Regulatory Impact Assessments

Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill

14 March 2024

Included in this pack are the following Regulatory Impact Statements:

1. Reducing the bright-line period for taxing residential property
2. Reintroducing interest deductibility on residential investment property
3. Removing building depreciation
4. Disposals of trading stock at below market value
5. Online Casino Taxes

Regulatory Impact Statement: Reducing the bright-line period for taxing residential property

Coversheet

Purpose of Document	
Decision sought:	*Agree to repeal the current 10-year bright-line test, 5-year new-build bright-line test, and 5-year bright-line test, and replace them with a new 2-year bright-line test.*
Advising agencies:	*Inland Revenue*
Proposing Ministers:	*Minister of Finance* *Minister of Revenue*
Date finalised:	*8 December 2023*

Problem Definition
The Government's objective in repealing the current bright-line tests and replacing them with a new 2-year bright-line test is to reduce upward pressure on rents.

Executive Summary
The Government intends to repeal the current 10-year bright-line test, 5-year new-build bright-line test, and 5-year bright-line test, and replace them with a new 2-year bright-line test, with the intention of reducing upward pressure on rents. The bright-line test is one rule for determining whether the capital gains from the sale of property are taxable based on the time the property has been held. This is in addition to other rules that tax property sales, such as when property was acquired with the intent of disposing of it ("the intention test") and when property is disposed of as part of a business of trading/developing property. The bright-line test was originally introduced with a 2-year period and was intended to be a proxy for the intention test. Subsequent extensions have taken the bright-line period to 5 years and then 10 years, with a 5-year period still available for new-build land in the latter case (defined as land that has a self-contained residence or abode that received a Code Compliance Certificate on or after 27 March 2020). A shorter bright-line period makes residential property more attractive as an investment because fewer property sales, which would not otherwise be subject to tax, will be taxed under the bright-line rule. As investment in residential property becomes more attractive, this can incentivise housing construction. A greater supply of housing can reduce upward pressure on rents in the longer run with effects that get larger over time. Due to time constraints, two options are considered. **Option 1** is the status quo (a 10-year bright-line test, a 5-year bright-line test, and a 5-year new-build bright-line test). **Option 2** (the Government's proposal) is to replace the existing tests with a 2-year bright-line test, with the intention that properties acquired before 1 July 2022 are not taxable under any bright-line test.

Inland Revenue's recommended option is Option 2. The main reason is that a lengthy bright-line test such as 10 years is likely to be an inefficient way of collecting tax revenue. Taxes that generate a lot of behavioural changes while raising relatively small amounts of revenue tend to be very inefficient. If the bright-line test causes taxpayers to hold onto their properties for more than 10 years, the government will obtain no tax revenue from these people. In these cases, the tax is causing people to act in ways that can be undesirable (by holding onto a property longer than would be desirable in the absence of tax) while raising no revenue.

Option 2 will also assist with the Government's objective of putting downward pressure on rents because a smaller likelihood of gains being taxed is likely to incentivise landlords to invest in rental housing, which will, to some extent, encourage the building of dwellings and provision of rental housing.

A potential disadvantage of Option 2 is that it will mean a narrower capital income tax base because fewer gains will be taxed. However, we consider that a 10-year bright-line is unlikely to be an efficient way of taxing this capital income. If the government wanted to tax the income, it would be preferable to have a tax on these gains irrespective of when the assets were sold.

Views of stakeholders

The Treasury

The Treasury agrees that the current 10-year bright-line test likely has significant efficiency costs relative to the revenue raised, and that the arbitrary time boundary raises issues of fairness. However, the Treasury does not have a firm view on whether a 2-year bright-line test is preferable to the current 10-year test.

The Treasury recommends a 20-year bright-line test or longer. This would capture more capital gains, thereby improving the fairness of the tax system and supporting more sustainable house prices.

Treasury considers it unlikely that landlords will pass on the tax change through lower rents in the short run. Research by the Housing Technical Working Group, a cross-agency group of housing experts, found that the main drivers of rents over the past twenty years have been household income growth and the physical supply of rental housing relative to demand. The Treasury therefore expects that reducing the bright-line period would not significantly impact rents in the short run, as the stock of housing supply is fixed.

In the longer term, the change could result in some increase to rental housing supply, thereby putting downward pressure on rents. This will depend on the degree of flexibility in urban land supply and/or opportunities to intensify existing land. As a result, the impact of reducing the bright-line period in the long term will depend on future policy. Supporting the flexibility of urban land supply will make it more likely that reducing the bright-line period increases the supply of housing in the long run rather than primarily raising house prices.

Ministry of Housing and Urban Development - Te Tūāpapa Kura Kāinga

HUD agrees with Inland Revenue's assessment of the impact on supply, house prices, and rents. Based on research by the Housing Technical Working Group, a cross-agency group of housing experts, showing rents are primarily driven by household incomes and the relative supply and demand for housing, HUD believes the impact on rent prices in the short term will be negligible. In the long term, reinstatement should make rents under Option 2 less than under Option 1, with the magnitude of that contingent on any improvements to overall efficiency of urban land supply response.

General public

There was a wide range of views expressed when the bright-line test was introduced and then extended. There is both support and opposition for the bright-line test. For the current 10-year test, it has been noted that having a long bright-line period is a departure from the original policy motivation of being a proxy for the intention test, as it becomes more tenuous to argue that someone who sells a property they purchased 9 years ago had purchased with the intent of disposing of it. Contrary views note that a longer bright-line test helps to mitigate property speculation and purchasing only to make a capital gain.

Limitations and Constraints on Analysis

The key limitations and constraints applying to this analysis are as follows:

1. Single option analysis: Due to time constraints, and as the Government has already announced its intention to repeal the current bright-line tests and replace them with a new 2-year bright-line test, this analysis is focussed solely on the implementation of that option, rather than any other option to address the Government's objective to reduce upward pressure on rents.

2. Time constraints: Policy advice is being prepared within the timeframes required to progress decisions on this proposal in December 2023. Accordingly, this analysis has been prepared within tight time constraints.

3. Consultation: While views were previously expressed during the original development and various changes to the bright-line test, officials were not able to directly consult on the current proposal.

Responsible Manager(s) (completed by relevant manager)

Phil Whittington

Chief Economist

Policy and Regulatory Stewardship

Inland Revenue

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8 December 2023

Quality Assurance (completed by QA panel)

Reviewing Agency:	IRD
Panel Assessment & Comment:	The Quality Assurance reviewer at Inland Revenue has reviewed the regulatory impact statement (RIS) prepared by Inland Revenue. The reviewer considers that information and analysis summarised in the RIS *Reducing the bright-line period for taxing residential property* partially meets the quality assurance criteria. The proposal being considered by Cabinet supports a broader tax reform package developed in response to the *coalition*

	government of National, ACT and New Zealand First. As such, the options under consideration were limited to the status quo and introducing a 2-year bright-line test. Time constraints also applied to the policy development of the proposal and has not permitted consultation on the various options, or refinement of the preferred option.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

The rental market

1. Upward pressure on rents can be driven by many factors that influence the supply of rental properties. These factors may be related or unrelated to tax settings.

2. However, moving back to a 2-year bright-line test can reduce pressure on rents by encouraging the construction of dwellings and thus putting downward pressure on rents.

3. Rental affordability is a significant issue in New Zealand. Based on Household Economic Survey data for the year ended June 2022, a quarter of renting households were spending over 40% of their disposable income on housing costs, and rents have risen faster than mortgage payments. Renters also have higher rates of reporting housing issues like dampness, mould, and lack of heating.[1]

4. While rental affordability (measured by the ratio of changes in rent prices to changes in incomes) has been mostly constant over the past decade,[2] New Zealand has not fared favourably in international comparisons. The proportion of low-income households (the lowest income quintile) in New Zealand spending over 40% of their income on rent was the highest in the OECD in 2018 data at 61%.[3] The same analysis for households of all incomes finds New Zealand is also near the top of OECD countries for the proportion of renters spending over 40% of their income on housing costs (24%),[4] and for median spend on housing costs by renting households (28% of household income).[5] The latter measure of median spend increases to 41% for low-income households.[6]

The bright-line test

5. The bright-line test was originally introduced in 2015 to improve compliance with the land sale rules in the Income Tax Act 2007 by supplementing the intention test.[7] Under the intention test, gains from the sale of land purchased with a purpose or intention of disposal are taxable. However, this test can be difficult to enforce because there can be difficulties determining a taxpayer's purpose or intention in relation to land. The difficulties meant that some land speculators were not paying tax on gains from property sales in instances where they should have been paying tax.

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[1] https://www.stats.govt.nz/news/housing-affordability-more-challenging-for-renters-than-homeowners/

[2] https://www.hud.govt.nz/assets/Uploads/Documents/Methods-Nov-2022.pdf

[3] International comparisons of housing affordability for renters and owners, p. 18.

[4] International comparisons of housing affordability for renters and owners, p. 20

[5] International comparisons of housing affordability for renters and owners, p. 22.

[6] International comparisons of housing affordability for renters and owners, p. 23

[7] The regulatory impact statements published for the introduction of these rules, as well as the subsequent extensions of these rules, are available here (2015), here (2017), and here (2021).

6. The bright-line test originally applied to residential property that was acquired and disposed of within 2 years. The test was extended to acquisitions and disposals within 5 years in 2018, with the objective of ensuring that tax is paid on the gains from property speculation and to improve housing affordability for owner-occupiers by reducing demand from speculators.

7. The test was extended again in 2021 to apply to acquisitions and disposals within 10 years (or 5 years for new builds). This extension was intended to reduce investor demand for property. This would reduce the amounts investors were prepared to pay for houses and the number of houses they would buy, thereby supporting first-home buyers and helping lift New Zealand's home ownership rates.

8. The Government is concerned that the current 10-year bright-line test treats a very wide group of investment property owners as property speculators. In addition, the Government is concerned that the current bright-line tests place upward pressure on rents. This can happen in the longer run, by reducing the supply of dwellings.

9. The Income Tax Act 2007 contains other provisions that impose income tax on property transactions. However, it continues to be the case the that the key provision taxing gains from speculation (the intention test) is difficult to enforce. As a result, if there is no bright-line test, it is likely many people who have gains from the sale of land that should be subject to tax under the intention test will fail to comply.

What is the policy problem or opportunity?

10. While the gains on any residential investment property purchased with the intention to sell are taxable, the subjective nature of determining investors' intention makes this difficult to enforce. Therefore, there are good policy reasons to continue to have a bright-line test to provide more clarity to the taxation of gains from residential property sales.

11. However, the longer 10-year bright-line period gives rise to a large "lock-in" effect, where investors are incentivised to hold onto property until the bright-line period has expired to avoid tax liability. This can be an inefficient way of raising revenue. In addition, this can reduce the stock of dwellings over time (relative to what the stock would have been without this lengthy bright-line test). This can put upward pressure on rents.

What objectives are sought in relation to the policy problem?

12. The Government's objective in repealing the current bright-line tests and replacing them with a new 2-year bright-line test is to reduce upward pressure on rents.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

13. The likely impact of the options will be assessed against the status quo under the Government's objective of reducing upward pressure on rents and improving housing affordability in the rental market. The impact on housing affordability and home ownership is also considered, given those outcomes were a motivation for the status quo bright-line test.

14. The options will also be evaluated against the traditional tax policy criteria of efficiency, equity, integrity, fiscal impact, compliance and administration costs, and coherence. These are described below.

    a. **Efficiency:** Taxes should be, to the extent possible, efficient and minimise (as much as possible) impediments to economic growth. That is, the tax system should avoid unnecessarily distorting the use of resources (e.g., causing biases toward one form of investment versus another) and imposing heavy costs on individuals and firms.

    b. **Equity:** The tax system should promote fairness. The burden of taxes differs across individuals and businesses depending on which bases and rates are adopted. Assessment of both vertical equity (the appropriate treatment of those on different income levels or in different circumstances) and horizontal equity (the consistent treatment of those at similar income levels, or similar circumstances) is important.

    c. **Revenue integrity:** The tax system should be sustainable over time and minimise opportunities for tax avoidance and arbitrage.

    d. **Fiscal impact:** Tax reforms need to be affordable given fiscal constraints, and the system must raise sufficient revenue to support the Government's fiscal strategy.

    e. **Compliance and administration costs:** The tax system should be as simple and low cost as possible for taxpayers to comply with and for Inland Revenue to administer.

    f. **Coherence:** Individual reform options should make sense in the context of the entire tax system. While a particular measure may seem sensible when viewed in isolation, implementing the proposal may not be desirable given the tax system as a whole.

What scope will options be considered within?

15. The Government has already announced its intention to repeal the current bright-line tests and replace them with a new 2-year bright-line test.

16. Ministers have directed officials to provide advice on this policy within the timeframes required for decisions in December 2023. Therefore, the scope of feasible options is

limited. Officials are progressing this advice on the basis of the commitment made in National's Back Pocket Boost, as the coalition agreements are silent on changes to the bright-line test. This is for the bright-line proposal to take effect from July 2024 so that properties acquired before July 2022 will not be subject to taxation under the bright-line test.

Limitations on consultation

17. Formal stakeholder engagement following the Generic Tax Policy Process has not been possible in the time allowed for preparation of this advice. The risks of a lack of formal consultation include the potential for unintended consequences arising from the policy change. Consultation also enables a more rigorous understanding of trade-offs when making policy changes. This is pertinent for a proposal like reducing the bright-line test, which could have impacts on the rental property market and the housing system more generally with respect to prices, rents, and the supply of housing. Because the bright-line test has been subject to several changes since introduction, its impacts on the housing system, as well as the mechanics of the changes and how the proposal will work, have been discussed and submitted on previously.

18. The absence of consultation for the current proposal means that officials have not been able to establish whether issues raised in previous submissions are just as relevant to the current proposal. For example, no formal consultation has occurred to determine whether stakeholders consider moderating growth in house prices is as much of a priority for the current proposal compared to when previous bright-line changes were being considered. This is an important point when considering that the current proposal has a different motivation to that of the status quo. This is reflective of trade-offs, for which consultation would ideally occur to help improve understanding of the relevant issues.

19. One issue in particular that may be affected by a lack of consultation is the 1 July 2024 implementation date. This is out of sync with the tax year and has implications for property owners in trying to understand how the rules apply to them part-way through the year. This will be mitigated through taxpayer guidance and website updates to ensure the timing of the change is well signalled.

What options are being considered?

Option 1: Retain the status quo

20. Option 1 is to retain the status quo. Under current law, a 5-year bright-line test applies for properties acquired on or after 29 March 2018 and before 27 March 2021. A 10-year bright-line test applies for properties acquired on or after 27 March 2021, except for new-build land, for which a 5-year bright-line test applies.

21. Option 1 addresses concerns around property speculation by dampening demand. In addition, it ensures that speculators are taxed on gains from the sale of residential investment land. Due to the length of the 10-year period, it is likely to result in significant lock-in effects and may, in the longer run, place upward pressure on rents.

Option 2 – Introduce a new 2-year bright-line test

22. Option 2 is to repeal the current bright-line tests and introduce a new 2-year bright-line test. This test would tax properties sold after the application date, provided they were acquired within 2 years of the date of sale.

23. Option 2 will address the Government’s concerns that a very wide group of investment property owners are being treated as property speculators.

24. Option 2 will also continue to address concerns around property speculation by providing a clear rule under which gains from property speculation will be taxed. At the same time, it will support two of the other objectives of the original 2-year test. These were to minimise the number of sales made taxable that were acquired without an intention of resale, and to minimise costs to taxpayers in complying with the bright-line test.

Options analysis

25. Option 2 is assessed relative to Option 1 (the status quo) against the Government’s objective of reducing upward pressure on rents as well as the criteria listed above.

26. **Reducing upward pressure on rents and impact on home ownership:** Option 2 will mean that beyond a 2-year period, residential investment property owners will not be subject to the bright-line test. This will reduce the total taxes they pay if they end up needing to sell a property within the 2–10 year period. This can incentivise new construction, which would put downward pressure on rents in the longer run. This would help renters.

27. A shorter bright-line period decreases the tax cost of investing in residential property. An increase in demand for purchasing such property could then put upward pressure on property prices compared to the status quo. This would be detrimental to first-home buyers. The impact on home ownership rates cannot be quantified.

28. **Efficiency:** The change is likely to have limited effects on economic growth but a significant effect on other aspects of economic efficiency.

29. The key potential efficiency advantage of taxing gains generated by investors in residential property is that the gain is a form of economic income. Not taxing these gains when other forms of income are taxed can reduce the efficiency of the tax system. This is a possible reason for preferring Option 1 relative to Option 2.

30. However, we consider that this is a very weak argument for preferring Option 1. It is a reason for taxing gains irrespective of how long an investment property is held. It is not a good argument for taxing gains only if a property is sold within 10 years of acquisition.

31. The original 2-year bright-line test had a clear rationale. This was to tax gains when it was very likely that the gains should have been taxed under the intention test. The 2-year bright-line test did this without the difficulties and economic costs of applying the intention test while at the same time minimising the number of sales that were taxed without an intention of resale. This rationale cannot be reasonably said to apply for a 10-year bright-line test.

32. Taxing gains only if investment property is sold within 10 years can be a very inefficient way of taxing gains on investment property. This is because if a property appreciates significantly in the first few years it is owned, there can be a large incentive for the owner to hold the property for at least 10 years so that gains are not taxed.

33. These "lock-in" effects constitute deadweight costs that decrease economic efficiency, as residential property owners may hold rentals for longer than they otherwise would if not for the bright-line test. Option 2 decreases some of the inefficiencies associated with lock-in.

34. The compounding effect of capital gains for a property owner who is "locked" into holding the property for 10 years creates a proportionately large distortion compared to a property owner who is locked in for 2 years where capital gains have less time to accrue.

35. In many cases, it will also be likely that the gains accrued during a 2-year lock-in period would have been taxable under the intention test anyway, which decreases the economic distortions the bright-line test creates when considered in conjunction with existing taxing provisions. Conversely, the gains accrued during a 10-year lock-in period are less likely to have been taxable under the intention test, leading to larger inefficiencies.

36. Taxes that are easy to step around are inefficient. They can produce behavioural changes while generating very little revenue. It is inefficient to provide an incentive for a taxpayer who wishes to sell a property after 5 years to hold onto the property for an additional 5 years. This has a large efficiency cost per dollar of revenue raised when many properties are held for more than 10 years and no revenue is gained on these properties.

37. Overall, there are significant efficiency gains achieved by reducing the bright-line period, and this is a strong reason to prefer Option 2.

38. **Equity:** One possible fairness disadvantage of Option 2 relative to Option 1 is that it taxes less capital income. People are normally taxed on their income and exempting capital gains can be criticised as horizontally inequitable. It favours those who earn income as capital gains over those who are earning most other forms of income. If those who earn this sort of income tend to be better off, this can also be criticised on vertical equity grounds if this undermines a government's tax progressivity goals.

39. However, once again this provides very weak fairness grounds for taxing gains on residential investment properties if these properties are sold within 10 years of acquisition but not if they are held for a longer period. It also provides weak fairness grounds for taxing gains on residential investment property when other gains are not being taxed.

40. By contrast, there is a good fairness ground for the original 2-year bright-line test. This is that most sales within this short period will have been in cases where the intention test should have applied and the income should have been taxed under general income tax principles.

41. **Revenue integrity:** Revenue integrity may decline under Option 2 as it is possible that properties held for more than 2 years that should have been caught by the intention

test may no longer have tax paid on sale. At the same time, it minimises the number of cases where the tax will apply even though the gains should not have been caught by the intention test.

42. **Fiscal impact:** The expected fiscal cost of Option 2 over the forecast period (to 2027/28) is estimated to be approximately $202 million.

43. **Compliance and administration costs**: A reduced bright-line test will capture fewer property transactions and affect fewer people, which reduces compliance costs. The complexity that exists in the current bright-line settings could also be reduced to further lessen compliance costs. Changing the bright-line test will create some initial administrative work such as providing guidance and education campaigns.

44. **Coherence:** There appears to be little policy rationale for taxing gains on investment properties only if the properties are sold within 10 years. By contrast there is a policy rationale for a 2-year bright-line test, being that it ensures gains are taxed when they should have been taxable under the intention test. Thus, Option 2 appears superior to Option 1 on grounds of coherence.

Treasury assessment of the options

45. The Treasury agrees that the current 10-year bright-line test likely has significant efficiency costs relative to the revenue raised, and that the arbitrary time boundary raises issues of fairness. However, the Treasury does not have a firm view on whether a 2-year bright-line test is preferable to the current 10-year test.

46. The Treasury recommends a 20-year bright-line test or longer. This would capture more capital gains, thereby improving the fairness of the tax system and supporting more sustainable house prices.

47. In the short and medium term, the bulk of the impact from reducing the bright-line test to 2 years is likely to be reflected in house prices, with minimal impacts on rents. House price impacts are highly uncertain and will depend on the timing of reducing the bright-line period. The Treasury will analyse these potential impacts further and may adjust our house price forecasts to reflect them as part of the *Budget Economic and Fiscal Update*.

48. In the long run, tax changes could also impact the supply of housing by incentivising new construction, and could therefore have more significant impacts on rents. The long-run incidence on house prices and rents will depend on the flexibility of urban land supply and the availability of opportunities to intensify existing urban land:

    a. low flexibility of urban land supply and limited opportunities to intensify mean the policy will primarily raise house prices in the long run.
    b. high flexibility of urban land supply and significant opportunities to intensify mean the policy will primarily reduce rents in the long run.

49. Research by the Housing Technical Working Group, a cross-agency group of housing experts, suggests that rents are primarily driven by household incomes and the relative supply and demand for rental housing. The Treasury therefore expects that reducing the bright-line test to 2 years would not significantly impact rents in the short run, as the stock of housing supply is fixed.

50. The Treasury's assessment of the evidence is that urban land supply has been highly restrictive over the last two decades, as demonstrated by the gradual fall in interest rates pushing up house prices rather than pushing down rents.

51. Recent policy changes (such as the Auckland Unitary Plan) appear to have improved the responsiveness of supply for higher-density housing. However, without further changes, housing supply may continue to be unresponsive to demand in the long term.

52. As a result, the impact of reducing the bright-line period in the long term will depend on future policy. Supporting the flexibility of urban land supply will make it more likely that reducing the bright-line period increases the supply of housing in the long run rather than primarily raising house prices.

Ministry of Housing and Urban Development – Te Tūāpapa Kura Kāinga assessment of the options

53. HUD agrees with Inland Revenue's assessment of the impact on supply, house prices, and rents. Based on research by the Housing Technical Working Group, a cross-agency group of housing experts, showing rents are primarily driven by household incomes and the relative supply and demand for housing, HUD believes the impact on rent prices in the short term will be negligible. In the long term, reinstatement should make rents under Option 2 less than under Option 1, with the magnitude of that contingent on any improvements to overall efficiency of urban land supply response.

How do the options compare to the status quo/counterfactual?

	Option 1 *Status quo*	Option 2 *2-year bright-line test*
Reducing upward pressure on rents	0	+
Efficiency	0	++
Equity	0	0
Revenue integrity	0	0
Fiscal impact	0	--
Compliance and administration cost	0	+
Coherence	0	+
Overall assessment	0	+

Example key for qualitative judgements:

++ much better than doing nothing/the status quo/counterfactual

\+ better than doing nothing/the status quo/counterfactual

0 about the same as doing nothing/the status quo/counterfactual

\- worse than doing nothing/the status quo/counterfactual

\- - much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

54. Inland Revenue considers that Option 2 is preferable to Option 1. In particular, the positive effects on efficiency and on reducing upward pressure on rents are strong reasons to prefer Option 2.

55. Overall, reducing the bright-line period for taxing residential property is most likely to meet the Government's objective of reducing upward pressure on rents. Residential property investment will become more attractive, which may increase rental supply in the long-run.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Other interested parties – first-home buyers	Moving back to a 2-year bright-line test is likely to put some upward pressure on property prices.	House price impacts are highly uncertain and will depend on the timing of reducing the bright-line period. The Treasury will analyse these potential impacts further and may adjust house price forecasts to reflect them as part of the *Budget Economic and Fiscal Update*.	Low
Regulators – wider government	Decreased revenue would be collected from moving to a 2-year bright-line test.	The expected fiscal cost is $202m over the five years to 2027/28.	Low
Total monetised costs		The expected fiscal cost is $202m over the five years to 2027/28.	Low
Non-monetised costs	We do not have confidence in our ability to provide a total non-monetised benefit.	Low	Low
Additional benefits of the preferred option compared to taking no action			
Regulated groups – residential property investors	Moving to a 2-year bright-line will reduce tax payments on residential property owners in the first instance.	The reduced tax payments are estimated to be $202m over the 5 years to 2027/28.	Low
Others interested parties – renters	Over time, additional supply of rental housing will tend to put downward pressure on rents.	It is not possible in the time available to attempt to quantify this impact.	Low
Non-monetised benefits	We do not have confidence in our ability to provide a non-monetised benefit.	Low	Low

Section 3: Delivering an option

How will the new arrangements be implemented?

56. This change will give rise to minimal system changes, and tax return processes will remain the same. Changes required will include updating all taxpayer guidance, websites, and calculators.

57. It is currently proposed that the changes will apply to disposals of residential land after 1 July 2024. There is a potential for confusion resulting in errors by taxpayers and significant software challenges for accounting software suppliers, arising from an application date that does not align with the ordinary tax year (1 April to 31 March). This could be mitigated by applying the proposals from 1 April 2024, which would be Inland Revenue's preference.

How will the new arrangements be monitored, evaluated, and reviewed?

58. Inland Revenue currently has processes in place to monitor all New Zealand property transactions and to identify possible bright-line transactions and notify taxpayers. Inland Revenue may request transactors in property to update transaction details accordingly in myIR. None of these processes are expected to change as a result of the proposal.

59. Where non-compliance is identified, there are process for reminders, compliance visits and audits (where necessary). These processes will continue for any amended bright-line test.

Regulatory Impact Statement: Reintroducing interest deductibility on residential investment property

Coversheet

Purpose of Document	
Decision sought:	*Agree to phase the ability to claim interest deductions for residential investment property back in over three years.*
Advising agencies:	*Inland Revenue*
Proposing Ministers:	*Minister of Finance* *Minister of Revenue*
Date finalised:	*8 December 2023*

Problem Definition

The Government's objective in reintroducing interest deductibility for residential investment land is to reduce upward pressure on rents, and to tax landlords on rental profit by allowing deductions for all costs.

Executive Summary

The Government intends to phase back in the ability to claim interest deductions over three years, with the intention of reducing upward pressure on rents.

Tax settings generally allow deductions to be claimed against income so that overall taxation is imposed on a net profit basis. However, the interest limitation settings applicable to residential investment property do not allow interest to be claimed as a deduction for tax purposes. All else being equal, this impacts on the attractiveness of residential property as an investment. This can reduce new construction and, in the longer-run, put upward pressure on rents. This issue is likely to grow over time as a smaller number of new builds can lead to a proportionately large change in the housing stock.

Due to time constraints, only two options are considered.

Option 1 is the status quo. Under current settings, interest deductibility is denied for properties purchased on or after 27 March 2021. For other properties, interest deductibility is phasing out such that 50% of interest costs may be deducted in the 2023–24 (tax) year, 25% in the 2024–25 year, and 0% in the 2025–26 and later years.

Option 2 is for interest deductibility to be restored via phasing back in over three years: for 50% deductibility in the 2023–24 (tax) year, 80% in the 2024–25 year, and 100% in 2025–26 and later years.

For an income tax to be based on ability to pay, there needs to be a deduction for the costs of producing the income[1]. Compared to the status quo, Option 2 will support income being used as a measure of a taxpayer's ability to pay tax.

Inland Revenue's recommended option is Option 2. Option 2 means that income will be a better measure of ability to pay than would have been true under Option 1. It also means that tax will be less of a barrier to people making efficient commercial decisions. Finally, Inland Revenue is concerned that the denial of interest deductions is likely to make investment in rental housing an unattractive proposition for many investors. Over time, this is likely to reduce the supply of housing and rental housing (relative to what would be the case if interest expense was deductible). This would place upward pressure on rents, which would increase housing costs for tenants and decrease the equity with the tax treatment of other investments that are taxed on a net basis.

Views of stakeholders

The Treasury

Treasury agrees that allowing deductions for costs incurred in deriving income ensures that income tax reflects ability to pay and that restoring interest deductions will make the income tax system more consistent and coherent.

Treasury considers it unlikely that landlords will pass on the tax change through lower rents in the short run. Research by the Housing Technical Working Group, a cross-agency group of housing experts, found that the main drivers of rents over the past twenty years have been household income growth and the physical supply of rental housing relative to demand. The Treasury therefore expects that restoring interest deductibility would not significantly impact rents in the short run, as the stock of housing supply is fixed.

In the longer term, the change could result in some increase to rental housing supply, thereby putting downward pressure on rents. This will depend on the degree of flexibility in urban land supply and/or opportunities to intensify existing land. As a result, the impact of interest deductibility in the long term will depend on future policy. Supporting the flexibility of urban land supply will make it more likely that restoring interest deductibility increases the supply of housing in the long run rather than primarily raising house prices.

Ministry of Housing and Urban Development – Te Tūāpapa Kura Kāinga (HUD)

HUD agrees with Inland Revenue's assessment of the impact on supply, house prices, and rents. Based on research by the Housing Technical Working Group, a cross-agency group of housing experts, showing rents are primarily driven by household incomes and the relative supply and demand for housing, HUD believes the impact on rent prices in the short term will be negligible. In the long term, reinstatement should make rents under Option 2 less than under Option 1, with the magnitude of that contingent on any improvements to overall efficiency of urban land supply response.

General public

There was a wide range of views expressed when the current interest limitation rules were introduced, and there is likely to be that same wide range of views expressed as those

[1] It has been common for people to argue that tax should be levied on the basis of ability to pay, i.e. that those with greater ability to pay should pay more tax. If income is used to measure ability to pay, this means that those with greater incomes should pay more tax. In this context income is a net concept, after accounting for expenses incurred in earning that income, like interest.

limitation rules are effectively reversed. While some people are of the opinion that business expenses should always be allowable as deductions against business income, there are also people who believe that not having a comprehensive capital gains tax was justification for removing the ability to deduct interest on residential land. However, interest expense is allowed as a deduction in other areas where an investment partly financed with borrowed funds generates taxable income. This is the case even if the investments generate non-taxable capital gains (for example, a commercial rental property or a farm). Also under Option 1, interest deductions are being denied for residential rental properties even if the property does not generate a capital gain.

Limitations and Constraints on Analysis

The key limitations and constraints applying to this analysis are as follows:

1. Single option analysis: As the coalition Government has already announced its intention to reintroduce interest deductibility for residential investment properties, this analysis is focused solely on the implementation of that option, rather than any other option to address the Government's objective to reduce upward pressure on rents.

2. Time constraints: Policy advice is being prepared within the timeframes required to progress decisions on this proposal in December 2023. Accordingly, this analysis has been prepared within tight time constraints.

3. Consultation: While views were previously expressed during the development of the original interest limitation rules, officials were not able to directly consult on the current proposal.

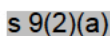
Responsible Manager

Phil Whittington

Chief Economist

Policy and Regulatory Stewardship

Inland Revenue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8 December 2023

Quality Assurance

Reviewing Agency:	IRD
Panel Assessment & Comment:	The Quality Assurance panel at Inland Revenue has reviewed the regulatory impact statement (RIS) prepared by Inland Revenue. The panel considers that information and analysis summarised in the RIS: *Reintroducing interest deductibility on residential investment property parti*ally meets the quality assurance criteria. The proposal being considered by Cabinet supports a broader tax reform package developed in response to the coalition agreements of the government. As such, the options under

	consideration were limited to the status quo and reintroduction of interest deductibility. Time constraints also applied to the policy development of the proposal and has not permitted consultation on the various options, or refinement of the preferred option.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

The rental market

1. Upward pressure on rents can be driven by many factors that influence the supply of rental properties. These factors may be related or unrelated to tax settings.

2. However, restoring interest deductibility could have a long-term effect on reducing the cost of housing for tenants by incentivising new construction with this putting downward pressure on rents. This is even true under the status quo with a new build exemption from the rules that deny interest deductions if it creates incentives for an important group of investors to pull back from investing in the housing market.

3. Rental affordability is a significant issue in New Zealand. Based on Household Economic Survey data for the year ended June 2022, a quarter of renting households were spending over 40% of their disposable income on housing costs, and rents have risen faster than mortgage payments. Renters also have higher rates of reporting housing issues like dampness, mould, and heating.[2]

4. While rental affordability (measured by the ratio of changes in rent prices to changes in incomes) has been mostly constant over the past decade,[3] New Zealand has not fared favourably in international comparisons. The proportion of low-income households (the lowest income quintile) in New Zealand spending over 40% of their income on rent was the highest in the OECD in 2018 data at 61%.[4] The same analysis for households of all incomes finds New Zealand is also near the top of OECD countries for the proportion of renters spending over 40% of their income on housing costs (24%),[5] and for median spend on housing costs by renting households (28% of household income).[6] The latter measure of median spend increases to 41% for low-income households.[7]

Interest limitation rules

5. The interest limitation rules for residential investment property were originally introduced to address housing affordability.[8] The aim of the rules was to reduce demand for residential property by preventing investors from deducting interest expenditure for tax purposes.

6. The interest limitation rules were introduced in 2021 and deny a deduction for interest incurred for residential investment property. For property acquired on or after 27 March

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[2] https://www.stats.govt.nz/news/housing-affordability-more-challenging-for-renters-than-homeowners/

[3] https://www.hud.govt.nz/assets/Uploads/Documents/Methods-Nov-2022.pdf

[4] International comparisons of housing affordability for renters and owners, p. 18.

[5] International comparisons of housing affordability for renters and owners, p. 20

[6] International comparisons of housing affordability for renters and owners, p. 22.

[7] International comparisons of housing affordability for renters and owners, p. 23

[8] The regulatory impact statement published for the introduction of these rules is available here.

2021, interest deductions have been denied in full since 1 October 2021. For property acquired before 27 March 2021, and borrowings drawn down before 27 March 2021, the ability to claim interest deductions is being phased out as follows:

Period that interest is incurred	Percentage of interest deductions allowed
1 April 2021–30 September 2021	100%
1 October 2021–31 March 2022	75%
1 April 2022–31 Mach 2023	75%
1 April 2023–31 March 2024	50%
1 April 2024–31 March 2025	25%
On and after 1 April 2025	0%

7. Interest is still deductible in some situations. For example, an exemption from interest limitation is allowed for properties defined as new builds (defined as land that has a self-contained residence or abode that received a Code Compliance Certificate (CCC) on or after 27 March 2020), for a period of 20 years after the CCC is issued. There are also exemptions for property developers, and for land used for social, emergency or council housing.

8. The Government has agreed, as part of its coalition agreements, that it will phase back in the ability to claim interest deductions over three years, with the intention of reducing upward pressure on rents. The Government has also signalled that it will make other changes to the taxation of property, including changes to the bright-line test and to non-residential building depreciation.

What is the policy problem or opportunity?

9. There are good reasons for allowing interest deductibility, including the following:

    a. To allow deductions for costs of earning income so that income tax reflects ability to pay.

    b. Concerns about longer-term impacts of the lack of interest deductibility on rents.

Income tax based on ability to pay

10. For an income tax to be based on ability to pay, deductions must be allowed for the costs of producing the income. For example, if a landlord earns $30,000 of rental income and incurs no costs of doing so, other things being equal, that increases their ability to pay by $30,000. If, instead, the landlord earns $30,000 but interest and other costs amount to $25,000, other things being equal, the landlord's ability to pay has increased by $5,000, not $30,000.

11. Denying deductions for interest expenses moves away from taxing income based on ability to pay. Restoring interest deductions is an important step to make the income tax more consistent and coherent. Interest expense is allowed as a deduction in other areas of the tax system where investment partly financed with borrowed funds generates

taxable income. Deductions are generally allowed whether or not assets generate non-taxable gains as well as taxable income.

Impact of deductibility settings on rents

12. In addition, denial of interest deductions may be reducing new construction and the supply of dwellings below the level that would have arisen if interest continued to be deductible. Over time, this could put upward pressure on rents and gradually make rental properties less affordable for tenants. A healthy housing market requires a good supply of housing for both tenants and owner-occupiers.

13. The reintroduction of the ability to claim interest deductions for residential investment properties would reduce pressure on landlords which, in the longer run, should have a flow-on effect in reducing rents for tenants.

What objectives are sought in relation to the policy problem?

14. The Government's objective in reintroducing interest deductibility for residential investment land is to reduce upward pressure on rents.

15. In addition, restoring interest deductions is an important step to make the income tax system more consistent and coherent by ensuring tax is based on ability to pay.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

16. The likely impact of the options will be assessed against the status quo under the Government's objective of reducing upward pressure on rents and improving housing affordability in the rental market.

17. The options will also be evaluated against the traditional tax policy criteria of efficiency, equity, integrity, fiscal impact, compliance and administration costs, and coherence. These are described below:

    a. **Efficiency:** Taxes should be, to the extent possible, efficient and minimise (as much as possible) impediments to economic growth. That is, the tax system should avoid unnecessarily distorting the use of resources (e.g., causing biases toward one form of investment versus another) and imposing heavy costs on individuals and firms.

    b. **Equity:** The tax system should promote fairness. The burden of taxes differs across individuals and businesses depending on which bases and rates are adopted. Assessment of both vertical equity (the appropriate treatment of those on different income levels or in different circumstances) and horizontal equity (the consistent treatment of those at similar income levels, or similar circumstances) is important.

    c. **Revenue integrity:** The tax system should be sustainable over time and minimise opportunities for tax avoidance and arbitrage.

    d. **Fiscal impact:** Tax reforms need to be affordable given fiscal constraints, and the system must raise sufficient revenue to support the Government's fiscal strategy.

    e. **Compliance and administration costs:** The tax system should be as simple and low cost as possible for taxpayers to comply with and for Inland Revenue to administer.

    f. **Coherence:** Individual reform options should make sense in the context of the entire tax system. While a particular measure may seem sensible when viewed in isolation, implementing the proposal may not be desirable given the tax system as a whole.

What scope will options be considered within?

Government commitments

18. The Government has already announced its intention to phase the ability to claim interest deductions for residential investment properties back in with the phasing and timing specified described in Option 2 below.

19. Ministers have directed officials to provide advice on this policy within the timeframes required for decisions in December 2023. Therefore, the scope of feasible options is limited.

Limitations on consultation

20. Formal stakeholder engagement following the Generic Tax Policy Process has not been possible in the time allowed for preparation of this advice. The risks of a lack of formal consultation include the potential for unintended consequences arising from the policy change. Consultation also enables a more rigorous understanding of trade-offs when making policy changes. This is pertinent for a proposal like reintroducing interest deductions, which could have impacts on the rental property market and the housing system more generally with respect to prices, rents, and the supply of housing.

21. The intention to change the interest limitation rules was signalled in the pre-election manifestos of the parties that have formed the Government.

What options are being considered?

Option 1: Retain the status quo

22. Option 1 is to retain the status quo. Under the status quo, the ability to claim interest deductions for residential investment properties will continue to be denied entirely for properties purchased on or after 27 March 2021. For properties acquired before 27 March 2021 (and lending drawn down before that date), the ability to claim interest deductions will continue to be phased out, with a deduction for 50% of the interest being allowed in the current income year (2023/24), a deduction for 25% of the interest being allowed in the next income year (2024/25), and no deductions for interest being allowed in all subsequent income years.

Option 2: Reintroduce interest deductibility

23. Option 2 is to phase back in the ability to claim interest deductions for residential investment properties. The option would allow a deduction for 50% of the interest in the current income year (2023/24), a deduction for 80% of the interest in the next income year (2024/25), and full deductions for interest in all subsequent income years. Although the percentage of deductions allowed for the 2023/24 income year does not change from the status quo above, it will apply for all property owners unlike the status quo, so there is some retrospective effect.

Options analysis

24. Option 2 is assessed relative to Option 1 (the status quo) against the Government's objective of reducing upward pressure on rents as well as the tax policy criteria listed above.

25. **Reducing upward pressure on rents:** Option 2 will remove a tax bias that is discouraging debt-financed investors from acquiring rental properties. This makes it less likely that leveraged investors will withdraw from the property market. This can increase the construction of new dwellings and, over time, reduce upward pressure on rents.

26. **Efficiency:** Restoring deductions for the costs of earning income will tend to promote economic efficiency. If someone discovered a profitable venture where they could earn revenue of $30,000 by incurring costs of $25,000, this would be a worthwhile venture in

the absence of tax because of the $5,000 of net income it generates. If a taxpayer faced an income tax rate of 30%, the venture would still be worthwhile to undertake so long as expenses are deductible. In that case the taxpayer would pay tax of $1,500 on the $5,000 of profit and earn an after-tax income of $3,500.

27. However, if the revenue is taxed but the expense is not deductible, the taxpayer would pay tax of $9,000 on the gross revenue of $30,000, and make a loss of $4,000. Failing to allow deductions for the costs of earning income can create a penalty standing in the way of people making decisions which would be sensible in the absence of tax. By doing so, this will tend to reduce economic efficiency.

28. Denying deductions for interest can also reduce economic efficiency by encouraging investment to be undertaken with a landlord's own funds rather than through using borrowed funds. Investment in rental property that is debt-financed can be double taxed. If investment in rental property is financed with a landlord's own funds, rental income will be taxed in the landlord's hands. But suppose, instead, that the investment in a rental property is financed by borrowing from another New Zealander. The rental income will be taxed in the landlord's hands in the same way as if the investment were equity financed. There will be no deduction for interest, but the lender of the funds will also be taxed on the interest stream. This creates a tax bias discouraging the debt finance of residential rental property.

29. The current 20-year exemption from the interest limitation rules for new builds can also increase economic inefficiencies by encouraging leveraged landlords to invest in new residential rental properties ahead of existing properties. This biases the stock of rental and owner-occupied housing by encouraging landlords to hold a greater fraction of new builds in their portfolios, and owner-occupiers to hold a smaller fraction of new builds than would be the case under more neutral tax settings.

30. **Equity:** Denying interest deductions for residential rental property can also reduce horizontal equity. Suppose that A earns $30,000 of residential rental income with no interest expense, B earns $30,000 of residential rental income with $25,000 of interest expense and C earns $30,000 of rental income from a commercial (non-residential) property with $25,000 of interest expense.

	A (residential rental with no interest)	B (residential rental with interest)	C (commercial rental with interest)
Rental income	$30,000	$30,000	$30,000
Interest expense	$0	$25,000	$25,000
Rental profit	$30,000	$5,000	$5,000
Taxable income if interest is denied for residential rental	$30,000	$30,000	$5,000

31. In reality, A has $30,000 of income while B and C have $5,000 of income. C is taxed on their $5,000 of income because their investment is in a commercial property. However, B is taxed on $30,000 as though they were in the same position as A while, in reality, B

has only earned $5,000 just like C. If taxes are not horizontally equitable, they will not be vertically equitable because income becomes a poor measure of ability to pay.

32. As has been noted, some might argue that denying B an interest deduction may be an offset for the possibility that B might be generating untaxed capital gains. However, this is a weak rationale for denying interest deductions, given that A or C may also be generating untaxed capital gains.

33. There is another potential fairness issue. Under current settings where interest deductions are denied on rental property, there is a 20-year exemption for new builds. This means that someone who purchased a property that was a new build just before the new rules came into effect is having interest deductions phased out over 4 years while someone who purchased a property just after the new rules came into effect is allowed interest deductions for 20 years. This can be seen as unfair to leveraged investors with sunk investments who purchased a residential rental property shortly before the new rules came into force.

34. **Revenue integrity:** There are no revenue integrity impacts, other than compliance issues arising from the complex nature of the interest limitation rules.

35. **Fiscal impact:** The expected fiscal cost of Option 2 over the forecast period (to 2027/28) is estimated to be $2,920m.

36. **Compliance and administration costs**: Option 2 is likely to reduce ongoing administration and compliance costs. It will reduce the complexity of the rules for taxpayers; interest limitation sits alongside already complex rules for the taxation of investment property, including the bright-line test, loss ring-fencing and rules for mixed-use assets such as holiday homes. A reduction in complexity consequently leads to less customer contact for Inland Revenue in supporting the interest limitation rules. Restoring interest deductibility retrospectively (i.e., changing the proportion of allowed deductions for the 2023/24 income year for property owners currently being denied any deductions) will create some initial administrative work such as providing guidance and education campaigns (detailed in Section 3).

37. **Coherence:** Limiting interest deductions has reduced the coherence of the tax system. A principle underlying the tax system is that generally only the amount of income after deducting any associated costs is taxable. Denial of interest deductions was an exception to this rule. Restoring interest deductions would therefore increase coherence.

Treasury assessment of the options

38. Treasury agrees that allowing deductions for costs incurred in deriving income ensures that income tax reflects ability to pay and that restoring interest deductions will make the income tax system more consistent and coherent.

39. In the short and medium term, the bulk of the impact from restoring interest deductibility is likely to be reflected in house prices, with minimal impacts on rents. House price impacts are highly uncertain and will depend on the final policy design and timing of the reintroduction of interest deductibility. The Treasury will analyse these potential impacts further and may adjust our house price forecasts to reflect them as part of the *Budget Economic and Fiscal Update*.

40. In the long run, tax changes could also impact the supply of housing by incentivising new construction, and could therefore have more significant impacts on rents. The long-run incidence on house prices and rents will depend on the flexibility of urban land supply and the availability of opportunities to intensify existing urban land:

    a. low flexibility of urban land supply and limited opportunities to intensify mean the policy will primarily raise house prices in the long run.

    b. high flexibility of urban land supply and significant opportunities to intensify mean the policy will primarily reduce rents in the long run.

41. Research by the Housing Technical Working Group, a cross-agency group of housing experts, suggests that rents are primarily driven by household incomes and the relative supply and demand for rental housing. The Treasury therefore expects that restoring interest deductibility would not significantly impact rents in the short run, as the stock of housing supply is fixed.

42. The Treasury's assessment of the evidence is that urban land supply has been highly restrictive over the last two decades, as demonstrated by the gradual fall in interest rates pushing up house prices rather than pushing down rents.

43. Recent policy changes (such as the Auckland Unitary Plan) appear to have improved the responsiveness of supply for higher-density housing. However, without further changes, housing supply may continue to be unresponsive to demand in the long term.

44. As a result, the impact of interest deductibility in the long term will depend on future policy. Supporting the flexibility of urban land supply will make it more likely that restoring interest deductibility increases the supply of housing in the long run rather than primarily raising house prices.

45. The Treasury recommends phasing the restoration and consideration of a cap on deductions (either as a maximum dollar amount or a fraction of interest expenses) to manage the large fiscal cost of restoring interest deductibility.

Ministry of Housing and Urban Development – Te Tūāpapa Kura Kāinga assessment of the options

46. HUD agrees with Inland Revenue's assessment of the impact on supply, house prices, and rents. Based on research by the Housing Technical Working Group, a cross-agency group of housing experts, showing rents are primarily driven by household incomes and the relative supply and demand for housing, HUD believes the impact on rent prices in the short term will be negligible. In the long term, reinstatement should make rents under Option 2 less than under Option 1, with the magnitude of that contingent on any improvements to overall efficiency of urban land supply response.

How do the options compare to the status quo/counterfactual?

	Option 1 Status quo	Option 2 Restoring interest deductions
Reducing upward pressure on rents	0	+
Efficiency	0	++
Equity	0	++
Revenue integrity	0	0
Fiscal impact	0	--
Compliance and administration cost	0	++
Coherence	0	++
Overall assessment	0	++

Example key for qualitative judgements:

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
- -	much worse than doing nothing/the status quo/counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

47. Inland Revenue considers that Option 2 is preferable to Option 1. While restoring interest deductibility has a significant fiscal cost, Inland Revenue considers that this cost is outweighed by the positive impacts on the rental market (less upward pressure on rents) and on the tax system (through improvements to the various criteria like efficiency, equity, and coherence, as discussed above).

48. Overall, restoring interest deductibility is most likely to meet the Government's objective of easing upward pressure on rents. Residential property investment will become more attractive, which may increase rental supply.

What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Other interested parties – first-home buyers	Restoring interest deductions for residential rental property is likely to put some upward pressure on property prices, making buying	House price impacts are highly uncertain and will depend on the final policy design and timing of the reintroduction of interest deductibility.	Low

	a first home somewhat less affordable.	The Treasury will analyse these potential impacts further and may adjust house price forecasts to reflect them as part of the *Budget Economic and Fiscal Update*.	
Regulators – wider government	Decreased revenue would be collected from the reintroduction of interest deductions for residential property investors.	The expected fiscal cost is $2,920m over the five years to 2027/28.	Low
Total monetised costs		The expected fiscal cost is $2,920m over the five years to 2027/28.	Low
Non-monetised costs	We do not have confidence in our ability to provide a total non-monetised cost.	Low	Low
Additional benefits of the preferred option compared to taking no action			
Regulated groups – residential property investors	Restoring interest deductions will reduce tax payments on residential property owners in the first instance. This group will also benefit from a decrease in compliance costs.	The reduced tax payments are estimated to be $2,920m over the five years to 2027/28.	Low
Regulators – Inland Revenue	Restoring interest deductions is likely to reduce ongoing administration costs for Inland Revenue, though with some initial implementation costs.	It is not possible in the time available to attempt to quantify this impact.	Low
Other interested parties – renters	Over time, additional supply of rental housing will tend to put downward pressure on rents.	It is not possible in the time available to attempt to quantify this impact.	Low
Non-monetised benefits	We do not have confidence in our ability to provide a	Low	Low

	non-monetised benefit.		

Section 3: Delivering an option

How will the new arrangements be implemented?

49. It is intended that the ability to deduct interest for residential investment properties will be reintroduced as follows, as per Option 2:

	Percentage of interest deductions allowed
1 April 2023–31 March 2024	50%
1 April 2024–31 March 2025	80%
On and after 1 April 2025	100%

50. Given the proposal is to start phasing back in interest deductibility in the current year, including for property owners currently being denied any deductions, this proposal will have retrospective effect. Consequently, some minor systems changes will be required to accommodate a retrospective change in deductibility, including the need to amend taxpayer guidance and communicating with taxpayers before they file their tax returns. Those changes can be accommodated, but need to be considered alongside any other changes the Government may require as part of its 100-day plan.

51. Taxpayers will have made decisions based on the current law at the beginning of the year. Therefore, a retrospective change of this nature will have an impact on them. While returns for the 2023/24 income year do not need to be filed until 7 July 2024 (or 31 March 2025 if the taxpayer has a tax agent), taxpayers will have made provisional tax payments throughout the year based on the current level of deductibility. Increasing interest deductions may mean they have overpaid their tax, however, most of these taxpayers will have the ability to correct this overpayment at their final instalment of provisional tax. Any overpaid tax will ultimately be refunded. Some taxpayers with early balance dates (i.e., balance dates between 1 October 2023 and 31 March 2024) may also file their tax returns before the changes are finalised, meaning their returns will need to be reassessed.

How will the new arrangements be monitored, evaluated, and reviewed?

52. Inland Revenue's initial focus will be on communication and education. Information will be provided to increase awareness of the new arrangements and support customers in getting their obligations right from the start.

53. Inland Revenue currently monitors work on compliance using a range of interventions, and so the proposed changes to interest limitation will be integrated into existing systems for the purposes of monitoring and evaluation. Guidance will be updated on Inland Revenue's website.

Regulatory Impact Statement: Removing building depreciation

Coversheet

Purpose of Document	
Decision sought:	*Analysis produced for the purpose of informing final Cabinet decisions*
Advising agencies:	*Inland Revenue*
Proposing Ministers:	*Minister of Finance* *Minister of Revenue*
Date finalised:	*7 December 2023*

Problem Definition

The Government is proposing to remove the ability to depreciate commercial and industrial buildings at the current rate of 2% diminishing value from the start of the 2024/25 income year (1 April 2024 for most taxpayers). This will support the Government's fiscal requirements by raising tax revenue.

Executive Summary

Depreciation deductions are a means of matching the cost (decline in market value) of buildings over their useful life while they are used to derive assessable income.

The ability to claim depreciation deductions for commercial and industrial buildings with an estimated useful life of 50 years or more was reinstated in 2020. These buildings can be depreciated at a 2% diminishing value or 1.5% straight line.

The changes in 2020 were part of a package of economic policy responses to COVID-19. Reinstating building depreciation was previously identified as a key priority for improving productivity by the Treasury and Inland Revenue. This was due to the weight of international evidence suggesting buildings do depreciate, together with studies suggesting that New Zealand had a high effective tax rate (and high cost of capital) for investments in buildings compared to most OECD countries.

The Government is considering whether depreciation deductions for commercial and industrial buildings should be reduced to zero (a return to the settings that existed between 2010 and 2020) as a means of funding its overall fiscal package. Based on returning the depreciation deduction rules to previous settings, we estimate the change will generate $2.31 billion over the forecast period (2024/25 – 2027/28).

Inland Revenue recommends retaining the status quo and recommends the Government reconsider introducing commercial and industrial building depreciation when fiscal conditions allow.

Limitations and Constraints on Analysis

The proposal is part of the coalition Government's fiscal plan. This RIS compares the proposal to the status quo. Due to time constraints, we have not considered other policy options.

Income tax principles suggest that business costs should be deductible when determining tax liability. Whether building depreciation is a business cost turns on whether buildings decline in market value over time (economic depreciation). Studies on the economic depreciation of buildings are complex and expensive to conduct. A Treasury analysis in 2010 of QV data on building values from 1994 to 2008 suggested that, on average, buildings have not depreciated in market value in New Zealand over that period. However, the weight of international evidence suggests that the depreciation rate is positive for commercial and industrial buildings.

Cabinet is expected to make decisions on 11 December 2023. We have not had an opportunity to engage with stakeholders. Some recent anecdotal comments from stakeholders have focused on: the fact that buildings do depreciate, ensuring consideration is given to building fit-out, and selecting an appropriate implementation date. Given a similar proposal was implemented in 2010, we consider the implementation risks are reasonably well known and the experiences have been reflected in this RIS

Responsible Manager(s) (completed by relevant manager)

Phil Whittington

Chief Economist

Inland Revenue

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7/12/2023

Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance reviewer at Inland Revenue has reviewed the regulatory impact statement (RIS) prepared by Inland Revenue. The reviewer considers that information and analysis summarised in the RIS *Removing building depreciation* partially meets the quality assurance criteria. The proposal being considered by Cabinet supports a broader tax reform package developed in response to the coalition government of the New Zealand National Party, ACT NZ, and New Zealand First. As such, the options under consideration were limited to the status quo and the removal of depreciation deductions for commercial and industrial buildings. Time constraints have applied to the policy development of the proposal and this has not permitted

	consultation on the various options, or refinement of the proposed option.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

The purpose of allowing deductions for business costs

1. Building depreciation – the decline in a building's market value – warrants tax deductions for the same reasons that other business expenses like wages and depreciation on computers do.

2. Allowing deductions for business expenses ensures tax liability is based on ability to pay. It also ensures taxes are as neutral as possible across different forms of investment, ensuring investment flows to the most productive areas of the economy.[1]

3. Economic depreciation is the fall in market value of an asset. In the context of a tax on income, supporting productivity means that tax deductions for depreciation mirror economic depreciation as closely as possible. Failure to allow tax depreciation for assets which fall in value results in an effective tax rate for those assets that is higher than the statutory rate. On the other hand, allowing tax depreciation for assets which do not fall in value may result in an effective tax rate for those assets that is lower than the statutory rate.

Previous changes to building depreciation in New Zealand

4. New Zealand previously allowed tax depreciation on buildings on a widespread basis at a rate of 3% diminishing value (or 2% straight line) for buildings with an estimated useful life of 50 years or more. This changed following an announcement in the 2010 Budget to reduce the rate to 0% from the 2011-12 income year. The removal of depreciation deductions applied to both new and existing buildings. Depreciation remained available for buildings with an estimated useful life of fewer than 50 years.[2]

5. The decision in 2010 was supported by Treasury analysis of QV data on the value of land and buildings which suggested that buildings appreciated in New Zealand over the data period (1994 to 2008). Officials noted at the time that the weight of international studies indicated that buildings do depreciate.[3]

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[1] In the absence of taxes, investment would flow to the most productive areas of the economy, maximising total welfare. Taxes, however, can distort people's decisions, with the result that heavily taxed activities may receive less investment, even if they have higher risk-adjusted, pre-tax returns than other investments. The outcome is that capital is allocated less productively, and we are poorer and have lower income and growth than otherwise.

[2] These buildings include barns, chemical works, fertiliser works, powder dryer buildings, tanneries, and hydroelectric powerhouses (treated as plant rather than buildings).

[3] Probably the most widely quoted estimates are from the Bureau of Economic Analysis in the United States. These suggest economic deprecation rates of 3.14% for industrial buildings, 2.47% for commercial buildings, 1.14% for residential structures of 1 to 4 units and 1.4% for residential structures of 5 or more units. These

6. In 2019, the Treasury and Inland Revenue advised the government that reinstating building depreciation could improve productivity in New Zealand. This was supported by the weight of international evidence that long-lived buildings do depreciate, together with studies suggesting that New Zealand had a high effective tax rate (and high cost of capital) for investments in buildings compared to most OECD countries.[4]

7. In 2020, depreciation for long-lived buildings (other than residential buildings) was reinstated from the 2020-21 income year at a rate of 2% diminishing value (or 1.5% straight line). This change was introduced as a component of an economic policy response to COVID-19 to improve productivity and stimulate business activity.

What is the policy problem or opportunity?

8. The coalition Government's fiscal plan includes a commitment to end depreciation for commercial buildings that was introduced in 2020 as part of a COVID-19 business support package. The Government wishes to remove building depreciation as a revenue generating measure. Changes would apply from the 2024/25 income year (beginning 1 April 2024 for most taxpayers).

9. The changes in 2020 reintroduced depreciation for non-residential buildings which include commercial buildings and industrial buildings. Whether a building is a non-residential building is determined based on the building's predominant use. For more information on when building owners can currently claim depreciation see: Claiming depreciation on buildings (ird.govt.nz).

10. Since residential buildings are currently not depreciable for tax purposes, this would apply the same tax treatment to all buildings used for investment or business (other than certain short-lived buildings with an estimated useful life of less than 50 years).

What objectives are sought in relation to the policy problem?

11. The objective is to implement this change as part of the Coalition Government's tax changes which includes personal income tax reductions.

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results are consistent with a number of other studies that have been undertaken in the United Kingdom and United States. Studies for Canada have tended to suggest higher rates of economic depreciation. For a comprehensive assessment as at 2018, see the following analysis from the secretariat to the Tax Working Group: Appendix C: Depreciation on Buildings: Further information on potential revenue reducing options - July 2018 - Information Release - Tax Working Group - New Zealand.

[4] This was explored in depth in Inland Revenue's Long-term Insights Briefing "Tax, foreign investment and productivity".

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

12. The options will be evaluated against the traditional tax policy criteria of efficiency, equity, integrity, fiscal impact, compliance and administration costs, and coherence. These are described below.

    a. **Efficiency**: Taxes should be, to the extent possible, efficient and minimise (as much as possible) impediments to economic growth. That is, the tax system should avoid unnecessarily distorting the use of resources (e.g., causing biases toward one form of investment versus another) and imposing heavy costs on individuals and firms.

    b. **Equity**: The tax system should promote fairness. The burden of taxes differs across individuals and businesses depending on which bases and rates are adopted. Assessment of both vertical equity (the relative position of those on different income levels or in different circumstances) and horizontal equity (the consistent treatment of those at similar income levels, or similar circumstances) is important.

    c. **Revenue integrity**: The tax system should be sustainable over time and minimise opportunities for tax avoidance and arbitrage.

    d. **Fiscal impact**: Tax reforms need to be affordable given fiscal constraints, and the tax system must raise sufficient revenue to support the Government's fiscal strategy.

    e. **Compliance and administration costs**: The tax system should be as simple and low cost as possible for taxpayers to comply with and for the Inland Revenue Department to administer.

    f. **Coherence**: Individual reform options should make sense in the context of the entire tax system. While a particular measure may seem sensible when viewed in isolation, implementing the proposal may not be desirable given the tax system as a whole.

13. Some of these criteria trade-off with each other so there is some subjectivity to coming to an overall recommendation. The discussion under option 2 provides more information on the exact nature of how the proposal rates against the criteria which helps us to arrive at an overall judgement.

What scope will options be considered within?

14. Options are constrained by the coalition Government's fiscal plan which includes removing building depreciation. We have not been asked to provide advice on alternative options. In addition, we have only considered the impacts of this proposal compared to the status quo, not the suite of tax changes as a whole.

What options are being considered?

Option One – *Status Quo*

15. Continue to allow depreciation deductions for buildings (other than residential buildings) with an estimated useful life of 50 years or more at a rate of 2% diminishing value (or 1.5% straight line).

Option Two – Remove building depreciation

16. The proposal to remove building depreciation could be done in a similar manner to the removal of building depreciation in 2010 (including subsequent remedials). This would mean that:

    a. changes to depreciation rates for buildings would apply to existing and newly acquired buildings with an estimated useful life of 50 years or more.

    b. special depreciation rates would not be allowed for taxpayers who can establish that they have a different useful life than generally applies. However, depreciation would remain available for buildings with a shorter estimated life e.g., barns, chemical works, dairy sheds, fertiliser works, fowl houses, and tanneries.

    c. previous depreciation deductions on buildings would remain recoverable if the building is sold for more than its tax book value. This means building depreciation would technically be deducted at a rate of 0%.

    d. taxpayers would be unable to claim a disposal loss deduction if a building is sold for less than its tax book value (except for certain buildings acquired before August 2009). This is because land and buildings are usually sold together, and it is difficult to establish how much of a total loss or gain is attributable to loss on the building itself.

    e. building owners would be able to depreciate building fit-out.

17. The main difference between the current proposal and the changes in 2010 is that the depreciation rate for residential buildings is currently 0% and so does not need to change.

18. **Efficiency:** The denial of deductions for building depreciation will impact the profitability of investments and cause investors to underinvest in buildings relative to other investments where business costs continue to be deductible.

19. In our last Long-Term Insights Briefing, we noted that under some assumptions made by the OECD (including that non-residents demand a 3% real return on their capital), New Zealand was likely to have had the highest hurdle rate of return for investment in commercial and industrial buildings for the 38 countries in the OECD. This was when New Zealand allowed 2% depreciation on these buildings. Denying depreciation deductions will drive up these hurdle rates of return even higher and make New Zealand a less attractive location for investment.

20. This tax distortion does not only impact building owners. To the extent that the additional cost is passed on and there is less investment, it also impacts any business that needs to use a building and the customers of such a business. It thereby negatively impacts productivity more generally.

21. **Equity**: A fundamental principle of New Zealand's tax system is not to advantage any form of investment relative to other forms of investment, unless there is an over-riding reason for doing so. The goal is to ensure horizontal equity and reduce tax-driven distortions by ensuring that tax is as neutral as possible across different forms of investment.
22. Restricting building depreciation deductions may be considered unfair (violates horizontal equity) as it disallows a deduction for industries whose business rely more heavily on buildings. This tax outcome will have a corresponding negative effect on the balance sheets of those affected.
23. Users of buildings would be at greater risk if safety upgrades such as seismic strengthening are made less frequently due to the inability of the owner to depreciate the cost of the upgrade, although safety regulations are more likely to drive this investment than tax settings.
24. **Revenue integrity**: Based on the simplicity of the change and past experience implementing the change, it should have little overall impact on revenue integrity.
25. **Fiscal impact**: The expected revenue gain from this option is $2.31 billion over the forecast period (2024/25 to 2027/28). This estimate is based on a number of assumptions, such as the portion of buildings in some industries being outside of the tax base (e.g., owned by the government). To the extent these assumptions are wrong, the estimate of fiscal cost would also be incorrect.
26. **Compliance and administration costs**: In addition to paying more taxes, there may be some initial compliance costs for building owners as they separate building fit-out from the rest of the building for depreciation purposes. There will be a transitional rule for owners who have not previously recorded fit-out separately and do not wish to obtain a new valuation.
27. Historically, taxpayers who have elected not to separate out the fit-out costs from the building itself have done so to reduce their compliance costs. Their rationale is generally that while they may not get the full deductions for depreciation, the loss of a deduction is offset by the compliance cost savings. That logic no longer applies at a 0% depreciation rate for buildings, so there will be an increase in taxpayers' compliance costs. However, those costs are minimised by the transitional rule for fit-out.
28. If taxpayers decide to undertake a complete audit of their fit-out to record them separately from the building, Inland Revenue will need to be mindful of the valuation methodology used by taxpayers/valuers to ensure the costs are based on historic cost, less depreciation claimed to that point.
29. Removing building depreciation deductions would also involve increased initial administration costs for Inland Revenue. This includes providing guidance and support for taxpayers to comply with rules changes.
30. **Coherence**: Removing building depreciation deductions will decrease the coherence of the tax system. A principle underlying the tax system is that generally only the amount of income after deducting any associated costs is taxable. This policy would create an exception to that general rule.
31. It should also be noted that regularly changing the rules on building depreciation affects taxpayer expectation about the predictability of the tax rules and has the potential to undermine certainty in the tax system with flow-on effects to business investor confidence.

How do the options compare to the status quo/counterfactual?

	Option One – Status quo	Option Two – Remove Building Depreciation Deductibility
Efficiency	0	-
Equity	0	-
Revenue integrity	0	0
Fiscal impact	0	+
Compliance and administration costs	0	-
Coherence	0	-
Overall assessment	0	- -

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

32. We do not consider the removal of building depreciation to be a fair and efficient way of raising revenue. We are particularly concerned about the efficiency impacts which will make New Zealand even more of an outlier in pushing up cost of capital for commercial and industrial buildings. We therefore recommend the retention of the status quo. We note that this RIS is not evaluating the merits of the Government's tax package as a whole.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Regulated groups - commercial and industrial building investors	Denying building depreciation deductions would increase the tax cost of commercial and residential buildings compared to the status quo. All else being equal, this would put downward pressure on demand and therefore on building prices. The impact of the proposal on building prices would be very difficult to determine. For the marginal investor, the proposal could be the 'tipping point,' so they would forgo the purchase of, or possibly sell their existing building, as other alternative investments become relatively more attractive. This proposal could also reduce the investment in new buildings and capital improvement of existing buildings including investment which makes buildings safer, such as seismic strengthening. The value of commercial and industrial buildings used in our costing is $212 billion.	The additional tax paid by building owners is expected to be $2.31 billion over the forecast period (2024/25 to 2027/28). The compliance and administration costs on building owners would be modest. The changes will be more burdensome for owners who have not separated fit-out but still not significant.	Medium
Users of commercial and industrial buildings	The proposal may put upward pressure on rents through decreasing building supply in the long term. This means renters may be negatively impacted by the proposals.	Unknown	Medium

	Users would also be impacted by the quality of the building if capital improvements are made less frequently.		
Inland Revenue	Costs associated with providing guidance on the changes.	Unquantified costs which should only place marginal pressure on the business.	Medium
Total monetised costs			
Non-monetised costs		*(High, medium or low)*	
Additional benefits of the preferred option compared to taking no action			
Regulated groups			
Regulators			
Others (eg, wider govt, consumers, etc.)			
Total monetised benefits		$2.31 billion over forecast period	Revenue was forecast using a historical model. There are a range of uncertainties in the model.
Non-monetised benefits		*(High, medium or low)*	

Section 3: Delivering an option

How will the new arrangements be implemented?

33. It should be possible to make the change through an Amendment Paper to the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill at the Committee of Whole House stage. This Bill is expected to be enacted before the end of March 2024.

How will the new arrangements be monitored, evaluated, and reviewed?

34. **Monitoring**. Inland Revenue will monitor compliance with the tax change as part of its usual monitoring of taxpayers.

35. **Review**: Inland Revenue regularly reviews tax settings on an ongoing basis and provides advice and updates to the Government accordingly. Policy officials maintain strong communication channels with stakeholders in the tax advisory community, including through the generic tax policy process, and these stakeholders will be able to correspond with officials about the operation of the new rules at any time. If problems emerge, they will be dealt with either operationally, or by way of legislative amendment if agreed by Parliament.

Regulatory Impact Statement: Disposals of trading stock at below market value

Coversheet

Purpose of Document	
Decision sought:	*Analysis produced for the purpose of informing final Cabinet decisions.*
Advising agencies:	*Inland Revenue*
Proposing Ministers:	*Revenue portfolio*
Date finalised:	*20 December 2023*

Problem Definition

A long-standing rule in the Income Tax Act 2007 deems a person who disposes of trading stock at below market value to derive as income the market value of the trading stock on the date of disposal (the "valuation rule"). Under this rule, the recipient is also deemed to acquire the trading stock at market value for tax purposes. We consider the valuation rule is appropriate in relation to some disposals (for example, where the parties to the disposal are associated, and where goods are taken by a business owner for their own use or consumption). However, we also consider it over-reaches in relation to ordinary business disposals between non-associated parties, and it acts as a significant disincentive to donate trading stock which distorts donation behaviour.

Executive Summary

Problem definition

Under the Income Tax Act 2007 a business that holds trading stock is entitled to a deduction for the opening value of that trading stock in the year of disposal. The business must also return as income the proceeds from the sale of that trading stock in the year of disposal. Where a business disposes of their trading stock for less than market value, there is a special valuation rule which treats the business as having derived as income the market value of the trading stock on the date of disposal. If the market value of the trading stock is greater than its opening value, the business will have a net tax liability in relation to the disposal of trading stock (because the deemed income is greater than the available deduction). This means a business may have to pay tax on income it never actually derives.

We consider the valuation rule is appropriate in relation to disposals of trading stock between associated persons and where goods are taken by a business owner for their own use or consumption. In relation to these disposals, the rule is an important integrity measure that reflects commercial arm's-length principles. For example, it was intended to counter situations such as where a retiring farmer transfers livestock to a relative who is also a farmer for no or minimal consideration. Without this rule in place, income tax on the transfer would be avoided by the retiring farmer.

We also consider the valuation rule is appropriate when the disposal has no nexus with business income. However, in the case where there is no nexus with business income and the disposal is a donation, the valuation rule acts as a significant disincentive to

donate, distorts donation behaviour and is widely perceived to be unfair. Businesses may delay donating their trading stock until it has a low or nil market value. In the case of perishable goods such as food, this means the donations are typically not accepted by charities and ultimately add to food wastage. Alternatively, businesses may incur costs by entering sponsorship agreements with recipients so they effectively receive a market value in advertising, which is not something all charities are prepared to do. In many other cases, the valuation rule is simply not complied with when goods are donated.

We consider the valuation rule has two issues which justify legislative reform.

- Issue one: in relation to disposals that are made in the ordinary course of business, the valuation rule over-reaches where the disposal is between non-associated parties. It imposes income tax where there is unlikely to be an integrity concern to address.
- Issue two: in relation to disposals that are not made in the ordinary course of business and which are donations, the valuation rule also over-reaches. However, there are also integrity concerns if the valuation rule is not applied to certain donations, such as donations made to individuals or overseas organisations. The compromise that we think balances these concerns is to not apply the valuation rule where the donations are made to approved donee organisations, Donee organisations are generally registered charities that apply their funds wholly or mainly to charitable purposes in New Zealand, or charities that carry out their charitable purposes overseas and have been specifically approved to be donee organisations by Parliament. Removing the valuation rule for donations made to donee organisations would resolve the over-reach for most donations, ensure the tax concessions for donated trading stock and donations of money are consistently targeted, and minimise integrity risks.

Government intervention is required to address these two issues

In 2021, the Government enacted emergency provisions as part of the COVID-19 response to temporarily support businesses to donate their trading stock and to temporarily remove the application of the rule to non-associated person transactions.[1] This relief meant that during COVID-19 as well as future emergency events agreed by the Minister of Revenue, donations to donee organisations and public authorities would be excluded from the valuation rule, as would be disposals to non-associated parties. Other donations would be removed from the valuation rule and subject to a valuation rule equivalent to cost or opening book value. This relief addresses the two issues outlined above for times of emergency; however, it is due to expire on 31 March 2024. We consider that providing this relief solely in emergency times does not provide a comprehensive answer to the long-standing issues with the application and effect of the rule, which, although they may be more pronounced in an emergency context, exist at all times.

We have considered nine different options to address these two issues

In relation to issue one, we considered three different options to address the over-reach where there is a disposal between non-associated parties including the status quo option.

In relation to issue two, we considered six different options to address the disincentive to donate trading stock including the status quo option.

[1] The changes were included in the Taxation (Annual Rates for 2021–22, Feasibility Expenditure, and Remedial Matters) Act. The relief was effective from 17 March 2020.

All options we considered other than the status quo option are regulatory options. Non-regulatory options could not address either issue given the problems stem from unclear legislation and inappropriate policy settings.

To address both issues, our preferred option is to (in effect) make the temporary emergency relief permanent for disposals of trading stock to non-associated persons (option two), and to remove the valuation rule for donations of trading stock to donee organisations (option six).

We consider this combination of options best reflects general income tax principles while protecting against integrity risks and minimising compliance costs for taxpayers. This approach also aligns, to a large extent, with the current concessionary framework for donations of money, which limits donation deductions to donee organisations.

We have consulted with the public on the problem and possible solutions

We initially undertook targeted consultation on the problem in 2020 ahead of the enactment of the temporary emergency response provisions.

In July 2023 we publicly released an Officials' Issues Paper outlining our view of the problem and the possible options to address the issues.[2] We received fifteen submissions on the paper and met with submitters to discuss their submissions and our proposed approach to address them between September and December 2023.

All submissions supported reform in this area to better reflect taxpayer practice and general income tax principles, although there were some differing views on the best way to achieve this objective.

There were differing views on the problem definition. A number of submitters agreed with officials' view (communicated in the issues paper) that the valuation rule can result in an over-reach in relation to disposals of trading stock that are not donations between non-associated persons (issue one). Others thought that the current valuation rule did not over-reach, because they did not consider the provision would apply to general business disposals of trading stock. We consider these opposing views reflect general uncertainty as to how and when the valuation rule should apply, and point to the need for legislative reform.

Some submitters preferred an additional concession for associated person disposals where a disposal to an associated person is also subject to FBT or deemed dividend rules, because they were concerned a "double tax" can arise. We believe the complex interaction with these rules could raise integrity issues if the valuation rule does not apply to these associated party transactions. In addition, double tax concerns for deemed dividends can be addressed by affected businesses through the use of the imputation rules. However, it is an issue we will continue to monitor and will consider in future reviews of the FBT and deemed dividend rules.

Several submitters who represent large businesses noted that a legislative response involving donations could be problematic without an appropriate "gift" definition. They took the view all disposals of their trading stock were business transactions, with some being both altruistic as well as good for business. We agree that the tax status of some disposals

[2] Disposals of trading stock at below market value – an officials' issues paper, July 2023, Inland Revenue, available at: https://www.taxpolicy.ird.govt.nz/consultation/2023/2023-ip-disposal-tradingstock-below-mktvalue

will be subject to the facts of each case and the interpretation is not always clear. Legislative reform should focus on whether the disposal has a nexus with business income, rather than whether there is a donation.

Submitters who represented small businesses, such as farmers who donate livestock to charities such as foodbanks, supported the removal of the valuation rule for donations of trading stock. They were primarily concerned with compliance costs if a legislation change still required them to calculate and report the market value of the donated trading stock.

Several submitters requested that a permanent concession be extended to donations made to public authorities such as hospitals. While the temporary COVID-19 measure did allow a deduction for donations made to public authorities, this was targeted at the specific needs at the time, such as the donation of sanitizers to hospitals. We do not support a permanent concession for donations of trading stock made to public authorities as it would be inconsistent with the donations framework, which targets donations made to donee organisations.

Limitations and Constraints on Analysis

Our analysis was informed by relatively extensive consultation with taxpayers over a number of years. Despite this, we did have to make assumptions about current taxpayer behaviours in order to cost the policies and understand their impacts on taxpayers from a compliance perspective. In particular, we did not have any data to show the extent to which taxpayers were complying with the valuation rule. We therefore relied on anecdotal evidence that suggested that compliance with the rule was low in respect of some disposals (particularly donations).

Responsible Manager(s) (completed by relevant manager)

Peter Frawley

Policy Lead

Policy and Regulatory Stewardship

Inland Revenue

s 9(2)(a)

20 December 2023

Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance panel at Inland Revenue has reviewed this "*Disposals of trading stock at below market value*" Regulatory Impact Statement (RIS) and considers that the information and analysis summarised in this RIS meets the quality assurance criteria

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. When a person disposes of trading stock at below market value a special rule in the Income Tax Act 2007 (the ITA) deems them to derive the market value of the trading stock on the date of the disposal (the valuation rule). Further, an amount equal to the market value of the trading stock at the time of disposal is treated as expenditure incurred by the transferee in acquiring the trading stock.
2. The valuation rule has been a long-standing feature of the ITA. A key rationale for the rule is the potential for tax minimisation arrangements to take place in its absence. Without the rule, trading stock could be sold at a deep discount to an associated person for example, allowing the transferor and transferee to benefit from the transferee's lower rate when they in turn dispose of the property. However, we consider the rule is unnecessarily wide, resulting in unprincipled tax outcomes in relation to disposals of trading stock between non-associated parties.
3. Since before the COVID-19 pandemic, taxpayer representatives have sought revisions to the valuation rule, citing unfairness and concerns that the rule acts as a disincentive to businesses wanting to donate their trading stock.
4. Over the past two decades three separate legislative overrides to the valuation rule have been enacted to address some of these concerns. The overrides mean that a full deduction of the cost of the trading stock was recognised without any deemed income. Most recently, a temporary override was put in place from 2020 for a four-year period to support businesses as part of the Government's COVID-19 response. This override ends on 31 March 2024. As part of this reform, provision was also made for the temporary relief to be switched on in relation to future emergencies.
5. Although the temporary measures put in place for the COVID-19 response and potential future emergencies did alleviate some of the more immediate concerns of taxpayers, we consider a more permanent solution that also applies in non-emergency times is necessary.
6. In August 2023 we released a public issues paper on the problem and possible solutions to the valuation rule. We received fifteen submissions – the majority from taxpayer representatives, three from large businesses and two from not-for-profit organisations. This, as well as our targeted consultation in 2020 with six taxpayer representatives and one large not-for-profit, has informed our understanding of the problem definition and our analysis of the options.

What is the policy problem or opportunity?

7. We have identified two related issues with the valuation rule:
   - Issue one: in relation to disposals that are made in the ordinary course of business, the valuation rule over-reaches where the disposal is between non-associated parties. It imposes income tax where there is unlikely to be an integrity concern to address.
   - Issue two: in relation to disposals that are not made in the ordinary course of business and which are donations, the valuation rule also over-reaches. However, there are also integrity concerns if the valuation rule is not applied to certain donations, such as donations made to individuals or overseas organisations. The compromise that we think balances these concerns is to not apply the valuation rule where the donations are made to approved donee organisations, Donee organisations are generally registered charities that apply their funds wholly or mainly to charitable purposes in New Zealand, or charities that carry out their

charitable purposes overseas and have been specifically approved to be donee organisations by Parliament. Removing the valuation rule for donations made to donee organisations would resolve the over-reach for most donations, ensure the tax concessions for donated trading stock and donations of money are consistently targeted, and minimise integrity risks.

8. While submitters all agreed that there were issues with the valuation rule, there were differing views on the exact nature of those issues. For example, some submitters did not consider that the valuation rule would apply to arm's-length business transactions, and therefore did not consider that the rule could be said to 'over-reach' by deeming someone to derive income above the amount economically derived by them. However, other submitters considered the valuation rule did result in over-reach (described as 'issue one' in this paper). We consider this uncertainty points to the need for a permanent legislative solution. The Tax Counsel Office is considering the need for guidance to assist with the interpretation of these changes.

9. In general, our consultation in 2020 and 2023 highlighted that to many businesses the valuation rule is unintuitive and unfair and, perhaps as a result, anecdotal evidence suggests that compliance with the rule may be low.

What objectives are sought in relation to the policy problem?

10. The main objective of this work is to determine a fair and principled approach to the taxation of trading stock disposed of at below market value and the taxation of donated trading stock.
11. A fair and principled approach should protect the revenue base, support taxpayer compliance and withstand the test of time, removing the need for ad-hoc changes to respond to specific emergencies.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

12. We have used the following criteria to assess the options against our objectives:

- Revenue integrity. Does the option minimise opportunities for tax avoidance and tax evasion?
- Efficiency. Does the option raise tax revenue in a way that minimises distortions and costs to the economy?
- Compliance costs: Does the option minimise costs for taxpayers?
- Coherence: Does the option make sense within the entire tax system?

13. To the extent that there are trade-offs between these criteria their weighting will be determined in light of the overarching objective of determining a 'fair and principled approach' to the taxation of disposals of trading stock at below market value and donations of trading stock.

What scope will options be considered within?

14. The scope of feasible options is limited to some extent by New Zealand's long-standing tax policy settings. These settings have been established in line with a broad-base low-rate framework. This framework supports the consistent application of tax across the economy in a non-distortive manner, and thus any departure, including the provision of concessionary treatment, requires strong justification.
15. These settings rule out any options that significantly deviate from the framework in a manner that is unjustified. What is justifiable in this context is informed by the scope and nature of any current concessions, and the connection between the deviation and the pursuit of wider societal imperatives.

What options are being considered?

16. We have separated out the options as they relate to the two issues with the valuation rule. These options were included in the public issues paper published in August 2023 and our analysis is informed by feedback from submitters on the options.
17. Other than the status quo option, the options are all regulatory in nature. We did not consider any non-regulatory options because the identified issues arise from unclear legislation and policy settings.

The following options relate to disposals that are made in the ordinary course of business:

Option One – *Status quo*

18. Option one would maintain the status quo. When the emergency relief ceases in March 2024, businesses would be required to return deemed income at market value when they dispose of their trading stock at below market value to both associated and non-associated parties (outside of limited emergency times).
19. This option ensures there is a backstop principle for goods exchanges. It promotes revenue integrity by protecting the revenue base from the artificial reduction of business profits through transfers of trading stock in ways that result in an incorrect reflection of the real income generated by the business.
20. However, it does not address the identified over-reach in relation to non-associated transactions. Where parties are not associated, we do not consider a valuation rule is necessary; businesses transacting at an arm's-length are free to set prices as they see fit and not have these interfered with, unless there is something in the nature of tax avoidance which can be dealt with separately under other provisions in the ITA.

Option Two – *Limit the valuation rule to associated person transactions (officials' preferred option)*

21. To address the identified over-reach, option two would limit the valuation rule to cases where trading stock is disposed at below market value to an associated person.
22. This option recognises that transfers of trading stock between non-associated persons that are below market value and are not donations are nonetheless made by the business for a valid business purpose and therefore the price set by the parties should stand. Any revenue integrity concerns arising from transactions between non-associated persons can be dealt with by the general anti-avoidance rule in the ITA. This option also aligns with some taxpayers' current view of the operation of the valuation rule.
23. It would reduce compliance costs for businesses not dealing with associated persons who would no longer have to apply the valuation rule.

Option Three - *Retain the deemed market value adjustment and deem the adjustment to be an expense of the taxpayer for non-associated disposals*

24. Under this option, the valuation rule would continue to apply as in option two for associated person disposals. For disposals to non-associated persons, the valuation rule would also continue to apply, however, the market value adjustment would be deductible to the transferor provided the disposal met the general permission. The effect of this would be to allow a net deduction for the opening value of the trading stock disposed of at below market value where the disposal was connected with the derivation of business income.
25. Officials considered this option could support revenue integrity by ensuring any deductions have a connection with the derivation of income. However, submitters pointed out that a disposal that was not a donation, and was not to an associated person, would generally have a connection with income (and thus meet the general permission). Hence they did not support this option as it would increase their compliance costs for no real gain in terms of revenue integrity.

The following options relate to disposals of trading stock that are not made in the ordinary course of business and are donations

Option Four – *Status quo*

26. Option four would retain the status quo in relation to donations. A person making a donation of trading stock would be treated as deriving the market value of the trading stock, apart from in limited emergency times when the concessionary relief may be switched on.
27. The relief turns off the valuation rule for donations. For businesses donating trading stock to approved donee organisations and public authorities, a concessionary (compared to a cash donation requirement) net deduction is allowed during the emergency period. For businesses donating trading stock to other persons that are not associated, the business is instead deemed to derive income equal to the cost of the trading stock, resulting in neither a net deduction nor net income for tax purposes.
28. This option recognises that during times of emergency there may be a more pressing need for donations of trading stock and a greater desire on the part of businesses to donate. This targets the relief to short periods of time and so generally maintains the broad base low-rate system.
29. However, the option does not address the disincentive to donate outside of limited emergency times. It also results in administration and compliance costs as the relief must be turned on and off and treatment adjusted accordingly.

Option Five – *Make the temporary relief permanent*

30. Option five would make the temporary relief apply at all times (i.e. outside of emergencies such as floods, earthquakes, and pandemics).
31. This option removes the disincentive to donate by introducing a permanent broad concession. However, it lacks coherence with current settings as it is more concessionary than current concessions for donations of money, which are limited in several ways for integrity and fiscal reasons. This is because the temporary relief was mainly developed with the COVID-19 emergency context in mind and with the understanding that it would apply for limited periods only. A sustainable permanent option should more closely align with the current concessionary regime for donations of money.

Option Six – *Make the temporary relief permanent for donations to donee organisations only (officials' preferred option)*

32. Option six would align the temporary relief with the current donation deduction framework to a large extent, by limiting the relief so that it is only available in relation to donations of trading stock to donee organisations. The concession would be available for all types of trading stock, in contrast to the temporary relief which excluded land and timber. This would remove the current disincentive to donate trading stock to donee organisations whilst utilising an existing integrity measure (the requirements for becoming a donee organisation) to protect the revenue base. The rationale for this relief is the same as the rationale for providing relief for donations of money, which is to encourage and reinforce giving by lowering the cost of giving.
33. Unlike the rules for donations of money made by companies and Māori authorities, this option does not require the net donation deduction to be capped to the donor's net income. While a cap would align this option more closely with the donation rules, the compliance and administrative costs and complexity of applying a cap to all businesses subject to the valuation rule, including trustees and sole traders, would outweigh the benefits of alignment. We consider that a restriction of the concession to donee organisations is sufficient to address integrity concerns in the case of trading stock disposals.
34. We do not consider that a permanent concession should be extended to include donations to public authorities, as is available under the temporary relief. This would create an inconsistency with the existing donation framework and was only introduced as a temporary measure due to COVID-19 and the donations being made to hospitals.

Option Seven – *Make the temporary relief permanent for donations to donee organisations subject to several limitations*

35. Option seven limits the relief provided in option six for donations to donee organisations to further align the relief with the current donation deduction framework:

- In relation to donations of trading stock to donee organisations, the valuation rule would continue to apply; however, a deduction would also be available for the market value adjustment (provided the donation is made to a donee organisation). The net effect of this is to allow a deduction for the opening value of the donated trading stock. This deemed deduction approach would also allow Inland Revenue to monitor use of the concession to ensure businesses comply with the rules and there is no unanticipated abuse of the concession that would warrant application of the avoidance provisions and/or a policy response. However, this approach would not reduce compliance costs for businesses that want to donate their trading stock.

- The value of the deduction available to businesses that donate their trading stock to donee organisations would be limited to the net income of the business in the income year the donation is made (if the donee is not an individual) or otherwise their taxable income.

36. This option would ensure the tax rules for donations of trading stock align with the broad donation framework, and that they do not act as a disincentive for businesses donating trading stock to donee organisations.

37. However, this option does not reduce compliance costs for businesses, who are still required to determine the market value of their trading stock upon donating it and return this as income. Compared to the status quo, they are additionally required to claim this market value amount as an expense in order to receive a net deduction.

Submitters have pointed out that, from a compliance perspective, it would be simpler for businesses to not return any income in relation to the donation, which would also remove the need to create a deemed expense.

38. The imposition of a cap on the value of deductions would also increase compliance costs for businesses compared to the temporary relief, as they would be required to keep track of the value of trading stock donated to donee organisations.

Option Eight – *Deem all donors to derive income at cost or opening value of the donated trading stock*

39. Option eight removes the direct cost of donated trading stock from the tax base entirely (rather than allowing a concession for any donation of trading stock). This is achieved by changing the valuation rule from a market value adjustment to a lower of cost or opening value adjustment. The effect of this option is that the deduction and deemed income net off so that there is minimal tax impact on the making of a donation (the donor would still deduct overhead and indirect costs relating to the trading stock). This treatment would be available for all donations of trading stock, no matter the recipient.

40. This option reduces compliance costs for businesses compared with the status quo, to the extent that it is easier to identify the cost of the trading stock compared to market value. It also maintains the broad-base low-rate framework. However, it would create a significant inconsistency between goods used for private consumption and goods subject to deemed dividend rules (which remain subject to market value calculations) compared to goods which are donated (which would be subject to a cost adjustment). This could create integrity and coherence issues. Further, the requirement to make a cost adjustment for all donation disposals will continue to impose compliance costs on businesses.

Option Nine – *Provide specific relief for donations of food only*

41. Option nine was also considered as a narrow concession for donations of food only that addresses the environmental impact of the current rules. Under the status quo, businesses that donate food may in some cases have a tax liability if the market value of the donation is greater than its opening value. Because food is perishable, this disincentive may result in increased food waste.
42. This would create a more limited concession; however, it would not address the disincentive to donate other types of trading stock with equal benefit to the community.

How do the options compare to the status quo/counterfactual?

In relation to disposals of trading stock that are made in the ordinary course of business:

	Option One – Status quo	Option Two – Limit the valuation rule to associated transactions	Option Three – Retain the deemed market value adjustment and deem the adjustment to be an expense of the taxpayer for non-associated disposals
Efficiency	0	++	++
Revenue integrity	0	+	++
Compliance costs	0	++	-
Administration costs	0	++	-
Coherence	0	+	-
Overall assessment	0	++	0

In relation to disposals of trading stock that are donations (not made in the ordinary course of business):

	Option Four – Status quo	Option Five – Make the temporary relief permanent	Option Six – Make the temporary relief permanent for donations to donee organisations only	Option Seven – Make the temporary relief permanent for donations to donee organisations subject to several limitations	Option Eight– Deem all donors to derive income at cost or opening value of the donated trading stock	Option Nine– Provide specific relief for donations of food only
Efficiency	0	0	+	+	+	0
Revenue integrity	0	-	+	++	+	0
Compliance costs	0	+	++	0	-	-
Administration costs	0	+	+	-	0	+
Coherence	0	-	0	+	+	-
Overall assessment	0	0	++	+	+	0

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

43. We consider that a combination of option two and six would best achieve the objective of a fair and principled approach to the taxation of trading stock disposed of at below market value and the taxation of donated trading stock.
44. This combination of options removes the over-reach of the current valuation rule by limiting its application to disposals of trading stock to associated persons, the taking of trading stock for private use and donated trading stock. It also addresses the disincentive to donate trading stock to donee organisations specifically, by turning off the valuation rule (allowing a net deduction for the opening value of the donation) when trading stock is donated to a donee organisation.
45. We consider this approach to donations of trading stock strikes the right balance between achieving alignment with the current rules for donations (and thus protecting the revenue base) and limiting compliance costs for businesses. Although it does not achieve complete alignment with the settings for donations of money (unlike option seven which allowed for monitoring of the deductions claimed by businesses and required the value of deductions claimed to not exceed a net income cap), we consider the requirement for the donation to be to a donee organisation for the business to access the concession sufficiently addresses any integrity concerns, whilst also appropriately limiting compliance costs for businesses.
46. In relation to disposals that are not donations, we consider this combination of options sufficiently addresses revenue integrity concerns by protecting the tax base from artificial transfers of trading stock between associated parties for their timing benefits, whilst promoting efficiency and reducing compliance costs for disposals to non-associates that we consider to be of low-to-no risk from a revenue integrity perspective.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the preferred option compared to taking no action			
Regulated groups (businesses)	Significantly lower compliance costs as many of the deemed income requirements will no longer be required. Impact was assessed based on consultation with the public.	Medium	Medium
Regulators	Ongoing cost in form of lost revenue (monetised). The cost of this was based on limited data and so assumptions had to be made about the extent of behaviour change in response to law change. One-off cost in issuing guidance (absorbed into baselines).	Over the forecast period, a reduction in revenue of $13 million. Low (non-monetised costs).	Low
Donee organisations	No additional cost. We did not receive submissions from donee organisations on these proposals; however, we do not consider that there would be costs to them from these proposals given they should only encourage donating of trading stock.	-	Medium
Total monetised costs		$13million	$13million
Non-monetised costs		Low	Low
Additional benefits of the preferred option compared to taking no action			
Regulated groups (businesses)	On-going benefit as less tax to pay under proposals.	Over the forecast period a benefit of $13million.	Low (assumptions had to be made about extent to which law change would

	One-off reduction in compliance costs compared to the status quo in relation to disposals that are not donations.	Medium (non-monetised benefits).	change behaviours and result in more donations or the substitution of donations of money with trading stock).
Regulators (Inland Revenue)	Greater certainty, reduction in some on-going administration costs as no longer need to consider whether to switch the temporary relief on and off.	Medium	High (self-assessment of impact on the agency)
Donee organisations	On-going potential benefit as likely to receive more donations of trading stock than previously.	Medium	Low (we did not have any data to assess this so reliant on assumptions about taxpayer behaviour based on consultation)
Total monetised benefits		$13million	$13million
Non-monetised benefits		Medium	Medium

Section 3: Delivering an option

How will the new arrangements be implemented?

47. The options would come into force on 1 April 2024., They would be included in the Taxation (Annual Rates for 2023 – 24, Multinational Tax, and Remedial Matters) Bill by way of an Amendment Paper at the Committee of the Whole House Stage.
48. Guidance will need to be published by Inland Revenue explaining the changes and clarifications to the valuation rule. There is existing guidance about what meets the definition of a "gift" and Inland Revenue will consider whether further guidance is needed to assist with the interpretation of these changes. The Tax Counsel Office is considering the need for guidance to assist with the interpretation of these changes.

How will the new arrangements be monitored, evaluated, and reviewed?

49. Once the rules are implemented, Inland Revenue will monitor their effectiveness through our normal stakeholder feedback channels.

Regulatory Impact Statement: Online Casino Taxes

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing final Cabinet decisions
Advising agencies:	Inland Revenue
Proposing Ministers:	Minister of Revenue
Date finalised:	21 February 2024

Problem Definition

Offshore online casino websites face lower taxes compared to New Zealand casinos and gaming machines as well as the taxes that apply to online casinos in the UK and some European countries. This may allow online casinos to offer more attractive odds or promotions to New Zealand gambling customers. To the extent that this encourages gambling activity through online casinos, it will result in reduced tax revenues compared to if the gambling had been conducted through New Zealand operators. It is also likely to result in an increase in overall gambling harm given the accessibility of online gambling and that, unlike New Zealand licenced operators, offshore operators are not required to employ any harm minimisation practices.

Executive Summary

Currently, the only tax applying to offshore casino websites is GST.

The objectives of the proposal are to increase tax collection and to minimise gambling harm.

This RIS considers the following options of taxing online casinos:

- Consistent with onshore casinos (GST, income tax and 4% casino duty)
- Consistent with gaming machines (GST and 20% gaming duty)
- Introducing a new 12% gaming duty in addition to the existing GST (officials' preferred option).

Officials recommend the option of introducing a new 12% gaming duty which would be imposed in addition to the existing GST. Such a tax would be in line with how some other countries tax offshore casino websites.

While the proposal would mean online casinos would face lower tax and regulatory obligations than onshore casinos or gaming machines, tax collection and fairness would still be significantly improved compared to the status quo.

The recommended option is expected to lead to most gambling activity being conducted with compliant operators, significantly improving tax collection without undermining the

Government's harm minimisation objective. It is estimated to collect $35 million of additional tax revenue in the 2024/25 fiscal year, growing by 5% each subsequent year.

The other two reform options involve a higher risk of non-compliant online casinos increasing their market share compared to compliant operators. Under those options, the overall costs imposed on operators which complied with New Zealand's tax rules would be significantly higher than the taxes applied by other countries. This could result in more gambling occurring through non-compliant operators which would erode the tax revenues which could be collected. Harm minimisation would be also lower as non-compliant operators are unlikely to use harm minimisation practices.

Taxes would be collected by Inland Revenue and apply from 1 July 2024. There is an implementation risk that some online casino operators may not have sufficient time before 1 July 2024 to adjust their systems and commercial practices to comply with the new requirements and may block their New Zealand customers or become non-compliant. This risk can be reduced by aligning the design of new taxes closely with existing GST obligations (e.g., imposed on gross betting revenue (GBR) and quarterly filing) and by announcing and legislating the changes shortly after Cabinet decisions have been made. Accordingly, the overall impact of this risk is considered low.

Limitations and Constraints on Analysis

Given earlier Ministerial decisions, this RIS is limited to options for improving the tax collection of online casino gambling, which is defined as gambling through offshore websites other than racing and sports betting.

As Ministerial decisions are to apply any of the tax options from 1 July 2024, there is a need to make Cabinet decisions in early 2024 to provide certainty to the affected gambling operators. This RIS is limited to options to improve tax collection. Non-tax regulatory options such as developing a licensing system or banning online casino websites from offering gambling to New Zealanders are outside the scope of this RIS. The Department of Internal Affairs advised Ministers that banning offshore casino websites from operating in New Zealand is likely to be ineffective and costly to try to enforce so this option has not been further considered as a potential option for improving tax collection.

Time constraints meant there was no consultation with stakeholders on the options. This increases the risk of unintended consequences or that some of the potential impacts may differ from what officials expect. Where relevant, we have attempted to identify the risks and the uncertainty of impacts.

To quantify the costs and benefits of the options it was necessary to make several assumptions. The estimated costs and benefits are sensitive to these assumptions, meaning that a wide range of impacts could be generated if different assumptions had been used. The main risks with the assumptions are:

- There is limited data on the size of the total market for online gambling as well as the profitability of the industry. We have relied on data collected by Inland Revenue and the Department of Internal Affairs to establish our assumptions.
- Many countries, including Australia, Canada, Singapore, and the United States of America, do not allow offshore websites to provide casino gambling. The United Kingdom and some European Union member countries do allow online gambling but do not apply GST or income tax. Instead, they apply gaming duties. This makes it difficult to use data from international comparators to estimate the impacts of the options, particularly when determining future market size and how much gambling activity will be channelled towards compliant gambling providers.

- The total GBR that New Zealanders spend through online casinos is unknown. We have used data on the GST currently collected from online gambling operators as we consider this is the most reliable way to estimate the GBR on which gaming duties and income tax could be collected.
- While the estimated impacts are based on historic Inland Revenue and Department of Internal Affairs data reported by online gambling providers, there is significant uncertainty about the future size of the compliant market.
- The forecast estimates are sensitive to the growth rate assumption used (assumed to be 5% per annum). There could be either much higher growth or a declining amount of online gambling spending.
- While we have assumed that imposing a duty or tax, and the increased compliance costs, will reduce the amount of GBR on which the taxes are collected, the size of these impacts is uncertain. There is a risk that some tax options have a larger or smaller impact on the tax base than we have assumed.
- If the proposed duty or taxes have high compliance costs, some of the online casino operators may choose to respond by blocking or reducing promotions to their New Zealand customers or by not complying with the taxes. This may lead to New Zealand customers conducting more gambling activity through non-compliant operators which would reduce tax collection and increase gambling harm (as non-compliant operators are less likely to apply harm minimisation measures such as promoting problem gambling services). We expect these risks would be higher for income taxes and for options where New Zealand would impose a much higher tax rate on online casinos than other jurisdictions.
- Previous surveys indicate that online gambling is more prevalent among Māori, young people (aged 16 to 24 years), men, and Pacific women, than other population groups. The status quo and reform options are expected to have a larger impact on these groups. However, due to data limitations we have not attempted to quantify the impacts for segments of gambling consumers.

Overall, officials consider the assumptions used are reasonable and conservative, and can be relied upon when comparing the relative impact of the different options.

Responsible Manager

Martin Neylan

Policy Lead

Policy and Regulatory Stewardship

Inland Revenue

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21 February 2024

Quality Assurance (completed by QA panel)	
Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance reviewer at Inland Revenue has reviewed the Regulatory Impact Statement (RIS) prepared by Inland Revenue. The reviewer considers that information and analysis summarised in the RIS *Online Casino Taxes* partially meets the quality assurance criteria. Given earlier Ministerial decisions, the options under consideration were limited to options for improving the tax collection of online casino gambling. Time constraints also applied to the policy development of the proposal and have not permitted consultation on the various options. To quantify the costs and benefits of the options it was necessary to make several assumptions. The estimated costs and benefits are sensitive to these assumptions, meaning that a wide range of impacts could be generated if different assumptions had been used.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

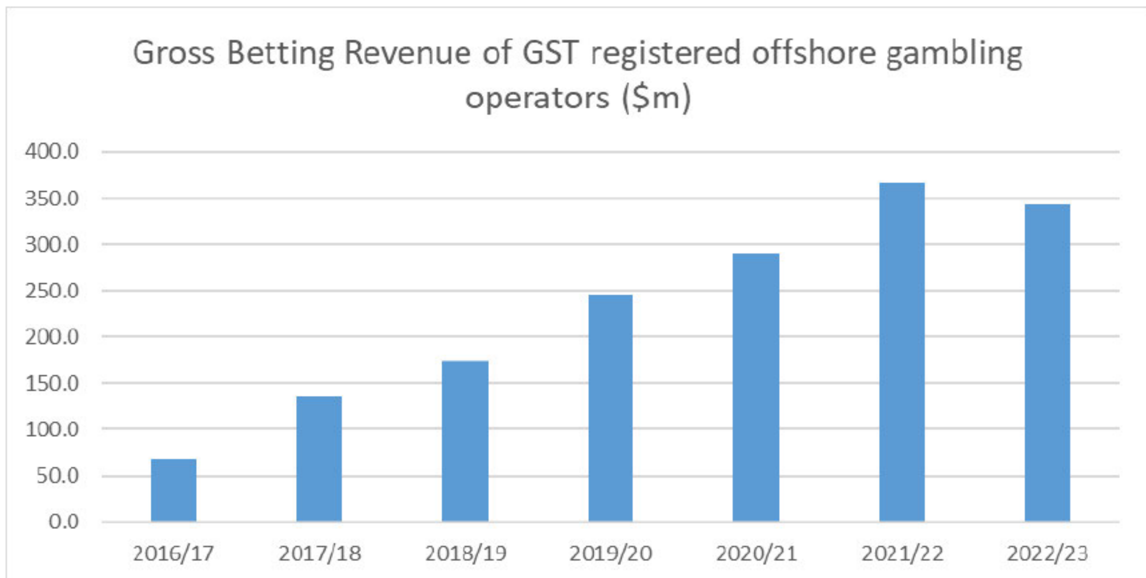
The online casino market is large and growing

1. In their 2022/23 Annual Report, SkyCity estimated New Zealanders gambling through offshore online casino websites (as opposed to the total online gambling market) comprised between $400 million and $500 million of gross betting revenue (GBR). Gross betting revenue refers to the net losses for gamblers (bets received minus prizes paid out).
2. Offshore gambling operators that are registered for GST[1] reported $342.5 million of GBR from New Zealand customers in 2022/23.[2] $42.8 million of GST was collected from these operators in 2022/23. About 11% of this was from racing or sports betting. We expect there are many other online gambling operators who are not registered and do not pay GST[3], but these are likely to be smaller operators than those registered for GST.
3. Given the uncertainty of the size of the total market, we estimate the total online casino market size was about $400 million of GBR in 2022/23. This estimate is larger than the market size indicated by GST collection but is at the lower end of the range estimated by SkyCity.
4. Between 2016/17 and 2021/22, when digital services became mass-market, the GST registered offshore gambling GBR grew at a high rate (above 20% most years). In 2022/23 there was a 7% decline, reflecting that online gambling was higher in 2021/22 due to Auckland COVID restrictions.

[1] The GST rules require offshore providers of gambling services to New Zealanders to register and pay GST if they provide more than $60,000 of these services in a 12-month period.

[2] The 12 months ending 30 June 2023.

[3] Applying GST to gambling is unusual internationally so some providers may not be aware that they are required to pay GST.



5. When analysing options in this RIS, we have assumed modest growth of 5% p.a. from 2023/24 onwards due to current cost of living pressures and because online casinos are less likely to target New Zealand gamblers as the proposed tax options would make New Zealand a less profitable market (relative to promoting gambling by customers in other jurisdictions).

Online casinos face lower taxes than competing forms of gambling

6. Currently, the only tax that applies to offshore gambling websites is GST.[4] GST has applied since 2016 as part of a wider reform which applied GST to remote (mainly digital) services. $42.8 million of GST was collected from offshore gambling websites in the 12 months ending 30 June 2023.

7. Because online casinos are located offshore, they do not have to pay New Zealand income tax. This reflects the fact that international tax settings generally only impose income tax on non-resident business income when it is generated through a physical presence in New Zealand (such as premises or offices).

8. Similarly, gaming duty and problem gambling levy currently only apply to New Zealand licenced gambling providers. Revenue from gaming duty goes into the consolidated fund, while the problem gambling levy is used to fund problem gambling services.

9. The current mechanisms to collect tax from online casinos are limited compared to New Zealand casinos and gaming machines that they compete with. The taxes and levies paid by gaming machines and casinos are shown in the table below:

[4] Offshore racing and sports betting websites are also required to pay 10% point of consumption charges on the gross betting revenue they earn from New Zealand customers which is used to fund sports and racing organisations.

Operator	Taxes and levies
Class 4 operators **(gaming machines in pubs and clubs)**	• gaming machine duty (20% of GBR) • GST • problem gambling levy of 1.08% of GBR and after society and venue expenses
New Zealand licenced casinos	• casino duty (4% of GBR) • GST • problem gambling levy of 0.87% of GBR • income tax on their profits.[5]

10. Internationally, the most common approach to regulating online casinos is to not allow offshore websites to operate (by making them illegal).[6] However, banning or blocking access to certain types of websites is very difficult for gambling regulators to enforce. The United Kingdom and some European countries have taken a different approach of allowing online gambling but applying gaming duties to online gambling operators as a percentage of the GBR earned from their residents (similar to New Zealand's GST rules). The relevant gaming duty rates applying in these countries are displayed below.

11. New Zealand is one of the last countries in the OECD with an unregulated online gambling market, which makes it a target for offshore operators with aggressive online advertising and marketing to New Zealand-based customers. New Zealanders have unrestricted access to overseas gambling websites, many of which have little to no harm minimisation or consumer protection standards. There is no oversight of harm minimisation and consumer protections, including ensuring that operators reliably return winnings.

[5] Income from Gaming Machines, Lotto NZ and TAB NZ are exempt from income tax due to specific exemptions in the Income Tax Act.

[6] Including in Australia, Canada, Singapore, and the United States of America.

12. Most people do not experience any negative effects from online gambling. However, gambling can be highly addictive and can lead to harm to individuals and the wider community. The proportion of people who sought help for gambling harm related to online gambling has almost doubled between 2018 and 2022.[7] Online casino gambling is likely to be at least as harmful as Class 4 gaming machines, with harmful features such as the continuous nature of play, 24/7 accessibility and its appeal to young people.

What is the policy problem or opportunity?

13. Offshore online casino websites face lower taxes compared to New Zealand casinos and gaming machines as well as the taxes that apply to online casinos in the UK and some European countries. This may allow online casinos to offer more attractive odds or promotions to New Zealand gambling customers. To the extent that this encourages gambling activity to be conducted through online casinos, it will result in reduced tax revenues compared to if the gambling had been conducted through New Zealand operators. It is also likely to result in an increase in overall gambling harm given the accessibility of online gambling and that unlike New Zealand licenced operators, offshore providers are not required under New Zealand regulation to employ any harm minimisation practices.
14. That said, many online casinos comply with gambling regulations in other countries which include taxes and harm minimisation, so if New Zealand customers gamble using these compliant operators, harm minimisation will be better compared to non-compliant operators.
15. Regardless, offshore providers are likely to result in increased gambling harm given that, unlike New Zealand licenced operators, they are not subject to New Zealand gambling regulations which require harm minimisation practices. Online gambling is likely to be at least as harmful as gaming machines (pokies). It has features which increase the risk of harm such as the continuous nature of play, its 24/7 accessibility on mobile phones and other devices, and its appeal to young people and other vulnerable members of society.
16. Previous surveys indicate that online gambling is more prevalent among Māori, young people (aged 16 to 24 years), men, and Pacific women, than other population groups.[8] The status quo is expected to have a larger impact on these groups. However, due to data limitations we have not attempted to quantify the impacts for particular segments of gambling consumers.
17. Due to the time constraints mentioned in the constraints section, we have not publicly consulted on the problem or the specific tax options analysed in this RIS with stakeholders, including gambling operators, community groups, or specific populations of gamblers. Instead, we have relied on information from the Department of Internal Affairs gambling officials who have insights about these stakeholders and information provided through previous consultation or public comment.
18. The Department of Internal Affairs publicly consulted on regulating online gambling in 2019. While the focus of that consultation was on potential regulations to minimise harm,

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[7] Intervention services data, Ministry of Health, 2022

[8] The Ministry of Health's Health and Lifestyles survey found that Māori are more likely to gamble on online casino websites than non-Māori. The rate of Māori gambling on online casino websites has been increasing significantly over the years, from 1.3 percent in 2012 to 4.7 percent in 2020. 32 percent of people accessing clinical services who recorded online gambling as one of the types of gambling causing them harm identified as Māori. While data is limited, evidence suggests that young people (aged 16 to 24 years) and men may also be relatively more likely to have gambled on online casino websites. Pacific women were significantly more likely to gamble online than non-Pacific women, but Pacific men were less likely to gamble online than non-Pacific men.

some submitters commented on applying taxes to online gambling operators.[9] One submitter noted the additional revenue from online gambling operators would result in more tax revenue and ensure more gambling activity is conducted through compliant operators (compared to non-compliant operators). Two submitters suggested a taxation system based on gross betting revenue. These submitters believed this would be the most effective method of collecting tax. One submitter stated the taxation rate should be competitive for operators and not exceed global best practice rates.

19. SkyCity, which operates four of New Zealand's six casinos, has made public comment that "SkyCity supports the taxation of the online gaming market".[10]

What objectives are sought in relation to the policy problem?

20. The objectives are to increase tax collection and to minimise gambling harm.

21. There is a trade-off. If the proposed taxes have high compliance costs, some of the affected operators may choose to respond by blocking or reducing promotions to their New Zealand customers or by not complying with the taxes or other regulations. This may lead to New Zealand customers conducting more gambling activity through non-compliant operators which would reduce tax collection and increase gambling harm (as non-compliant operators are less likely to apply harm minimisation measures such as promoting problem gambling services).

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

22. The criteria that have been used to assess the options are:

• *Revenue collection:* Is the option effective at improving the tax revenue collected from gambling? Will it protect the sustainability of the gambling tax base going forward? Will the proposed taxes maximise the gambling activity that is conducted through compliant operators (compared to non-compliant operators)?

• *Harm minimisation*: Does the option minimise the harm caused by problem gambling? Does it channel New Zealand gambling customers towards compliant operators who implement harm minimisation measures?

• *Fairness*: Will the option be perceived by stakeholders as improving fairness? Would online casino operators face similar taxes as New Zealand gambling providers, other types of offshore businesses, and the taxes which apply to online casino gambling in other countries? Do the options avoid unintended distortions to competition, consumer, or business decisions?

• *Compliance costs*: Do the options encourage online casino operators to comply with their tax obligations with low compliance costs? Do they minimise the additional compliance costs which would be imposed on operators by the option?

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[9] Microsoft Word - Online Gambling - Summary of Submissions (dia.govt.nz), page 36.

[10] Online casinos 'aggressively targeting'' New Zealand (newsroom.co.nz). 10 October 2022.

• *Coherence:* Do the options make sense in the context of New Zealand's overall tax system including how offshore businesses are generally taxed? Is the option consistent with New Zealand's international tax and trade agreements.

• *Administration costs*: Are the options possible for Inland Revenue to implement in the necessary timeframe and administer without substantial ongoing administration costs?

What options are being considered?

Option One: Status quo

23. Option one is the status quo where the only tax applying to offshore casino websites is GST.

24. Accordingly, these websites face significantly lower taxes compared to New Zealand casinos and gaming machines that they compete with. This may allow online casinos to offer more attractive odds or promotions to New Zealand gambling customers. To the extent that this encourages gambling activity to be conducted through online casinos it will result in reduced tax revenues and contributions to New Zealand community groups. It is also likely to result in an increase in overall gambling harm given the accessibility of online gambling and that unlike New Zealand licenced operators, offshore providers are not required by New Zealand regulation to employ any harm minimisation practices (although they may do so voluntarily or because they comply with harm minimisation regulations imposed by other countries).

25. These problems are expected to become worse over time as the amount of gambling conducted by New Zealanders on offshore casino websites continues to grow (we have forecast it may grow by 5% each year).

Option Two: Tax consistently with New Zealand casinos

26. Option 2 would aim to tax online casinos in the same manner as casinos that are physically located in New Zealand. These taxes are GST, a 4% casino duty on gross betting revenue (GBR) and a 28% income tax on profits. Officials estimate this would equate to an effective tax rate of approximately 26% of GBR.[11]

27. To the extent that online casinos have similar characteristics and compete with New Zealand casinos this option would improve fairness. New Zealand casinos provide gambling to people who are in New Zealand (including tourists), whereas online casinos are based offshore and can offer a wide range of gambling products to customers in many countries. New Zealand casinos are also different from online casinos because they have exclusive casino licences, are more regulated, employ many New Zealand staff and offer many other services besides gambling.

28. Although it is technically possible to apply income tax to online casinos which are located offshore, we are not aware of any other country that does this. Instead, they apply gaming duties, which are consumption taxes on GBR.

29. Current international tax settings generally only impose income tax on non-resident business income when it is generated through a physical presence in New Zealand. In this regard, option 2 would provide less fair and coherent taxation of online casinos compared to how other offshore businesses are taxed.

30. New Zealand's 40 double tax agreements prevent New Zealand from collecting income tax on non-resident businesses from these treaty partners unless the income is attributable to a physical presence in New Zealand. Currently, most online casinos are in jurisdictions such as Malta and Gibraltar which New Zealand does not have double

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[11] Because GST on gambling is collected on a GST-inclusive basis, it is equivalent to a 13% tax on GBR. The 26% of GBR comprises 13% for GST plus 4% for casino duty plus 9% for income tax (28% income tax on an assumed profit of 33% of GBR is 28% x 0.33 = 9%).

tax agreements with. However, there is a risk that an online casino could be relocated so it is a tax resident of one of the 40 treaty partners. It may be possible to require online casinos to be located in New Zealand in order to legally provide gambling to New Zealanders, but such a requirement could potentially be challenged under a relevant trade agreement.

31. Applying income tax would also impose compliance costs on the affected casinos as they would need to calculate their New Zealand-sourced profits and comply with international tax rules. To avoid incurring these compliance costs it is likely that some online casinos would choose to leave the New Zealand market by blocking New Zealand customers, rather than become liable for New Zealand income tax. This could lead to more gambling activity being conducted with non-compliant operators who are less likely to use harm minimisation measures which could increase gambling harm compared to the status quo.[12]

32. Because it would require Inland Revenue to monitor and enforce income tax and international tax rules, option 2 would have higher administrative costs than the status quo and option 3.

Option Three: Tax consistently with gaming machines

33. This option would seek to tax online casinos consistently with gaming machines. This approach would improve fairness by ensuring online casinos pay similar gaming duties to the gaming machines (pokies) operating in pubs and clubs.

34. These gaming machines are subject to GST and a 20% gaming machine duty on GBR. Income subject to the 20% gaming machine duty is exempt from income tax.

35. Compared to option 2, which involved a low 4% rate of gaming duty and income tax, applying a higher rate of gaming duty (20% under option 3 or 12% under option 4) and not applying income tax would be simpler and more coherent with international tax policy settings. It would also be more consistent with the fact that some European countries apply gaming duties (but not income tax) to offshore online gambling.

36. Under option 3, the total tax collected would be 33% of GBR (a combination of GST[13] and gaming machine duty) which would be higher than taxes imposed by larger online gambling markets in the United Kingdom (21% of GBR) and European countries (ranging from 11% in Belgium to 29% in the Netherlands).

37. Because it imposes the highest overall tax rate, option 3 may collect more revenue than options 2 and 4 but is likely to have the biggest negative impact and downside risk on the amount of gambling activity that occurs through compliant online casino operators.

38. Imposing a high overall tax rate could make the New Zealand market much less profitable for online casinos. This significantly increases the risk that some online casino providers may choose to block or reduce promotions to New Zealand customers and focus on attracting customers from other countries instead. In response, New Zealand customers may shift their gambling activity to non-compliant online casino providers who do not pay any New Zealand taxes (including GST), which would result in a loss of tax revenues.

39. This behaviour would also undermine harm minimisation. Non-compliant operators are unlikely to implement any measures to mitigate harm (such as promoting problem gambling services). In contrast, compliant operators may voluntarily implement or comply with harm minimisation measures required by other countries.

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[12] Tax compliant operators are more likely to implement harm minimisation measures voluntarily or because they comply with harm minimisation regulations imposed by other countries.

[13] Because GST on gambling is collected on a GST-inclusive basis, it is equivalent to a 13% tax on GBR. i.e. if a gambler bets and loses $115, GST of $15 (13% of the $115 of gross betting revenue) is collected.

40. Option 3 would impose compliance costs on online casino operators compared to the status quo. These compliance costs include one-off costs of changes to IT systems and commercial practices to account for the new gaming duty (or block New Zealand customers if they choose to leave the New Zealand market). These implementation costs are expected to be low for those operators which already have similar systems in place for collecting GST.

41. Option 3 is expected to have slightly higher administration costs compared to the status quo as it would require Inland Revenue to implement systems changes and allocate compliance resources to assist the affected operators and their tax agents to comply with the new gaming duty.

Option 4: Align with tax rates imposed in other countries (officials' preferred option)

42. This option would seek to tax online casinos at a rate that is in line with the tax that other jurisdictions apply to online casinos.

43. Under option 4, services provided by online casinos would remain subject to GST in New Zealand. It is proposed that a new gaming duty of 12% would apply on top of the GST. This would result in online casinos paying the equivalent to a 25% tax on GBR.

44. An overall tax rate of 25% would put New Zealand near the midpoint of jurisdictions that impose gaming duties on online casino operators. Spain and Portugal apply a 25% tax rate while Denmark (28%) and the Netherlands (29%) apply higher rates. Other countries apply lower tax rates, including Belgium (11%), Italy (20%), UK (21%), Sweden (22%) and the Czech Republic (23%).

45. The main advantage of ensuring that the overall tax rate and compliance costs are internationally comparable is that it reduces the risk of online casinos responding to the higher costs and reduced profitability of operating in the New Zealand market by blocking or reducing promotions to their New Zealand customers. This reduces the corresponding risk that New Zealand customers shift their gambling activity to non-compliant online casinos, who do not pay taxes and are unlikely to implement harm minimisation measures.

46. In the racing and sports betting context, online betting providers are subject to both GST and 10% point of consumption charges in New Zealand. It is noted that this level of taxation (a 23% total tax rate) did not appear to cause any online racing and sports betting providers to leave the New Zealand market. However, the nature of the racing and sports betting market may be different than the online casino market.

47. A total tax of 25% would be a similar overall tax rate as option 2 (tax consistently with New Zealand casinos which is estimated to be roughly 26% of GBR). However, option 4 would have lower compliance costs and is expected to collect more tax revenue than option 2.

48. A disadvantage of option 4 is that it may be perceived as less fair by some gambling stakeholders compared to options 2 or 3. This is because 12% would be less than the 20% gaming machine duty which applies to gaming machines in pubs or clubs. It could be opposed by these gaming machine operators or lead to lobbying to reduce the rate of gaming machine duty to align it with offshore websites. Also, as the proposed 12% gaming duty would be more than the 4% casino duty, New Zealand casinos may seek policy changes to apply a lower 4% duty on gaming conducted through their offshore websites on the basis that they see this as being part of their casino, rather than a separate type of gambling activity. Other countries such as the UK have different gaming duty rates for online gambling (21%) compared to casinos (a progressive 15%-50% structure increasing with GBR) and gaming machines (5% to 25% depending on the cost to play and prize value).

49. As with option 3, option 4 would impose some one-off compliance costs for online casinos from changes to IT systems and commercial practices to account for the new gaming duty, although these costs are expected to be low for those providers which

already have similar systems in place for GST. Option 4 is expected to have similar administration costs to option 3.

How do the options compare to the status quo/counterfactual?

	Option One: *Status Quo*	Option Two: Tax consistently with New Zealand casinos	Option Three: Tax consistently with gaming machines	Option Four: Align with tax rates imposed in other countries
Revenue collection	0	+	+	+
Harm minimisation	0	-	-	0
Fairness	0	+	+	+
Compliance costs	0	- -	-	-
Coherence	0	-	+	+
Administration costs	0	- -	-	-
Overall assessment[14]	0	-	0	+

Key for qualitative judgements:

++ much better than the status quo

\+ better than the status quo/

0 about the same as the status quo

\- worse than the status quo

\- - much worse than the status quo

[14] For the overall assessment, more weight is placed on the main objectives of revenue collection and harm minimisation.

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

50. Officials recommend taxing online casino operators in line with the tax rates imposed in other countries (option 4).

51. While option 4 would mean online casinos would face lower tax rates than New Zealand casinos or gaming machines, tax collection and fairness would still be significantly improved compared to the status quo. Compared to the other reform options, option 4 is expected to lead to the most gambling activity being conducted with compliant operators. For this reason, it would significantly improve tax collection without undermining the Government’s harm minimisation objective.

52. Options 2 or 3 would involve a higher risk of New Zealand gamblers moving to non-compliant operators as the overall costs imposed on operators which complied with New Zealand’s tax rules would be significantly higher than the taxes applied by other countries. Compliant operators could put less effort into attracting New Zealand customers and may respond by choosing to block New Zealand customers from accessing their websites rather than face the high tax costs. This makes it likely that more New Zealand gamblers would gamble using non-compliant operators who do not comply with taxes and are unlikely to implement any harm minimisation measures.

What are the marginal costs and benefits of the option?

Affected groups *(identify)*	**Comment**	**Impact.**	**Evidence Certainty**
	Additional costs of the preferred option compared to taking no action		
Regulated groups *(online casino operators)*	One-off set-up costs of IT systems Additional tax, ongoing from 2024/25	Low, assuming they already have these systems in place for GST $35m in 2024/25 growing by 5% p.a.	Medium Medium
Regulators *(Inland Revenue)*	One-off capital cost of Inland Revenue systems changes Annual administration costs, ongoing	$1.5m capital cost in 2023/24 $0.5m staff costs and $0.3m of depreciation per year	High
Others	Ongoing costs Consumers may have more limited choice and competition compared to status quo as some websites may no longer accept NZ customers. Gambling harm could increase to the extent that more NZ gambling activity occurs through non-compliant operators who are less likely to use harm minimisation measures.	Low	Low
Total monetised costs	One-off Ongoing	$1.5m capital cost in 2023/24 $35.8m in 2024/25, increasing by about 5% each year	Medium
Non-monetised costs	One-off	Low	Medium
	Additional benefits of the preferred option compared to taking no action		
Regulated groups *(online casino operators)*	No obvious benefits	None	Low
Regulators	Additional tax, ongoing from 2024/25	$35m in 2024/25 growing by 5% p.a.	Medium

Others	Some NZ customers may gamble less (potentially reducing harm) if online casino websites reduce their promotions for NZ customers (or block access to NZ customers). Some gambling activity may shift to NZ operators which fund community and sports organisations.	Low Low	Low Low
Total monetised benefits	Ongoing	$35m in 2024/25, increasing by 5% each year	Medium
Non-monetised benefits	Ongoing	Low	Low

Section 3: Delivering an option

How will the new arrangements be implemented?

53. Inland Revenue will be responsible for the implementation and ongoing administration of the online casino taxes which would apply from 1 July 2024. Inland Revenue will need to update its systems and allocate compliance resources to assist the affected operators and their tax agents to comply with the changes. Inland Revenue has estimated it will cost $1.5m of capital costs in 2023/24 and annual operating costs of $0.5m in staff resources and $0.3m of depreciation each year to implement and administer the gaming duty proposal.

54. Inland Revenue will provide information to increase awareness and support taxpayers to comply with the new rules. This will include producing a relevant Tax Information Bulletin item and updating guidance on Inland Revenue's website.

55. There is an implementation risk that some online casino operators may not have sufficient time before 1 July 2024 to adjust their systems and commercial practices to comply with the new requirements and may block their New Zealand customers or become non-compliant. This risk can be reduced by aligning the design of new taxes closely with existing GST obligations (e.g., imposed on GBR and quarterly filing) and by announcing and legislating the changes shortly after Cabinet decisions have been made. Accordingly, the overall impact of this risk is considered low.

How will the new arrangements be monitored, evaluated, and reviewed?

56. The Department of Internal Affairs has regular contact with key gambling sector stakeholders, including licenced operators and interested community groups as part of its regulation of the sector. These contacts will be used to seek and receive input on the effectiveness and any issues arising under the proposed option.

57. Inland Revenue regularly reviews tax settings on an ongoing basis and provides advice and updates to the Government accordingly. Policy officials maintain strong communication channels with stakeholders in the tax advisory community and these stakeholders will be able to correspond with officials about the operation of the new rules at any time. If problems emerge, they will be dealt with either operationally, or by way of legislative amendment if agreed by Parliament.