The Treasury

Budget 2023 Tax Initiatives Information Release

July 2023

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[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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[36] 9(2)(h) - to maintain legal professional privilege

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Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

TE TAI ŌHANGA
THE TREASURY

Tax Policy Report: Cross-cutting advice on Budget 2023 revenue package

Date:	14 March 2023	**Report No:**	T2023/313 IR2023/095
		File Number:	SH-13-5-3-10

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Discuss the contents of this report with officials	16 March 2023
Minister of Revenue (Hon David Parker)	Discuss the contents of this report with officials	16 March 2023

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Shane Domican	Senior Analyst, The Treasury	[35]	✓
James Beard	Deputy Secretary, The Treasury		
David Carrigan	Deputy Commissioner, Inland Revenue		

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Tax Policy Report: Cross-cutting advice on Budget 2023 revenue package

Executive Summary

This report advises you on the cross-cutting issues relevant for the package of tax options being considered for Budget 2023. This includes the overall impact of the package, the implications of the package on your macroeconomic and fiscal objectives, and the proposed legislative timeframes for the packages.

Overall impact of package

Distributional impact

Overall, the package will help you achieve your distributional objectives of increasing the progressivity of the tax system and increasing the after-tax income of the majority of New Zealanders. These distributional impacts could support your objective to support households with the cost-of-living challenge and may also support your Wellbeing objective to reduce child poverty.

Economic and integrity risks

The package has risks, which could run counter to your economic goals and undermine the distributional gains of the package if they reduce the incomes of New Zealanders.

If you progress the package you may wish to consider offsetting measures to maintain progress against your economic goals. Although, it is less clear that such measures could fully offset the negative impacts of the proposed revenue package. In addition, officials would recommend taking time to consider the best approach before introducing any offsets.

Living standards perspective

These impacts will affect the wellbeing of New Zealanders beyond the channels described above. For example, the impact on social cohesion will depend on competing considerations on the overall fairness of the package. Increasing the taxation of those who can have light taxation due to non-taxation of capital gains could be seen as improving fairness. However, there is also a risk that the condensed processes for development and the retrospective elements of package could reduce social cohesion through reducing trust in our institutions. Any economic costs will also impact human capability and our stocks of financial and physical capital.

He Ara Waiora lens

We have used the He Ara Waiora framework to consider the package from a Te Ao Māori perspective. Due to constraints in developing our advice our consideration is incomplete and without the benefit of engaging with Māori partners.

A He Ara Waiora perspective highlights that the process for designing package is likely not developed in accordance with He Ara Waiora principles. While best endeavours have been made to understand and address any specific impacts on iwi and Māori communities, we have been unable to consult or collaborate with these groups. This means that it has not been developed in partnership and we likely do not fully understand the impact on these communities.

A He Ara Waiora lens also provides insight into the trade-offs for the package. The main impact of the package is on Te Ira Tangaata (the human domain), particularly through influencing the incomes and opportunities for New Zealanders. The personal tax relief could support wellbeing through directly supporting peoples prosperity and indirectly can support people to participate and connect with their communities and realise their aspirations. However, the economic impacts of the package may also run against this if it reduces economic opportunities available to New Zealanders or has unintended impacts on Māori businesses or commercial endeavours.

Macroeconomic and fiscal impacts

The long-term structural impacts of the package are uncertain. The personal tax cuts under consideration are not expected to have significant positive labour supply impacts. The downside risk is that the cumulative effects on economic efficiency from the wealth tax translates into permanently lower potential output and living standards.

From a fiscal perspective, it will be possible to deliver a package that is broadly fiscally neutral and largely consistent with your fiscal strategy objectives. However, there is fiscal risk associated with a tax switch that relies on raising revenue from a highly uncertain new tax base.

In the near-term, the tax switch is also expected to be stimulatory. This is because a larger consumption response is expected from those who benefit than those who pay more tax, and because the wealth tax is likely to come into effect after personal income tax cuts. While the relative magnitudes are uncertain, all else equal, this could increase inflationary pressures and prompt some additional tightening of monetary policy. The actual monetary policy response will also depend on the aggregate impact of fiscal policy decisions contained in the Budget and broader economic development.

If you proceed with a package for Budget 2023, we recommend you consider options that mitigate the near-term risks. For example, we recommend phasing in the personal tax changes over time, considering a package that raises revenue overall as well as bringing revenue reducing and revenue raising measures into effect at the same time.

Treasury and Inland Revenue recommendation

As outlined in other reports, Treasury and Inland Revenue recommend increasing the trustee rate and recommend against the supernormal profits tax on banks.

When considering the tax switch of net wealth tax and personal tax cuts, Treasury and Inland Revenue consider that it will help achieve Ministers distributional objectives. It will increase the progressivity of the tax system, increase the after-tax income of the majority of New Zealanders, and increase the tax paid by those who likely most benefit from the non-taxation of capital gains. These benefits could be partially offset in the near-term if the tax switch increases uncertainty about the Government’s forecast return to a surplus operating balance or adds to inflationary pressures.

While there is uncertainty over the economic and integrity costs of the package, The Treasury and Inland Revenue are concerned that these costs could be large. While the net wealth tax is an improvement over a minimum tax, there are likely to be significant costs above what we would expect for other options to tax the wealthy. This is due to the tax creating biases in investment, high compliance costs, and greater integrity risks. There is also a risk that those affected will migrate which could negatively impact entrepreneurship and innovation.

Our judgement is that a net wealth tax is likely to have greater economic and integrity costs than other options that could achieve Ministers distributional objectives. A capital gains tax or inheritance tax, both of which are common in OECD countries, would raise revenue from high wealth individuals with significantly lower economic costs.

The personal tax relief may provide some economic benefits that could offset these costs. This is particularly true if those changes are focused on threshold adjustments that support work incentives rather than a tax-free threshold, from which the efficiency benefits would be comparatively small. However, we consider this is likely to mitigate these costs only partially even with the most growth-friendly personal tax changes.

The scale and pace of reform increases the risks. Further time and consultation could reduce the risk of a poorer design and unintended consequences that could increase the costs of the tax. Progressing a supernormal profits tax on banks at the same time and pace as the net wealth tax increases the risk of creating uncertainty and undermining confidence of investors. Further consultation would also mean more opportunity to build social licence for the reform.

These impacts will ultimately affect the wellbeing of New Zealanders. The package will increase the post-tax incomes of the majority of New Zealanders and there are potential social cohesion benefits if the package is perceived as broadly fair. However, the economic costs will also ultimately impact our stocks of financial and physical capital, and human capability which will also flow through to incomes and wellbeing of New Zealanders.

Quantifying the size of these competing impacts is challenging and the package has very significant distributional impacts in line with Ministers' objectives for the tax system. If introducing other options, such as a capital gains tax are not possible, the decision on whether to proceed will depend on whether Ministers progressivity objectives are worth the costs. The Treasury and Inland Revenue do not have a view on this question as this would require making value judgements.

Process and revenue alignment

If Ministers wish to progress the package, then Treasury and Inland Revenue also have concerns about the process for progressing the package and recommend against progressing the tax switch on this timeframe. As outlined earlier the constrained timeframe could create significant costs and increase fiscal and economic risks.

The Treasury recommends that Ministers only proceed if the package is revenue positive or neutral. This includes ensuring alignment of the timing of both elements of the switch and consultation to refine design.

As a result, we recommend an application date of 31 March 2025 for the wealth tax and 1 April 2025 for personal tax reductions to align the dates and allow further consultation.

If Ministers want to progress personal tax reductions sooner, then Treasury recommends bringing forward the wealth tax to 31 March 2024 to minimise the gap between revenue reducing and revenue raising measures.

Implementing a package

If you decide to proceed with the package, we recommend introducing three bills to implement it. This is on the basis that you wish to introduce legislation on Budget night for all the measures.

One bill would contain the personal tax [33] and would be passed under urgency.

The remaining two bills would contain the remaining items in the package. These would follow a full Select Committee process which we recommend as this would allow for consultation and minimise some of the risks. Two bills are required as the Office of the Clerk has advised that a separate bill would be required for the wealth tax. These bills would be introduced on Budget night and enacted by the end of March 2024.

The proposals would have significant implementation implications for Inland Revenue, which is the subject of a separate Inland Revenue report (IR2023/096 refer).

Next steps

We recommend you discuss this report with officials at the Joint Ministers Meeting of 16 March 2023.

Recommended Action

We recommend that you:

a **note** that officials consider there are significant risks progressing the proposed revenue package for Budget 2023, particularly given the scale and speed of reform.

b **discuss** the contents of this report with officials at the on 16 March 2023.

c **agree** to take measures to mitigate macroeconomic and fiscal risks of the package:

a. Phasing in any personal tax changes over time

Agree/disagree *Agree/disagree*

b. Bringing revenue reducing and revenue raising measures into effect at the same time (e.g. both applying in 2025, or if personal tax reductions apply earlier then bring forward wealth tax to 2024)

Agree/disagree *Agree/disagree*

c. Targeting a revenue positive package

Agree/disagree *Agree/disagree*

Legislative timeframes

If you wish to progress a package and introduce Budget night legislation, we recommend that you:

d **agree** to introduce a bill on Budget night to implement the personal tax changes, and for this bill to be enacted under urgency

Agree/disagree *Agree/disagree*

e **agree** to introduce two Bills on Budget night to implement the remaining items in the package both to be enacted by March 2024 following a full Select Committee process

Agree/disagree *Agree/disagree*

James Beard
Deputy Secretary
The Treasury

David Carrigan
Deputy Commissioner
Inland Revenue

Hon Grant Robertson
Minister of Finance

_____/_____/_______

Hon David Parker
Minister of Revenue

_____/_____/_______

Tax Policy Report: Cross-cutting advice on Budget 2023 revenue package

Purpose of Report

1. In this report we advise on the cross-cutting issues relevant for the package of tax options being considered for Budget 2023. This includes:

   a A summary of the overall distributional and economic impacts of the package

   b A high-level analysis of the package using a living standards and He Ara Waiora lens

   c The impact on your fiscal and macroeconomic objectives

   d Officials proposed legislative timeframe for implementing the tax packages

   e Officials' overall recommendations on the packages

2. You have separately received our advice on each of the specific tax options which includes our detailed analysis and recommendations on them. These are:

   a Further Policy Advice on Personal Tax Relief (T2023/409, IR2023/094 refer)

   b Advice on a wealth tax (T2023/316, IR2023/067 refer)

   c Potential tax system responses to supernormal profits within the New Zealand banking sector (T2023/282, IR2023/084 refer)

   d Increasing the trustee rate to 39% - detailed design (IR2023/058, T2023/269 refer)

3. You have also received a separate report on a cyclone levy. This report does not consider this option.

Combined impact of measures

4. Table 1 below collates the interim fiscal estimates of the measures as advised in previous reports. As outlined in those reports, the revenue estimates have high uncertainty, and we are continuing to refine them.

5. The individual items that could form a package are largely discrete as tax policy measures and do not have significant interactions. As a result, when considering the overall impacts of a package we can largely add together the individual impacts of each of the proposals.

Table 1. Summary fiscal impact of potential tax package measures

$billion		2023/24	2024/25	2025/26	2026/27
Wealth tax	**$5m threshold with 1% rate**	-	2.4	2.5	2.7
Personal tax reductions	**$10,000 tax-free zone**	(2.7)	(4.4)	(4.6)	(4.2)
	$8,500 tax-free zone	(2.3)	(3.8)	(3.9)	(3.5)
	$7,500 tax-free zone	(2.1)	(3.3)	(3.4)	(3.1)

Note. This assumes wealth tax applies on an exemption basis from 31 March 2024 and personal tax cuts are implemented from September 1 2023. The personal tax reductions include increasing main benefits and removing independent earner tax credits. These are illustrative examples and accompanying reports provide more information on alternatives. We can provide updated revenue estimates following your feedback including packages that are fiscally neutral.

Overarching objectives

6. We understand you have three overarching objectives for the package:

   a **Progressivity.** Increase the progressivity of the tax system. In particular, address how high-wealth individuals can have relatively light taxation (primarily owing to the non-taxation of most capital gains)

   b **Income support.** Increase the after-tax income of the majority of New Zealanders

   c **Fiscally neutral.** The package should be broadly fiscally neutral

7. The package will help achieve these objectives. Table 2 below provides a summary of the distributional impacts of potential measures forming the package. It shows that the majority of New Zealanders will pay less tax, with the increase in tax being paid predominantly by a small group of high-wealth New Zealanders.

8. However, there is a risk that in the short-term it could add to inflation pressures which could partially offset these gains. In addition, the economic impacts could have wider impacts on incomes and living standards which could also run against these objectives. These are discussed further below.

Table 2. Summary distributional impact of potential packages

Measure	Number of people impacted and summary impact
Personal tax reductions	• Will benefit majority of New Zealanders • A $10,000 per annum tax-free threshold would give 3.2 million New Zealanders $1,050 and 900,000 New Zealanders a lesser amount • Raising the 14k and 48k thresholds would give 1.5 million New Zealanders $1,270 and 2 million a lesser amount
Net wealth tax	• Will directly impact a small proportion of New Zealanders • 46,000 affected if $5m threshold with average annual increase in tax of approximately $58,000 with a 1% rate[1] • 24,000 affected with $7.5m threshold with average annual increase in tax of approximately $79,000 with 1% rate[1]
Higher trustee rate	• 134,000 trusts earnt trustee income in 2021 which would be affected • However, most of the tax will be paid by a smaller group. For example, 14,000 of these trusts pay approximately 86% of the trustee tax in 2021
Supernormal profits tax on banks	• Would apply only to four main banks

Link to wellbeing objectives

9. These distributional impacts could support your objective to support households with the cost-of-living challenge and may also support your Wellbeing Objective to reduce child poverty. For example, if you decide to increase main benefits and remove the independent earner tax credit alongside personal tax reductions then it could reduce the number of children in poverty by up to 2,000 (on a moving line, BHC50 measure) or 20,000 (on an fixed line, AHC50 measure).

10. As we have previously advised there are other tax or expenditure that are likely to be more targeted towards child poverty objectives or towards different economic objectives. In the time available and based on your direction we have not considered these further.

However, the package comes with economic and integrity risks

11. The package has economic and integrity risks primarily due to the negative impacts of the wealth tax and the supernormal profits tax on banks. These will create economic costs via a range of channels including through investment, migration, innovation, lending, and high compliance costs.

12. These economic risks are exacerbated by the speed and scale of the package. For example, the risk of undermining confidence in the New Zealand tax system and stability of policy settings is likely greater due to progressing both the supernormal profit tax and net wealth tax at the same time and with limited time for analysis and consultation.

[1] This assumes the 'exemption' approach to the threshold is taken

Link to economic strategy objectives

13. These economic costs are likely in tension with your economic objectives, and particularly your focus on unleashing business potential.

14. If you progress a tax package at Budget 23, you may wish to consider offsetting policies to maintain progress against your economic goals. Given the most relevant impact will be to business potential, one area you could consider is your industry policy settings.

15. It is unclear that offsetting measures could fully offset the negative impacts of the proposed revenue package to do so materially would still require significant effort and resources. If offsets are of interest, officials would recommend taking more time before considering any major offsetting intervention. This would provide more time to consider where best to target those offsets such that they provide good value for money and align with your Economic Plan.

Living standards and He Ara Waiora analysis

16. These economic and distributional impacts will ultimately impact the wellbeing of New Zealanders. They will mainly impact on New Zealand's level of social cohesion as well as our human capability, and our stocks of financial and physical capital:

    a **Social cohesion.** The overall impact on social cohesion will depend on the competing considerations across progressivity, horizontal equity, and perceptions of fairness of the package. Increasing the taxation of those who can have relatively light taxation due to the non-taxation of capital gains could be seen as improving fairness. There is however a risk that the fast pace of the package and the retrospective supernormal profits tax create a risk of reducing trust in our institutions and the confidence in New Zealand having stable policy settings.

    b **Human capability.** The net wealth tax will likely cause some high wealth individuals to leave New Zealand and reduce incentives to migrate to New Zealand. This may negatively impact our human capability, particularly if it reduces entrepreneurship and innovation. The personal tax cuts may also impact incentives for people to build skills, however the overall impact is uncertain as there are competing impacts.

    c **Financial and physical capital.** The economic costs of the net wealth tax and supernormal profits tax will impact financial and physical capital. There may be some offsetting impact from the personal tax reductions increasing work incentives, however we expect this to be relatively small.

He Ara Waiora analysis

17. We have also analysed the package using the He Ara Waiora (HAW) framework. This analysis has been done under significant time constraints, inability to consult and after the high-level design of the package has been completed. As a result, analysis is at a high level and incomplete particularly due to not having the benefit of engaging with Māori partners.

Means of He Ara Waiora

18. Within HAW the five 'means' can guide the process for designing tax policy. When considering these principles, there are common considerations across the revenue package.

Table 3. The means for He Ara Waiora

Principle/value	Description
Kotahitanga	Kotahitanga is ensuring that agencies work in aligned, coordinated way across the system and alongside iwi and Māori as Treaty partners, and other affected communities and groups.
Whanaungatanga	Working together to foster meaningful, reciprocal and enduring relationships with iwi and Māori, and affected communities and groups
Tikanga	Tikanga is when decisions are made by the right decision-makers, following a tikanga process, according to tikanga values.
Manaakitanga	Manaakitanga is a focus on improved wellbeing and enhanced mana for iwi and Māori, and for other affected communities and groups, demonstrating an ethic of care and mutual respect.
Tiakitanga	Tiakitanga focuses on providing a guardianship or stewardship. This econmpasses responsibility to work with iwi, Māori, Māori businesses and other agencies to improve their wellbeing.

19. The package has been designed with best endeavours to understand and address any specific impacts on iwi and Māori communities. This includes for example, providing an exemption for the Māori communally held assets from the net wealth tax and understanding the impact of the net wealth tax and higher trustee rate on Te Tiriti o te Waitangi (T2023/316, IR2023/067 refer). To the extent possible, Government agencies were consulted for specific elements of the package[2].

20. However, the very constrained process means that the revenue package has largely not been designed in accordance with these principles. We have not been able to consult or collaborate with iwi and Māori groups. Further, we have also not been able to undertake broader consultation under the generic tax policy process, the traditional tikanga for tax policy proposals, or emerging tikanga such as consultation with the Māori tax and social policy advisory panel.

21. This also means that we do not fully understand impact of the package on iwi and Māori communities. There are some aspects, of the package that may not be as well tailored towards Māori communities (for example the exemption for Māori communally held assets requires consultation to ensure it is designed appropriately). The Select Committee process for the measures will also provide some opportunity to work with iwi and Māori on the design of the measures.

Ends of He Ara Waiora

22. The ends of He Ara Waiora also provide a lens over the key trade-offs for the package. The main impact of the package is on Te Ira Tangaata (the human domain) which emphasises the mana of people and communities. The package mainly affects this through impacting people’s incomes which will directly support their power to grow sustainable and intergenerational wealth (mana whanake).

23. Increasing incomes can have flow on impacts to other connected parts of the ‘ends’ that support wellbeing such as their capability to pursue their aspirations (mana āheinga), participate and connect with their communities (mana tautuutu), to develop a

[2] Specifically there has been discrete consultation on elements of the package with the Ministry of Foreign Affairs - Manatū Aorere, Crown Law -Te Tari Ture o te Karauna, the Ministry of Social Welfare - Te Manatū Whakahiato Ora, the Financial Markets Authority – Te Mana Tātai Hokohoko, the Public Trust of New Zealand, The Office of the Māori Trustee - Te Tumu Paeroa, the Ministry of Disabled People - Whaikaha, the Ministry of Justice – Te Tāhū o te Ture, the Reserve Bank of New Zealand - Te Pūtea Matua, and the Australian Tax Office.

stronger sense of belonging and identity (mana tuku iho), and to have a greater ability to decide on, and realise their unique aspirations (mana āheinga).

24. Some may also consider that a more progressive tax system will increase the degree of reciprocity in society and sense of community.

25. However, the economic impacts of the package may also run counter to these potential gains. This can occur if it reduces people's economic opportunities or has unintended impacts on Māori businesses or commercial endeavours, for example if the package flows through to higher interest rates.

Macroeconomic and fiscal implications

26. Previous advice from the Treasury has set out how a tax package might influence your macroeconomic and fiscal objectives (T2023/136 and T2023/187 refer). This advice extends that analysis.

The long-term structural impacts of the package are uncertain, but are likely to have the biggest impact on living standards over time

27. The tax switch under consideration is a significant structural reform that will have both near-term and long-term effects. While the near-term implications are important to consider, the most important consideration is whether you judge the longer-term costs and benefits meet your economic and distributional objectives. This is because the cumulative effects of structural change are likely to have the most significant impact on living standards over time.

28. If the personal income tax cuts include changes to marginal tax rates, then we would expect a positive impact on labour supply. This would occur if workers demonstrated increased willingness to work by taking on more hours or entering the workforce. Based on the packages under consideration, we would expect the labour supply impacts to be relatively minor.

29. Our advice on the net wealth tax [T2023/316, IR2023/067 refers] notes that the policy could negatively affect incentives to save, invest or innovate, which would have implications for productivity growth and capital accumulation, in turn affecting labour productivity and potential output. We are unable to quantify these impacts but the risk is that the cumulative effects are sufficiently material to translate into permanently lower potential output and living standards.

Despite being broadly fiscally neutral, the tax switch presents fiscal risks

30. Any tax switch that is designed to be fiscally neutral at the end of the forecast period should only have a limited impact on your key fiscal indicators and targets.

31. If the personal tax cuts are implemented in 2023/24 and the wealth tax comes into effect in 2024/25, we would expect the OBEGAL to deteriorate by the size of the tax cut in 2023/24 only, with a corresponding one-off increase in net debt. For example, a tax package with a fiscal cost of $2b in 2023/24 that is fiscally neutral thereafter would reduce OBEGAL by 0.5% of GDP in 2023/24, and permanently increase net debt by the same amount.

32. In this scenario there would be no impact on your targets to return OBEGAL to surplus by 2024/25 and maintain a surplus thereafter. Net debt would also remain well below the debt ceiling.

33. Accordingly, the biggest fiscal risk is that the package relies on raising revenue from a highly uncertain new tax base. While the fiscal costing could under or overestimate

revenues from a net wealth tax, the consequences will be asymmetrical if the revenue will be used to fund personal tax cuts that will come into effect alongside or before the wealth tax. This risk increases the uncertainty about the Government's forecast path to surplus.

34. Recent guidance from credit rating agencies suggests that a revision to your short-term fiscal target, on its own, is unlikely to trigger a ratings downgrade[3]. Nevertheless, as the fiscal neutrality (from 2024/25) of the package relies on raising revenue from an uncertain new tax base, the tax package could make the Government's credit rating more sensitive to negative expenditure or revenue surprises. We will monitor credit rating agency sentiment in our usual post-Budget engagements and advise if there are any concerns raised about risks to the Government's ratings.

Short-term risks also arise in the current high inflation environment

35. Any tax package will be delivered in the context of a challenging macroeconomic environment. Inflation is above target and employment is above its maximum sustainable level, while interest rates are being raised to counter inflationary pressures. These factors are contributing to cost of living challenges for many New Zealanders, and the macroeconomic challenges will be exacerbated by the disruption and destruction from Cyclone Gabrielle and the Auckland flooding. A short and shallow economic downturn is forecast, which we consider to be a necessary consequence of the monetary policy response required to return inflation to the target band by re-anchoring short-term inflation expectations.

36. Despite being broadly fiscally neutral at the end of the forecast period, a tax switch as proposed is expected to be stimulatory due to two factors:

    a The progressivity of the package: the positive consumption response to the personal tax changes will far outweigh the reduction in consumption from those subject to the net wealth tax.

    b Timing mismatches between revenue raising and lowering changes: you have indicated that personal income tax cuts are likely to come into effect in 2023/24, while the net wealth tax would begin raising revenue in 2024/25.

37. While the relative magnitudes are uncertain, all else equal we expect the package to lead to an increase in private consumption, leading to lower unemployment and a smaller output gap. This is because the vast majority of taxpayers would benefit from the package. We would expect a rise in interest rates to offset any inflationary pressures that result. However, the actual monetary policy response will also depend on the overall fiscal impact of the Budget, of which a tax package would be just one component, as well as broader economic developments. The Treasury intends to provide further advice to the Minister of Finance on 17 March 2023 about the overall inflationary impacts of different fiscal choices.

If you decide to proceed, we recommend you consider options that mitigate the near-term risks

38. As set out below, whether or not to proceed with a tax package relies on a judgement across multiple objectives that extend beyond the macroeconomic and fiscal considerations.

39. Given the short-term risks identified above we recommend that you seek to minimise the possible macroeconomic and fiscal risks through careful design and implementation, regardless of what package you progress.

[3] For example, at S&P's latest ratings review of New Zealand in September 2022, S&P stated that they could "lower our ratings on New Zealand if the fiscal deficit does not narrow as we forecast and interest costs rise substantially to more than 10% of government revenues".

40. To this end, we recommend phasing in the personal tax changes over time and minimising the delay between implementing revenue reducing and revenue raising measures. Ideally, the personal tax cuts would be brought into effect at the same time as the wealth tax. While this would not fully address the macroeconomic risks, it would help to mitigate the concerns. Moreover, this approach would mean that the scale of tax cuts could be calibrated based on more certain forecasts of the revenue to be raised through other aspects of the tax package.

41. Fiscal objectives could also be given more weight by seeking to implement a package that raises revenue in net terms. Such an approach would provide a buffer against the risk of negative revenue surprises that may arise from the introduction of an uncertain new tax base, while also reducing trade-offs with near-term macroeconomic objectives.

42. Finally, as discussed with the Minister of Finance at the Weekly Agency Meeting on 6 March 2023, officials are beginning to liaise with the Reserve Bank about the inflationary impacts of possible changes to the aggregate fiscal stance arising from Budget 2023. This engagement does not seek to influence the MPC's subsequent monetary policy decision but is intended to allow you to better understand the Bank's possible response when making decisions.

Please note that the discussion was at working level (i.e. no senior staff involved) and was indicative only based on our understanding of the inflationary impacts of fiscal policy generally

Treasury and Inland Revenue recommendation

43. As outlined in other reports, Treasury and Inland Revenue recommend increasing the trustee rate and recommend against the supernormal profits tax on banks.

44. When considering the tax switch of net wealth tax and personal tax cuts, the Treasury and Inland Revenue consider that it will help achieve Ministers distributional objectives. It will increase the progressivity of the tax system, increase the after-tax income of the majority of New Zealanders, and increase the tax paid by those who likely most benefit from the non-taxation of capital gains. These benefits could be partially offset in the near-term if the tax switch adds to inflation pressures.

45. While there is uncertainty over the economic and integrity costs of the package, The Treasury and Inland Revenue are concerned that these costs could be large. While the net wealth tax is an improvement over a minimum tax, there are likely to be significant costs above what we would expect for other options to tax the wealthy. This is due to it creating biases in investment, high compliance costs, and greater integrity risks. There is also a risk that those affected will migrate which could negatively impact entrepreneurship and innovation.

46. Our judgement is that a net wealth tax is likely to have greater economic and integrity costs than other options that could achieve Ministers distributional objectives. A capital gains tax or inheritance tax, both of which are common in OECD countries, would raise revenue from high wealth individuals with significantly lower economic costs.

47. The personal tax relief may provide some economic benefits that could offset these costs. This is particularly true if those changes are focused on threshold adjustments that support work incentives rather than a tax-free threshold, from which the efficiency benefits would be comparatively small. However, we consider this is likely to mitigate these costs only partially even with the most growth-friendly personal tax changes.

48. The scale and pace of reform increases the risks. Further time and consultation could reduce the risk of a poorer design and unintended consequences that could increase the costs of the tax. Progressing a supernormal profits tax on banks at the same time and pace as the net wealth tax increases the risk of creating uncertainty and undermining confidence of investors. Further consultation would also mean more opportunity to build social licence for the reform.

49. These impacts will ultimately affect the wellbeing of New Zealanders. The package will increase the post-tax incomes of the majority of New Zealanders and there are potential social cohesion benefits if the package is perceived as broadly fair. However, the economic costs will also ultimately impact our stocks of financial and physical capital, as well as human capability which will flow through to the incomes and wellbeing of New Zealanders.

50. Quantifying the size of these competing impacts is challenging and the package has very significant distributional impacts in line with Ministers' objectives for the tax system. If introducing other options, such as a capital gains tax are not possible, the decision on whether to proceed depends on whether Ministers progressivity objectives are worth the costs. Because this requires value judgements, Treasury and Inland Revenue do not have a view on this question.

Process and revenue alignment

51. If Ministers wish to progress the package, then Treasury and Inland Revenue also have concerns about the process for progressing the package and recommend against progressing the tax switch on this timeframe. As outlined earlier the constrained timeframe increases risks and could create significant costs and increase fiscal and economic risks.

52. The Treasury recommends that Ministers only proceed if the package is revenue positive or neutral. This includes ensuring alignment of the timing of both elements of the switch and consultation to refine design.

53. As a result, we recommend an application date of 31 March 2025 for the wealth tax and 1 April 2025 for personal tax reductions to align the dates and allow further consultation.

54. If Ministers want to progress personal tax reductions sooner, then Treasury recommends bringing forward the wealth tax to 31 March 2024 to minimise the gap between revenue reducing and revenue raising measures.

Implementing a package

Administration impacts

55. If the proposals are agreed to this will have significant implementation implications for Inland Revenue. Inland Revenue is reporting separately to you on delivery pressures and the consequences of taking on a large Budget package (including the revenue and financial implications of the package, IR2023/096 refer). This reporting will also include trade-offs of internal and policy initiatives and may contain recommendations to defer the implementation of policies that have already received Cabinet approval.

Legislative impacts

56. This section outlines our proposed legislative process for implementing a Budget 2023 package. This is on the basis that you wish to introduce legislation on Budget night for all the measures.

57. Table 4 outlines our proposed 3 bills to implement the package.

Table 4. Proposed bills for B23 revenue package

Bill	Contents
Budget night urgent Bill	• Personal income tax rates and thresholds • [33]
Wealth tax Bill	• New wealth tax
Budget omnibus Bill	• Increasing trustee rate • Supernormal profits tax • Non-Budget tax proposals such as Pillar 2, lump-sum ACC/MSD payments, and setting the annual rates for the 2023-24 tax year

Budget night urgent bill

58. We propose the Budget night urgent Bill would be passed under urgency and not referred to a Select Committee. As these changes will potentially apply from 1 September 2023 or 1 April 2024, it is essential that these are enacted quickly to provide Inland Revenue and payroll software providers time to implement them.

Wealth tax and Budget omnibus Bill

59. We recommend separate Bills for the wealth tax and the remaining items as The Office of the Clerk has advised that an omnibus taxation Bill can only amend existing tax legislation and cannot also enact a new principal Act.

60. Table 5 outlines proposed timeframe for both the Wealth Tax Bill and Budget omnibus Bill. These follow similar tracks and would cross over the election period but would be enacted before the end of March 2024. This would not affect the fiscal impact or application date of the proposals.

61. We also propose that oral hearings of evidence are held after the election. We recommend this as there will likely be a new composition of the Finance and Expenditure Committee and it will be preferable for the new members to hear submitters directly as they will be reporting to the House on the Bill. We note that tax bills introduced in 2017 and 2020 followed a similar timeline and crossed the 2017 and 2020 elections.

Table 5. Recommended timeline for the Wealth tax Bill and Budget omnibus Bill

Milestone	Approximate date
Introduction	Mid-May 2023
First reading and referral to FEC	End of May 2023
Submission period	June-July 2023
Election period: August-October 2023	
Initial briefing and oral hearings of evidence	November 2024.
FEC report to the House	By February 2024
Royal asset	By end of March 2024

62. We have also considered an alternative timetable if the Government wants to enact the revenue package before the election. This would require a fourth taxation bill that would contain the increase in trustee rate and supernormal profits tax. This, however, would require a truncated select committee process. As a result, we recommend against this as it would limit the time available for experts to input on the bills and improve the quality of the legislation.

Next steps

63. We recommend you discuss this report with officials at the Joint Ministers Meeting of 16 March 2023.