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.

Inner City Wellington's Submission to the Tax Working Group

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1. Inner City Wellington's (ICW)[1] submission focuses on the need to provide relief for property owners who face significant seismic strengthening compliance costs imposed by the Government to achieve a public good outcome. Legislation changes applied retrospectively to achieve public good outcomes are 'shocks and surprises' to property owners that the tax system needs to take into account.[2]

What is the problem?

2. Property owners in Wellington (and across the country) are facing substantial costs for mandatory seismic strengthening.[3] This burden was initially imposed under the Building Act 2004, and then under the Building (Earthquake Prone Buildings) Amendment Act 2016. Public safety is the driver for the imposition of these costs, with the result that the cost of a public good is being borne by private owners.

3. For the majority of owners facing these costs, the imposition occurred after purchase so they had no choice about taking on that burden. Many owners have found that the analysis of the likely costs has been grossly erroneous and misleading and are faced with much higher costs than the Government and Parliament envisaged.

4. For the purpose of this submission, residential owners refers to owner-occupiers and commercial owners refers to all other private property owners.

Public safety outcomes v wellbeing and living standards of New Zealanders

5. The Living Standards Framework identifies four capital stocks that are crucial to intergenerational wellbeing: financial and physical capital, human capital, social capital and natural capital.

6. The costs of strengthening existing earthquake-prone buildings for public safety outcomes are being borne fully by the current owners, when the public safety benefits are spread over multiple generations of the public. The current owners bought buildings compliant with the codes at the time in good faith, but changing legislation and new methodologies and technologies for assessing compliance determines them to now be non-compliant. Central or local government owners facing mandatory seismic strengthening can incur debt and spread the burden over many generations of beneficiaries.

[1] Inner City Wellington advocates for residents, property owners, organisations and businesses in the inner city. The impacts of seismic strengthening has been a priority from the beginning in 2008. www.innercitywellington.nz
[2] Future of tax: submissions for background paper, p4.
[3] The costs include engineering reports (sometime multiple), geotechnical reports, detailed engineering plans, architectural fees, quantity surveyor fees, project management costs, legal fees, resource and building consent fees, scaffolding costs, GST for non-GST registered owners, make good costs, and displacement costs while the work is being done.

7. This is not possible for private owners who are spending all their savings or going into debt (often at later stages of their lives) for the benefit of future generations. This creates an inequity between owners facing the same compliance costs. Mandatory seismic strengthening costs are effectively a tax borne by the current private owners for a long-term public good.

8. Costs to strengthen earthquake-prone buildings can range from around $100,000 (if the owners are lucky) to $1.0 - $1.5m to $5m, $11m or the highest that we know about so far is around $25m. Owners have little real choice on how much to spend to strengthen the buildings. Their choice is based on the solutions that will address the structural weaknesses in the building and what percentage New Building Standard that will get them to. After that, comes the costs and affordability and whether the building as a whole or individual units are being over-capitalised.

Current tax treatment of seismic strengthening costs

9. IRD has argued that seismic strengthening costs are not maintenance as the building is 'improved' once the work is completed and any costs associated with the project are deemed to be capital costs.[4] Buildings with an Earthquake Prone Building Notice begin to lose value immediately the notice is issued – and continue to lose value until the strengthening is completed. Any 'improvement' in value is only to regain that lost value, if that occurs at all.

10. Feedback from body corporates going through the strengthening process is that additional work to 'add value' is required if there is to be any substantive improvement in the capital value of the building. Added value work could be replacing all the windows with double-glazed windows. This would add value, but adds substantive additional costs, which potentially puts the project beyond the reach of even more owners.

11. A different approach is required to the treatment of costs for mandatory seismic strengthening that recognises that commercial and residential owners are bearing the same costs. GST registered owners in a GST-registered body corporate can already claim GST paid on body corporate levies that include strengthening-related costs, which is not available to residential owners. This creates inequity between owners facing the same costs.

How other 'shocks and surprises' are treated

12. The previous government argued that the tax system must be kept simple and have used this as a reason to not consider any special tax treatment for owners facing mandatory seismic strengthening costs. But other sectors are provided with Government financial support when faced with shocks and surprises. Some examples include:

Driver for support	Form of assistance	Eligibility
Adverse effects affecting farmers	Income equalisation scheme (IRD)	All farmers in the area declared (eg, drought, flooding, disease, earthquakes, storms)
Weather-related events (flooding in Edgecumbe & Bay of Plenty)	Rural Assistance Payments and Rural Support Trust	Businesses in the affected area
Kaikoura Earthquake	Kaikoura Earthquake Relief	Farmers in affected area apply

[4] QB16/08 Income tax – deductability of the costs of obtaining a detailed seismic assessment of a building.

Driver for support	Form of assistance	Eligibility
	Fund ($12,000 to $50,000 per applicant)	to a panel
Kaikoura Earthquake	Primary Industries Earthquake Recovery Fund	Community groups, land owners and land managers in affected area
Weathertight homes caused by systemic regulatory failure	Financial Assistance Package & access to advisory service	Affected owners

Financial support available for owners facing mandatory seismic strengthening has primarily focused on heritage buildings and buildings in heritage areas:

Fund	Eligibility	Comment
National		
Heritage EQUIP	National heritage listing building Categories 1 and 2 once resource consents issued	Contributes towards investigation, planning and strengthening costs
Local – eg, Wellington[5]		
Built Heritage Incentive Fund	Any building on Wellington City Council heritage building list or building in a heritage area	Small contributions: Sept 2017: $2,150 - $50,000; but grants made for $400,000 for St Mary of the Angels, which received a total of $530,000
Building consent subsidy (since 2014)	Any earthquake-prone building after work completed, removed from Earthquake Prone Building List and received Code Compliance Certificate	10% of the cost up to a maximum of $5000. In 15/16 and 16/17 FYs approximately $11,000 for 20 buildings; an average of $566 per application.
Rates remission – once strengthened (since 2014)	Any earthquake-prone building once it has been removed from list and Code Compliance Certificate received. WCC reserves the right to determine valuation changes arising from seismic strengthening	Based on difference between pre-strengthened and completed values; 3 years for non-heritage; 5 years for heritage, 10 years for Heritage NZ Cat 1, 8 years for Heritage NZ Cat 2. Owners may need to pay for valuations to prove completed strengthening values.
Rates remission (since 2014)	While the building is unoccupied for strengthening and not capable of generating revenue.	Owners incur much higher costs associated with displacement of businesses or homes for many months. An example of the remission is $2,700 on rates of $22,250.
Rates rebate – building demolished	Earthquake-prone building that have been demolished	10% of rates payable for 3 years after demolition

[5]In two financial years only 27 buildings are receiving the rates remission following completed strengthening, and 20 buildings have received the building consent subsidy. ICW has requested data on the uptake of the building consent and rates remission measures since they were introduced.

What are the impacts being borne by private owners for a public good?

13. The variability of the costs of seismic strengthening is matched by the variability of financial circumstances of the owners. There are some commercial and residential owners who have the savings or the ability to service a loan, but it is still a significant financial impact on them through loss of funds and the accumulating interest.

14. Other owners are facing severe financial hardship. While it is mainly residential owners based on the feedback we have had, we know commercial owners are also impacted. The impact on commercial owners will increase as regional and provincial towns begin the process of identifying earthquake prone buildings.

15. Examples of the impact are:
    a. Using all their retirement savings when they are no longer in the workforce and are unable to recover it
    b. Having their retirement savings plan written off due to the costs of strengthening and/or inability to sell at a reasonable price
    c. Selling their units (often their homes at a loss (eg, land value only or less than what was paid for 10-15 years previously) either to remove themselves from stressful situations or knowing they will be forced to sell by the body corporate so the project can progress
    d. Credit servicing ability is diminished for commercial owners as the value of the building decreases and no economical strengthening option is available
    e. Not being able to raise a loan through retail channels due to lack of equity (as the value has dropped) or inability to service the loan (as no longer working)
    f. Not being able to sell their commercial or residential units at all as no one wants to incur the burden of strengthening.

16. We are beginning the process of collating data on actual costs being faced by affected owners.

17. Politicians wanting to keep the tax system simple cannot be justified when a small number of all property owners in New Zealand are funding public good outcomes for their local communities.

What is needed?

18. A system of rebates and transfers is required to provide financial recognition that commercial and residential private owners are funding a public safety outcome through mandatory seismic strengthening of existing buildings.

19. How it could work:
    a. Rebates for property owners who are earning income and paying taxes.
    b. Transfers for property owners who are not earning income. Government superannuation needs to be exempt as income as for many it is there only source of funding for living expenses.
    c. Set a maximum threshold for the rebate or transfer based on the owner's share of the project cost.
    d. Threshold be set at:
        - 33% of the owner's share. If donations to registered charities are eligible for a 33% rebate on tax, then private contributions toward public good outcomes should also be eligible for similar rebates.

- 18% for GST-registered owners owning commercial property or in GST-registered body corporates. These owners are able to claim the GST on their share of the strengthening costs or the body corporate strengthening project levies to ensure equity between the two categories of owners.

e. Eligibility based on evidence that property is on the earthquake prone building list held by the council (or MBIE national register when established)

f. Costs based on evidence provided by owner and/or body corporate of the full project costs for the mandatory seismic strengthening and the owners share. IRD reserves the right to access original documentation if needed.
    - Identifiable costs for 'added value components' will need to be kept separate from seismic strengthening costs. Based on feedback from some body corporate chairs, the construction industry does not readily split out 'added value component' costs from project management, resource consent, professional fee costs, scaffolding costs for the seismic strengthening. However, the majority of the costs (eg, construction and installation of double-glazing windows) will be readily identifiable and a small percentage could be added for the related wider project costs.

g. Owners can apply in the financial year that the costs were incurred.

h. Owners who have already completed the seismic strengthening work must be able to apply; they have still privately funded public good outcomes.

20. Yes, there is some administrative overhead with this. There undoubtedly was administrative overhead with the weathertight financial assistance package, and with the other financial support packages. Administration costs alone does not justify doing nothing. The Government has imposed the costs without completing a rigorous cost-benefit analysis and using erroneous costs in the process.

21. It is difficult to quantify the number of owners that will take up future tax relief as central government has not undertaken research on the number of owners of earthquake prone buildings or commercial units/apartments in earthquake prone buildings. Wellington City Council has consistently refused to do establish the number of owners, despite having the data and making one attempt to estimate in 2013. The government policy talks about 15 – 25,000 buildings, but the number of owners will be higher due to multi-owner buildings.

Concluding statement

22. Inner City Wellington raised the cost implication and downstream social impacts on owners at numerous Select Committees hearings and Wellington City Council committee meetings from the outset of this process. Politicians have known about the implications but have ignored it.

23. Government may consider mandatory seismic strengthening of earthquake prone buildings as a Wellington problem. While Wellington is facing it first, and is well into the 15 year timeframe for many buildings, it will begin to impact in the regions. At some point it will begin to hit in Auckland. For the regions it will mainly be commercial building owners that are affected. In Auckland and Dunedin there will also be significant numbers of residential owners.

24. The Tax Working Group is an opportunity to consider how 'shocks and surprises' are more fairly implemented to ensure that a few do not fund the public good for many. Inner City Wellington would appreciate the opportunity to talk with the Tax Working Group about the issues for owners facing mandatory seismic strengthening.

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