties as well as commercial buildings. The strengthening is needed to reduce the potential for injury and loss of life during earthquakes.

The ability to reflect these costs in rental returns is limited. This economic cost is exacerbated by the tax system either not allowing a direct deduction for such costs or allowing a deduction by way of depreciation of the buildings that have had the work undertaken on them.

The HNZC Group takes its obligations as landlords extremely seriously. No one wants to see injury or loss of life. The concern is that while there is a clear "social" good to earthquake strengthening the tax system penalises building owners from actively doing so. This is due to the absence of any tax recognition for the cost of building upgrades.

Conclusion
The TWG should consider the current tax policy setting of no tax deduction, by way of direct deduction or depreciation on buildings for earthquake strengthening costs.

Yours sincerely
Housing New Zealand Corporation

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Matthew Needham
Chief Financial Officer