The Treasury

Budget 2023 Tax Initiatives Information Release

July 2023

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Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

TE TAI ŌHANGA
THE TREASURY

Tax Policy Report: Budget 2023 Revenue Raisers and Medium-Term Revenue Strategy

Date:	18 August 2022	**Report No:**	T2022/1765, IR2022/387
		File Number:	SH-13-5-3

Action Sought

	Action Sought	**Deadline**
Minister of Finance (Hon Grant Robertson)	Discuss at Joint Ministers meeting of 25 August Direct Inland Revenue and Treasury to provide further advice	25 August
Minister of Revenue (Hon David Parker)	Discuss at Joint Ministers meeting of 25 August Direct Inland Revenue and Treasury to provide further advice	25 August

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**	**1st Contact**
Stephen Bond	Manager, the Treasury	[39]	
Phil Whittington	Chief Economist, Inland Revenue	[35]	
Trish Ieong	Principal Policy Advisor, 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/Yes (attached) OR Yes (iManage links)

Tax Policy Report: Budget 2023 Revenue Raisers and Medium-Term Revenue Strategy

Purpose of Report

1. This report seeks direction for Inland Revenue and the Treasury to provide further advice on revenue raising options. The report also supports a discussion at the Joint Ministers meeting of 25 August on the medium-term revenue strategy. This report:

   a Outlines the constraints and options for revenue raising as part of Budget 2023.

   b [33]

2. We will also provide advice shortly on a specific revenue raising option following a request from the Minister of Finance's office.

Context

3. In July 2022, the Treasury provided the Minister of Finance their initial thinking on the revenue strategy (T2022/1565 refers). As part of this, the Treasury outlined that there are fiscal challenges that may make it difficult to maintain operating surpluses and meet the government's fiscal objectives.

4. The Treasury recommended that the Minister of Finance commission further advice on revenue raising options and how we could better align revenue options with the Budget process.

5. The Minister of Finance agreed to discuss this further with the Minister of Revenue at a future Joint Ministers meeting.

Budget 2023

6. As Treasury advice (T2022/1734 refers) has set out, the Budget 2023 allowance of $4.5 billion (of which $2 billion has been allocated) is relatively constrained in the context of likely cost pressures, outstanding commitments, and other potential Budget priorities. Therefore, there is a strong case for considering revenue options as one of a range of options to support the delivery of that allowance and your new fiscal rules.

7. There are significant constraints on what is possible by Budget 2023. Base maintenance options are not generally feasible unless they have already been substantially progressed. Inland Revenue officials have not identified any significant base maintenance options that could be sufficiently developed in time for Budget 2023.

8. Changes to rates or thresholds for existing bases (personal or GST), removal or reduction of tax credits or increases in some excise taxes are feasible but come with trade-offs that you would need to consider.

Tax measures already progressing or may be progressed for Budget 2023

9. To be included in Budget 2023, the proposal must be developed enough for Cabinet to approve before the Budget moratorium period begins in April 2023.

10. There are two measures that Cabinet has agreed to since Budget 2022 that will be added to the forecasts at the Half-Year Economic and Fiscal Update (GST on managed funds and the Gig and Sharing Economy). Together, these are forecast to raise $417m over the forecast period, with some upfront implementation costs.

11. [33]

Changing tax rates or thresholds

12. Adjustments to tax rates or thresholds for existing bases (for example, GST and company tax) are feasible for Budget 2023. However, there are risks and trade-offs involved with changing rates or thresholds.

13. We outline at a high level the risks and trade-offs involved with:

    a increasing the trustee rate to 39%,

    b [33]

    c increasing personal taxes.

14. Officials can provide more detailed advice on each of these options at your request. Even if an option is not progressed for Budget 2023, officials can commence work on it for Budget 2024 if you wish.

Increasing trustee rate to 39%

15. This is estimated to raise approximately $350m p.a. Increasing the trustee rate is likely to reduce misalignment pressures but will not fully resolve them.

16. Cabinet has previously decided that a decision on whether to increase the trustee rate should wait until taxpayers have provided necessary information to test compliance and the effective operation of the 39% top personal income tax rate (CAB-20-MIN-0484 refers). To test this, disclosure requirements for trusts were increased from the 2021-22 income year. A full year of data will not be available until after 31 March 2023, when most trusts' 2021-22 return will be due.

17. Raising the tax rate on trusts can lead to increased over-taxation for trusts that do not or cannot allocate income to beneficiaries on lower tax rates (this can include trusts set up for children or people with disabilities). These issues cannot be resolved in time for Budget 2023 and their resolution will reduce the revenue raised from increasing the trustee rate. While raising the trustee rate by itself does not require many operational resources, resolving these consequential issues will.

[33]

[33]

Increasing personal taxes

21. Personal taxes could be increased by raising personal tax rates or lowering income tax thresholds.

22. Increasing the top personal tax rate will increase pressures on misalignment. Partly as a result, it is also unlikely to raise substantial additional revenue; raising the top rate by a further 6 percent would likely raise significantly less revenue than raising it to 39% did. We discuss the misalignment issue later in this report and separately in our misalignment report, provided alongside this report (T2022/1837, IR2022/352 refers).

23. Increasing other personal tax rates or lowering the thresholds at which higher rates apply is a simpler change and is unlikely to require significant operational resources to implement.

24. The revenue that could be raised by increasing personal taxes would depend on which rates or thresholds are changed. Officials can discuss options with you at the Joint Ministers meeting on 25 August and provide further advice and estimates after that meeting.

Other options

25. We have identified that it may also be feasible by Budget 2023 to:

    a Remove or reduce the size of **tax credits** such as the donation tax credit (cost around $300m p.a.), independent earner tax credit (cost around $200m p.a.) or the KiwiSaver Government contribution (cost around $1b p.a.). However, doing this may conflict with the Government's broader objectives.

    b Progressing simple rate changes to **corrective taxes** (particularly alcohol excise). However, officials would recommend that consultation is undertaken with other agencies before a decision is made to progress. Other excise taxes could be considered but are either currently hypothecated or have recently been significantly increased and further increased ruled out (such as tobacco excise).

26. We can provide you further advice on feasibility and potential options at your request.

Medium-term revenue strategy — Budget 2024 and onwards

27. You have a wider set of revenue options to consider at future Budgets. As Treasury officials have advised (T2022/1734 refers), pressures on the fiscal position are likely to accumulate over time and therefore developing options that allow for further revenue raising would give you a wider set of choices to deliver your fiscal rules.

28. In the medium term, there are further options to raise revenue within the existing tax system. However, the revenue from these options will tend to be in the tens to hundreds of millions per annum. As a result, they can support you in keeping within or setting annual Budget allowances but will not be large enough on their own to fully address the scale of medium-term fiscal pressures.

29. Options that more substantially raise the tax-to-GDP ratio to manage medium-term fiscal pressures will require longer term decisions about the broader structure of the tax system. We have identified three broad approaches below.

Changes within the existing system

30. We have identified three areas within our **current system** that we could explore which could support your fiscal objectives year-on-year:

a Base maintenance through the Tax and Social Policy Work Programme

b Expanding the use of corrective taxes and other charges

c [34]

31. These will generally be efficient revenue raisers that support horizontal equity or your wider economic objectives.

a. Base maintenance through the Tax and Social Policy Work Programme

32. There are options to raise revenue through addressing gaps in our income tax or GST rules. We can investigate whether there are further options to include in the next Tax Policy Work Programme to reduce gaps, limit tax concessions or address areas where we think there could be under-taxation. However, our impression is that the ability to raise significant revenue by addressing gaps is limited under the current tax system structure.

33. Further base maintenance options will require time to be developed and consulted on. While these options tend to make the tax system fairer and more efficient over time, they also include items that reduce revenue. Some options that raise revenue will have significant impact on particular stakeholders and will likely face strong opposition. This may make them challenging to implement. Other options are technically complex and may require substantial work and consultation.

34. We recommend you direct Inland Revenue and the Treasury to provide further advice on base maintenance options to consider as part of the Tax and Social Policy Work Programme refresh. If you agree, we will report back to you later this year on this.

Interaction with the Scorecard

35. You previously agreed that additional revenue from base maintenance measures should generally be put on the Tax Policy Scorecard to ensure changes can be made for the fair and effective functioning of the tax system (T2021/1273, IR2021/551). Using extra revenue from such measures for broader fiscal goals will reduce the extent to which improvements to the tax system can be made.

b. Expanding the use of corrective taxes and other charges

36. Corrective taxes and other charges are primarily used to support your economic and social objectives through altering incentives and delivering change across multiple parts of your economic strategy. However, such taxes and charges also deliver revenue and as noted above it would be feasible to increase some corrective taxes in Budget 2023 – e.g., alcohol excise. However, officials recommend that any further options are considered for future Budgets to allow more time for consultation.

37. We are aware of the following work underway on corrective taxes and other charges that could support your revenue strategy. As this work is still being developed, the extent to which any increases in rates are necessary to meet the social or economic objective of the tax or charge are still being determined:

a *Emissions pricing:* Work is underway on strengthening the emissions trading scheme, pricing agricultural emissions, and reducing emissions leakage.

[33]

38. As these proposals develop, we recommend that you consider how they could support your fiscal strategy. For example, decisions on whether to hypothecate new charges should consider the costs and benefits of hypothecation against your fiscal objectives. The Treasury can provide further advice on these at your request.

39. In addition, there may also be further options to use corrective taxes and charges to support your economic and revenue objectives (for example, reviewing duty free rules or additional environmental tax proposals).

40. We have not consulted with other agencies on this report. If you wish to commission further advice, we would like to discuss with you the best approach for engaging with other agencies.

c. [34]

41. Inland Revenue intends to discuss their compliance strategy with the Minister of Revenue, [34]

Structure of the tax system

42. As explained above, revenue from base maintenance, corrective taxes and improved tax compliance will not be enough on their own to fully address fiscal challenges. We have identified three longer term approaches for raising the tax-to-GDP ratio. These approaches will involve decisions about the broader **structure of the tax system**:

    a *Broadly maintaining the existing system but undertake increases to some tax rates for large bases.* This would maintain some level of misalignment for income tax rates but increase certain tax rates (such as GST or trustee rate), or potentially reduce thresholds, to address fiscal pressures; or

    b *Structural reform to the income tax base.* This would take a more strategic look at the tax system and look to move to a system where income tax rates are more aligned, which could allow for more revenue to be raised through the income tax system. We have also provided you with a report on the next steps for the work on the misalignment of tax rates (T2022/1837, IR2022/352 refers). This report outlines three indicative examples of the direction of possible structural reforms; and

    c *New or expanded tax bases.* This could be explored in combination with either of the above two options.

43. At the Joint Ministers' meeting on 25 August, we wish to discuss with you the process and timeframe for further engagement on the direction of the tax system's structure. We recommend reporting to you before the end of this year with preliminary analysis.

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[33]

Recommended Action

We recommend that you:

a **discuss** the contents of this report at the Joint Ministers meeting on 25 August.

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b **note** that officials will report to you in late September with further advice on a digital services tax.

c **note** that officials have not identified other significant base maintenance options that could raise revenue and be sensibly developed in time for Budget 2023.

d **indicate** if you want further advice on any of the following to consider as part of Budget 2023 (or alternatively Budget 2024):

i. increasing trustee rate to 39%

Request for Budget 2023/ Request for Budget 2024/ Do not request	*Request for Budget 2023/ Request for Budget 2024/ Do not request*

[33]

iii. increasing personal taxes

Request for Budget 2023/ Request for Budget 2024/ Do not request	*Request for Budget 2023/ Request for Budget 2024/ Do not request*

iv. reviewing tax credits

Request for Budget 2023/ Request for Budget 2024/ Do not request	*Request for Budget 2023/ Request for Budget 2024/ Do not request*

v. simple rate changes to corrective taxes (such as alcohol excise)

Request for Budget 2023/ Request for Budget 2024/ Do not request	*Request for Budget 2023/ Request for Budget 2024/ Do not request*

e **indicate** whether you want further advice on other tax issues for Budget 2023.

f **direct** Inland Revenue and the Treasury to report back on base maintenance policy options to consider for inclusion in the Tax and Social Policy Work Programme

Agreed/not agreed *Agreed/not agreed*

g **indicate** whether you want further advice on how corrective taxes and charges could be used to raise revenue and support your economic strategy for Budget 2024 onwards

h **note** that Inland Revenue will discuss the current compliance environment with the Minister of Revenue

i **discuss** with officials the process and timing for further advice on the direction of the tax system's structure, including dealing with the challenges of misalignment

Stephen Bond
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Phil Whittington
Chief Economist
Inland Revenue

Hon Grant Robertson
Minister of Finance

_____/_____/_______

Hon David Parker
Minister of Revenue

_____/_____/_______