

The Treasury

Budget 2023 Tax Initiatives Information Release

July 2023

This document has been proactively released by the Treasury, Inland Revenue, Minister of Finance (Hon Grant Robertson) and Minister of Revenue (Hon David Parker) on the Treasury website at:

<https://www.treasury.govt.nz/publications/information-release/budget-2023-tax-initiatives>

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;
- [36] 9(2)(h) - to maintain legal professional privilege
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [33] appearing where information has been withheld in a release document refers to section 9(2)(f)(iv).

Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are © **Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [<https://creativecommons.org/licenses/by/4.0/>].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

Reference: T2023/195

Date: 17 February 2023

To: Minister of Finance (Hon Grant Robertson)

Deadline: For discussion at Weekly Agency Meeting 20 February
(if any)

Aide Memoire: Taxation of supernormal profits in the New Zealand banking sector

1. We recently advised you on the extent of supernormal profits within the New Zealand banking sector, and possible tax mechanisms for responding to those profits [T2023/53 refers]. The purpose of this memoire is to note the key considerations of a supernormal profit tax, and to ensure that we are developing options that are deliverable to a Budget timetable.

We advised that the largest banks persistently make elevated profits

2. Our previous report noted that the elevated profitability of the four largest banks could indicate supernormal profits. The returns earned by the owners of these four banks are consistently elevated above both their smaller domestic competitors and international comparators. However, there is not conclusive evidence that this profitability can be attributed to uncompetitive behaviour.

Treasury can provide advice on tax options based on existing evidence

3. As noted in our previous advice, the Treasury's preferred approach is to await the findings of a market study on the extent of competition in the sector before considering any options related to supernormal profits. However, if you would like to pursue tax options in place of (or in advance of) any market study then there are options we can design and advise you on.
4. The simplest mechanism, and the only that we would be able to design in time for Budget 2023, would be to apply a levy on the profit of the relevant banks. Following discussions of our initial advice, we are now preparing tax options to apply to supernormal profits rather than windfall profits.
5. As a result, you have a choice on whether any levy is temporary and applied to prior years, or permanent and applied to future years (or a combination of both).

A temporary, retrospective levy could capture historical supernormal profits

6. If you only want to tax supernormal profits for a limited period, then the levy would need to be applied retrospectively (for example, on the basis of the last two tax years). As noted in previous advice there are several challenges of doing so (reduced confidence in the tax system, incidence of the tax), and while it will capture previous supernormal profitability in that period, it will not reduce future supernormal profits.
7. Also as noted in our previous advice, designing a temporary but prospective levy would generate significant integrity concerns (e.g., applying to the 2023 and 2024 income years only). Where a tax is temporary there are strong incentives on the taxpayer to shift income into years outside the period (e.g., into the 2025 year). This behaviour is likely to significantly decrease the efficacy of the levy.
8. As noted in prior advice, we are currently seeking legal advice on whether there are any legal risks with retrospectivity.

A permanent, prospective levy is a more fundamental change

9. If your objective is to tax the perceived supernormal profits of the largest New Zealand banks on an ongoing basis, a permanent levy would achieve that more effectively. While not discussed in length in our previous advice, a permanent levy would prevent income shifting between periods as there would be no periods that the levy would not apply to.
10. It would be possible to design a permanent levy that also had retrospective effect (a combination of both approaches). This would meet both of your objectives, though would be more complex to design and implement.
11. This would be a more fundamental tax policy change. As noted in our previous advice, if you wish to develop a permanent tax solution for supernormal profits, we would recommend further work. A solution to a Budget 2023 timetable would carry significant additional risk as a permanent levy would come with additional policy, operational, and integrity considerations that we could not advise on in the time available.
12. A market study could supplement a longer term approach and provide the supporting evidence for a permanent tax or regulatory solution informed by (and targeted at) the causes of supernormal profitability.

Next steps

13. Officials will discuss the scope of their work on this at your Weekly Agency meeting on 20 February.

Dan Doughty, Analyst, Tax Strategy, [39]
Stephen Bond, Manager, Tax Strategy, [39]