Date: 29 January 2010 SH-13-5-3

THE TREASURY
Kaitohutohu Kaupapa Rawa

To: Mike Nutsford, Office of the Minister of Finance;
Ainslie Fenwick, Office of the Minister of Revenue

AIDE MEMOIRE: COSTING DENIAL OF BUILDING DEPRECIATION DEDUCTIONS

The Minister of Finance has asked officials to provide a preliminary costing of the fiscal impact of removal of depreciation deductions for buildings. Officials had earlier advised the Tax Working Group that removal of depreciation deductions for buildings may generate revenue of up to $1.3 billion per year.

There is a large amount of uncertainty in producing a revenue estimate for removal of building depreciation, given the lack of tax return information of the amount of building depreciation and depreciation recovery currently being claimed. The estimate has therefore been based on public information on the value of buildings in the economy generally and assumptions were made on the total tax book value of these (which will differ from the current market value), the total proportion of those that are being depreciated, and the tax rate and tax position of the owners (ie, owners that may be taxable or tax exempt or in tax loss, where the removal of building depreciation may not result in immediate revenue gains). We assumed all buildings other than residential are being depreciated and the tax rate used was 30%, the company tax rate. We assumed 28% of residential buildings are being depreciated, which is roughly the proportion of those being rented as opposed to owner-occupied.

We have reduced the revenue estimate from the $1.3 billion provided to the Tax Working Group primarily because we have changed the estimate of the total tax book values of buildings currently to a figure we consider more accurate. The new estimates are:

- Immediate removal of all building depreciation and no gain or loss on sale being taxable or deductible - $920 million per year, increasing in later years;
- Immediate removal of all building depreciation and loss on sale being deductible but gains on sale not being taxable - $650 million, decreasing in later years;
- Immediate removal of all building depreciation with gains taxable and losses deductible - $1.2 billion, increasing in later years (however, due to taxpayer manipulation risk we doubt if this revenue estimate would be achieved).

For the latter two estimates, we assume strong anti-manipulation rules would be applied. Even with anti-manipulation rules, we consider that with the last option, taxpayers may be able to structure their transaction so that losses are taxable but gains not, so in practice option 3 may produce the same revenue as option 2.

In the first year, revenues would be less due to part-year effects.

These estimates are uncertain and highly dependent on assumptions and could be revised later, however, this is our best estimate at this time.

If you have questions on the estimate, you should contact [deleted–privacy] at Treasury ([deleted – privacy]) or Carolyn Palmer at IRD ([deleted – privacy]).

Steve Mack, Principal Advisor, Tax Strategy, Treasury, [deleted – privacy]
Carolyn Palmer, Senior Policy Advisor, Policy Advice Division, IRD, [deleted – privacy]