

The Treasury

Budget 2023 Tax Initiatives Information Release

July 2023

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Reference: T2023/456

Date: 17 March 2023

To: Minister of Finance (Hon Grant Robertson)

Deadline: None
(if any)

Fiscal impacts of BM4 Revenue Package

Purpose

This Aide Memoire summarises the fiscal impact of the decisions taken at Joint Ministers on 16 March and outlines high level options to make the revenue package fiscally neutral following decisions from Ministers yesterday.

This note supports other material you have received today on the macroeconomic and the fiscal impacts of a range of Budget decisions, including the tax package.

This Aide Memoire was prepared very quickly and is indicative only. The fiscal estimates included are rough estimates rather than full costings to support a discussion on what matters you would like further advice on or modelling of. In addition, the revenue estimates for the wealth tax are highly uncertain and have the caveats outlined in our previous report (T2023/316, IR2023/067).

Context

At Joint Ministers meeting on 16 March 2023, you indicated that you wish to progress a revenue package with the following parameters:

- **Wealth tax.** A wealth tax of 1.5% on wealth above \$5 million. The \$5m applies on an 'exemption' basis and so the 1.5% only applies to an individual's wealth above \$5m.
- **Personal tax reductions.** You indicated you wished to consider:
 - **Tax-free zone.** You previously indicated a preference for a \$10,000 tax-free zone.
 - **Threshold changes.** You asked for a costing of increasing the \$48,000 personal tax threshold to \$50,000.
 - **Welfare interaction.** You indicated you want to increase main benefits. Our current costings assume an increase in-line with the benefits other working individuals receive from a tax-free zone.

- **Removing the independent earner tax credit.**

You have indicated a preference for a fiscally neutral tax switch. This constraint could bind over two-time horizons:

1. Fiscally neutral by the end of the forecast period (2026/27), which is the important metric for making decisions that are fiscally sustainable in the long term
2. Fiscally neutral over the forecast period, which is the important metric for mitigating the transition to new tax settings (in fiscal or macroeconomic terms), such as mitigating any macroeconomic impacts

Tables 1 and 2 below show the net fiscal impact of these packages.

Table 1. Net fiscal impact of revenue package with threshold changes (\$b)

Potential gaps - threshold changes	2023/24	2024/25	2025/26	2026/27	Sum
10k tax-free zone alongside threshold package	-3.2	-1.8	-1.8	-1.2	-7.9
8.5k tax-free zone alongside threshold package	-2.8	-1.1	-1.1	-0.5	-5.5
7.5k tax-free zone alongside threshold package	-2.5	-0.6	-0.6	-0.1	-3.9

Table 2. Net fiscal impact of revenue package without threshold changes (\$b)

Potential gaps - no threshold changes	2023/24	2024/25	2025/26	2026/27	Sum
10k tax-free zone package	-2.8	-1.2	-1.2	-0.6	-5.8
8.5k tax-free zone package	-2.4	-0.5	-0.5	0.1	-3.3
7.5k tax-free zone package	-2.2	0.0	0.0	0.5	-1.7

Note. These figures are indicative and are not costings. Table 1 and 2 include the increase in main benefits and removal of the independent earner tax credit and an assumed administration cost. Table 1 includes increasing the \$48,000 threshold to \$50,000 while Table 2 does not.

These tables show that all the packages are revenue negative over the forecast period.

When looking at the end of the forecast period (2026/27):

- A \$8,500 tax-free zone package without threshold changes is fiscally neutral
- A \$7,500 tax-free zone package with threshold changes is also close to neutral, or revenue-positive without the threshold changes
- A \$10,000 tax-free zone package is not fiscally neutral

The separate material you have received show that the revenue negative packages could contribute to deferring your return to surplus.

Options to make a revenue neutral package at end of forecast period 2026/27

Making the tax switch fiscally neutral by the end of the forecast period (unless you choose one of the options that is already fiscally neutral or revenue positive) requires decisions that would reduce the cost of personal tax reductions or increase the tax raised.

Illustrative options that could help achieve this include:

- Reduce the size of personal tax reductions
- Reduce the accompanying size of main benefit increase
- Increase the wealth tax rate
- Reduce the \$180,000 personal tax threshold to withdraw the benefit of the tax-free zone

These options are illustrative and were primarily chosen for ease of modelling and we have not considered new options such as increasing other taxes. New options are unlikely to be deliverable on a Budget timetable.

The main trade-off from tax policy perspective for these four options is distributional versus efficiency. Decreasing the size of personal tax reductions or main benefit increases will reduce the progressivity of the tax package and provide less income support. Increasing the wealth tax rate or reducing the benefit of the tax change for higher earners will be more progressive but increase economic and integrity risks.

Table 3 illustrates the impact of four possible changes. It illustrates that making a \$10,000 tax-free zone fiscally neutral will require hard choices.

Table 3. Fiscal impact of four illustrative options

Option	Fiscal impact in 2026/27
Remove accompanying main benefit increase (so main benefit increase only increase due to indexation)	\$0.5b <i>For \$10,000 tax-free zone. Fiscal gain is less for smaller tax-free zones</i>
Increase wealth tax rate to 1.7%	\$0.3b
Increase wealth tax rate to 2%	\$0.6b
Reducing the \$180,000 personal tax threshold to \$165,000 ¹	\$0.1b

Note. These figures are indicative and are not costings.

Options to make neutral over forecast period

While these options could provide neutrality at 2026/27, they will still likely result in revenue negative packages when considered across the forecast period.

The main option to make it neutral over the forecast period is to 'phase in' the personal tax reductions.

¹ This threshold change would mean a higher tax bill of \$900 for an individual with income above \$180,000.

We have presented two illustrative scenarios below that phase in the tax changes on a straight-line percentage described below. These are not costings and do not incorporate different flow-on impacts that phasing the change in would generate.

Table 4. Illustrative scenarios for phasing tax-free zones

	1 Sept 2023	1 April 2024	1 April 2025	1 April 2026
<i>Scenario 1 (if applied to \$10,000 TFT)</i>	50% \$5,000	75% \$7,500	100% (\$10,000)	100% (\$10,000)
<i>Scenario 2 (if applied to \$10,000 TFT)</i>	50% (\$5,000)	50% (\$5,000)	75% (\$7,500)	100% (\$10,000)

Table 5 below shows the net fiscal impact if personal tax reductions are phased in with scenario 1. This would make a \$7,500 tax-free zone package fiscally neutral.

Table 5. Net fiscal impact of package with ‘phased-in’ tax-free zone and no threshold changes

Potential gaps - no threshold changes	2023/24	2024/25	2025/26	2026/27	Sum
10k tax-free zone package	-1.5	-0.1	-1.2	-0.6	-3.3
8.5k tax-free zone package	-1.3	0.4	-0.5	0.1	-1.2
7.5k tax-free zone package	-1.1	0.8	0.0	0.5	0.1

Note. These figures are indicative and are not costings. Table 5 and 6 do not incorporate increasing the \$48,000 threshold to \$50,000 but do incorporate the increase to main benefits and removal of the independent earner tax credit.

Phasing them in slowly in line with scenario 2 would mean that both the \$7,500 and \$8,500 tax-free zones are revenue positive over forecast period.

Table 6. Net fiscal impact with slower phased in tax-free zone and no threshold changes.

Potential gaps - no threshold changes	2023/24	2024/25	2025/26	2026/27	Sum
10k tax-free zone package	-1.5	1.1	0.0	-0.6	-1.1
8.5k tax-free zone package	-1.3	1.4	0.5	0.1	0.7
7.5k tax-free zone package	-1.1	1.6	0.9	0.5	1.8

Note. These figures are indicative and are not costings. Table 5 and 6 do not incorporate increasing the \$48,000 threshold to \$50,000 but do incorporate the increase to main benefits and removal of the independent earner tax credit.

Consultation

We have informed but not consulted with Inland Revenue on this Aide Memoire.

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