The Treasury

Budget 2023 Tax Initiatives Information Release

July 2023

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Overarching considerations for a Budget 2023 revenue package

Date:	15 February 2023	**Report No:**	T2023/136
		File Number:	SH-13-5-3-10

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Note** contents and **discuss** your fiscal objectives with officials at the next Weekly Agency Meeting	20 February 2023

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Ben Gaukrodger	Principal Advisor, Tax Strategy, The Treasury	[39]	✓
Stephen Bond	Manager, Tax Strategy, The Treasury		

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

Refer this report to the Minister of Revenue. **Return** the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Overarching considerations for a Budget 2023 revenue package

Purpose of Report

1. This report highlights some of the main cross-cutting issues relevant to the package of tax options being considered for Budget 2023 and seeks a discussion to understand your fiscal objectives for any package.

2. The report stops short of providing substantive recommendations as officials are still designing and analysing the package of options. More comprehensive advice on the package will follow by 10 March ahead of the Budget Ministers 4 meeting.

3. Accordingly, the intention of this interim report is to support ongoing decision-making on the detailed elements of each individual project in advance of our 10 March advice and the coordination with the 2023 Budget. We do this by highlighting the design choices that are most likely to affect some of your wider objectives. This includes your wellbeing objectives and economic strategy, and your macroeconomic and fiscal objectives.

Background and Context

4. You are considering tax changes for announcement in Budget 2023 in four areas, each of which you have received separate advice on:

   a Changes to personal taxes (T2023/157, IR 2023/037 refers);

   b The introduction of a minimum tax (T2022/2703, IR2022/516 refers);

   c An increase in the trustee tax rate (T2023/2469, IR2022/484 refers); and

   d A tax on supernormal bank profits (T2023/53 refers).

5. No decisions have been taken on prospective application dates if any of the changes proceed. If you wish to progress personal tax cuts quickly, then there is a risk that revenue reducers will precede the main revenue raising initiative (the deemed minimum income tax). The sequencing of application dates is therefore a key factor when considering the macroeconomic and fiscal elements of the package.

6. Any tax changes would be taking place in a challenging macroeconomic environment. Inflation is elevated, contributing to cost of living challenges for many individuals. Moreover, economic growth is forecast to slow considerably in the near term as interest rates rise to lower inflationary pressure. The Reserve Bank's November Monetary Policy Statement forecast inflation to return to the 1 to 3 percent target band in the second half of 2024. Both the Reserve Bank and the Treasury forecast a contraction in activity in the near term.

7. Implementation will be a challenge with any likely package, particularly where a new tax is introduced. Inland Revenue is reporting to the Minister of Revenue separately on these challenges and have recommend that report is referred to you.

Interactions with Your Broader Wellbeing and Economic Objectives

8. While the proposed tax package will be broadly neutral across most of your wellbeing-enhancing strategies (climate response, mental and physical health), it could have significant implications for achieving some of your wellbeing and economic objectives. The two most significant proposals – changes to personal income tax rates and the introduction of a minimum tax – will have the largest impacts.

9. These may have implications for realising some of your objectives, for example:

   a A cut to personal income tax rates (depending on scale and progressivity) could support households with the current cost-of-living challenge that the Government has signalled is a priority. If the benefits are mostly received by those on lower incomes, it may also be well-aligned with the Wellbeing Objective to *improve child wellbeing and reduce child poverty.*

   b There may however be tensions with some of your Economic Plan objectives, especially with your focus on *unleashing business potential*. In particular, the minimum tax may disincentivise innovation, and disproportionately impact the incentives for creating start-ups – many of which are focused on adopting new digital and technological innovations. Wealthy entrepreneurs may decide to leave New Zealand given the substantial increase in taxation some may face. However, there may be some offsetting impacts. For example, there could be some efficiency benefits from improving work incentives through personal tax cuts.

10. As you develop your approach, you may wish to consider the implications for firms given their size (micro, SME, large) and stage (start-up, growth, mature). The landscape of existing government support programmes that are available for business may also be relevant. For example, if you are concerned about start-ups, you could consider if impacts are (or could be) offset through government support. For example, programmes exist that target start-ups, including Callaghan Innovation's Technology Incubator repayable Grant and NZ Growth Capital Partner's Aspire NZ Seed Fund.

Tax Changes in a High-Inflation Environment

11. The net fiscal effects of any tax package and the distribution of any changes will have a critical influence on the overall macroeconomic implications of any tax package. The macroeconomic component of your fiscal strategy, which needs to be balanced against your other fiscal objectives, is to provide as much support to monetary policy as possible in achieving price stability.

12. A net neutral or slightly revenue raising package will be most likely to support the Reserve Bank's objective of returning inflation to within the target band. Conversely, staggering application dates such that personal tax reductions come into effect in advance of a deemed minimum income tax would have a positive but transitory inflationary impact. In the current inflationary environment, there is an elevated risk that any transitory impacts would feed through into inflation expectations and ongoing inflationary pressures, which could increase the economic cost associated with returning inflation to the target band.

13. The distribution of any changes is also expected to have an impact on consumption, inflation and output. Typically, those on lowest incomes are the most likely to increase consumption in response to tax changes. Accordingly, a highly progressive package, even if fiscally neutral, may still have a positive inflationary impact.

Consequences for the Fiscal Strategy

14. The Government's short-term fiscal target is to return OBEGAL to surplus by 2024/25. In the long-term, the objective is to maintain that surplus.

15. A package that is revenue neutral or revenue raising will support this long-term fiscal objective. A package that reduces revenue would run counter to that objective, but could be mitigated if part-funded through the existing operating allowances. However, as advised ahead of Budget 2022 and the Budget Policy Statement 2023, we consider the allowances to be currently set at a level that means Budgets 2024 to 2026 will likely be 'cost pressure-focused' Budgets in the absence of commensurate savings, reprioritisation or new ongoing revenue initiatives [T2022/244 and T2022/2030 refers].

16. With respect to achieving the short-term objective (and assuming a revenue neutral package overall) the application dates of the revenue raising and reducing elements of the package will be critical. HYEFU forecasts suggested an OBEGAL surplus of $1.7 billion in 2024/25. This could become a deficit if significant personal tax cuts are introduced before then but a deemed minimum income tax follows after 2024/25. There is scope to deviate from the short-term target, although it would be important to do this in a way that retained a credible path towards achieving your long-term fiscal objectives.

17. The credibility of the overall fiscal strategy is also likely to be influenced in part by the perceived risks associated with different elements of any package. Some risk arises in this regard by relying on the introduction of an uncertain new tax to raise revenue. Further, if Budget announcements indicate that a deemed minimum income tax will be refined through a select committee process, markets may perceive some risk that the revenue estimates will be lowered at implementation.

18. Officials recommend discussing the coordination of your fiscal strategy and any tax package at the Weekly Agency Meeting on 20 February. This will help officials understand your fiscal objectives and develop policy options to meet those objectives.

Recommended Action

We recommend that you:

a **note** the contents of this report

b **discuss** your desired fiscal objectives in the short and long-term with officials at the Weekly Agency Meeting on 20 February 2023

c **refer** this report to the Minister of Revenue.

Stephen Bond
Manager, Tax Strategy

Hon Grant Robertson
Minister of Finance

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