The Treasury

Budget 2023 Tax Initiatives Information Release

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POLICY AND REGULATORY STEWARDSHIP

TE TAI ŌHANGA
THE TREASURY

Joint Report: Further Policy Advice on Personal Tax Relief

Date:	14 March 2023	**Priority:**	High
Security level:		**Report number:**	IR2023/094 T2023/409

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson) **Minister of Revenue** (Hon David Parker)	**Agree** to the recommendations	Monday, 20 March, 2023

Contact for telephone discussion (if required)

Name	Position	Telephone
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Joint Report: Further Policy Advice on Personal Tax Relief

Executive Summary

This report provides further policy advice to support your decisions on personal tax relief measures for Budget 2023. It sets out the relevant decisions you will need to make and officials' recommended approach.

You have separately received advice on cross-cutting issues relevant to the overall package of tax measures under consideration for Budget 2023. We understand that your overarching objectives for the overall package are:

- **Progressivity**: Increase the progressivity of the tax system
- **Income support**: Increase the after-tax income of the majority of New Zealanders.

Personal tax relief options can support both objectives, although other measures in the package will have a greater impact on the progressivity of the tax system as a whole. This report considers a tax-free threshold, alongside officials' recommended option to increase the $14,000 threshold with a small increase to the $48,000 threshold.

Officials' recommendations

Officials recommend against a tax-free threshold. This is because:

- Introducing a tax-free threshold undermines the integrity of the personal tax system
- While a tax-free threshold benefits a greater number of taxpayers with lower individual incomes than any other option, the transfer system is a much more targeted and cost-effective mechanism to target lower income households
- A tax-free threshold will deliver smaller economic benefits than alternative options, as it has less impact on work incentives at the margin.

We recommend raising the $14,000 threshold, combined with a small increase in the $48,000 threshold. This would provide gains to those with low individual incomes and deliver greater economic benefits, in line with Treasury and Inland Revenue's cross-cutting advice.

Main benefits

Main beneficiaries will not automatically gain from changes in tax rates. This is because main benefits are set in net (after-tax) terms. Main benefits will increase as a result of higher average wage growth on 1 April 2024, but that increase will be less than the value of the tax change.

Therefore, officials recommend that a personal tax relief package includes an accompanying increase to main benefits, as long as the cost of such an increase is included in the tax switch. Without an increase in main benefits, tax changes could increase headline measures of child poverty and may not meet your distributional objectives.

There are a few ways this could be implemented, and you have a choice around the size of an increase. Officials recommend a flat dollar increase to main benefits, as it would be the simplest option to deliver and would not lead to different increases to different benefit rates.

Independent Earner Tax Credit

As previously advised, officials recommend abolishing the Independent Earner Tax Credit. Depending on application date, we would recommend abolishing it either from 1 April 2024 or 1 April 2025. This would generate fiscal savings of $121 million in 2024/25 (if abolished from 1 April 2024) and around $130m in each of 2025/26 and 2026/27.

Other considerations

There are three smaller decisions you need to make:

- Tax consequentials: officials recommend in this report that you agree to make other consequential changes to withholding and similar taxes such as PAYE, Fringe Benefit Tax, and Portfolio Investment Entity (PIE) tax.

- Minimum Family Tax Credit (MFTC): officials recommend that you increase the MFTC on the same day as the personal tax changes (whether as part of the 1 April annual adjustment process, or on 1 September 2023)
- Student support: Student Allowances will automatically increase as a result of tax changes, as they are set gross of income tax. This will have flow-on impacts for entitlement to student loans. Officials recommend you take a similar approach to applying this increase as is decided for main benefits.

Options modelled in this report

To help illustrate how a personal tax relief package could be sized once the revenue available for a tax switch is confirmed, we have modelled high, medium and low packages within the estimated range of revenue. We have modelled a tax-free threshold only package and an alternative package based on Officials' recommendations above.

In line with previous advice, we have modelled associated flow-on costs to transfer payments, consequential impacts on other tax types, an increase to main benefits, and withdrawal of the Independent Earner Tax Credit (IETC).

The table below summarises the highest cost options that we have modelled with all those associated impacts included:

	$ billion 2023/24	$ billion 2024/25	$ billion 2025/26	$ billion 2026/27
$10,000 tax-free threshold	(2.7)	(4.4)	(4.6)	(4.2)
Alternative IR/TSY recommendation*	(2.5)	(4.1)	(4.2)	(3.8)

*Increase $14,000 threshold to $25,000 and $48,000 threshold to $52,000

Implementation

Consistent with our macro-economic advice, we recommend sizing the personal tax option to a fiscal cost that would enable an overall package that is revenue positive and implementing it on a similar timing to the net wealth tax.

On that basis, officials recommend that, if you decide to proceed with a tax switch, you should implement any personal tax changes from 1 April 2025 alongside the application of the net wealth tax. If you opt for earlier application of the net wealth tax, then officials recommend that personal tax changes should be made from 1 April 2024 at the earliest.

If you prefer an earlier implementation date, Inland Revenue advises that personal tax and PAYE changes could be made from 1 September 2023, but that a number of consequential changes to other tax types could not occur until 1 April 2024 (largely due to the third-party system modifications required).

Subject to your decisions following Budget Ministers 4, officials will provide you with final policy options that fit within a fiscally neutral tax switch.

Recommended Action

We recommend that you:

Following the discussion at Budget Ministers 4 on 20 March

Main tax changes

a **Indicate** your preferred approach to providing personal tax relief:

EITHER

a. A tax-free threshold

Yes/No *Yes/No*

OR

b. Raising the $14,000 threshold, with a small increase to the $48,000 threshold **(recommended)**

Yes/No *Yes/No*

OR

c. A combined approach: a tax-free threshold and changes to existing thresholds **(not modelled in this report)**

Yes/No *Yes/No*

b **Note** that, in order to deliver a final fiscally neutral package you will need to make some adjustments to the tax changes, and we will report on that once you have confirmed your preferences on both elements of the tax switch;

c **Indicate** your preferred implementation date for the main tax changes**:**

EITHER

a. 1 April 2025 **(Officials' recommendation if you decide to proceed with the tax switch)**

Yes/No *Yes/No*

OR

b. 1 April 2024 **(Officials' recommendation if you decide to proceed with the tax switch earlier than 1 April 2025)**

Yes/No *Yes/No*

OR

c. 1 September 2023

Yes/No *Yes/No*

Consequential changes to other tax types

d **Note** that personal income tax changes have consequential impacts on several other tax types, and that implementation of changes to some of these tax types is not possible mid-year, and would be implemented at the beginning of a tax year;

e **Agree** to make consequential amendments to other tax types as required in line with your preferred option for the main tax changes in recommendation (a) above;

a. Portfolio Investment Entity tax (PIE tax)

b. Employer Superannuation Contribution Tax (ESCT)

c. Retirement Scheme Contribution Tax (RSCT)

d. Fringe Benefit Tax (FBT)

e. Resident Withholding Tax (RWT)

Agreed / Not Agreed *Agreed / Not Agreed*

f **Note** that the fiscal cost of these consequential changes has been included in this report;

Main benefits rate increase

g **Agree** to provide an accompanying increase to net rates of main benefits as part of the personal tax relief package, to align with your preferred timing in recommendation (c) above;

Agreed / Not Agreed *Agreed / Not Agreed*

Subject to your agreement to provide an accompanying main benefit increase in recommendation (g) above

h **Indicate** your preferred option to provide an accompanying increase to net rates of main benefits;

EITHER

a. Approach 1 – an increase to main benefits equivalent to the gain from the tax changes, rounded to the nearest dollar (*not recommended for any option other than a tax-free threshold*)

Yes/No *Yes/No*

OR

b. Approach 2 – a flat dollar increase of an alternative amount *($10 per adult recommended for a threshold change option*)

Yes/No *Yes/No*

$5 per adult	$7.50 per adult	$10 per adult	$12.50 per adult	$15 per adult

Student Support

i Note that the rates of student allowance are set gross and therefore, in the absence of further decisions, recipients will gain from the tax changes, with consequential impacts on student loan entitlement

If approach 2 (a fixed dollar increase to main benefits) was agreed in rec [h]:

j **Agree** to adjust the rates of student allowance, with consequential impacts on student loan entitlement, to apply the same after-tax increase as agreed for main benefits above

Agreed / Not Agreed *Agreed / Not Agreed*

k **Note** that further advice will be provided on increases to student living support, in line with your decisions above and we will engage with the Ministry of Education

Minimum Family Tax Credit (MFTC)

l **Agree** to increase the MFTC on the same day as the personal tax changes (whether as part of the 1 April annual adjustment process, or on 1 September 2023)

Agreed / Not Agreed *Agreed / Not Agreed*

Independent Earner Tax Credit (IETC)

m **Agree** to remove the IETC **(recommended)** from**:**

- 1 April 2025 if you agree to an application date for personal tax changes of 1 April 2025 (recommendation c-a above)
- 1 April 2024 if you agree to an application date for personal tax changes of either 1 April 2024 or 1 September 2023 (recommendation c-b or c-c above)

Agreed / Not Agreed *Agreed / Not Agreed*

n **Note** that if removed in April 2024, removal of the IETC would result in estimated savings of around $120 million in 2024/25 that can be offset against the fiscal costs of the personal tax changes;

Implementation and administrative implications

o **Note** that you have separately received advice from Inland Revenue, on the overall revenue, expenditure, and capacity impacts of all proposed Budget 2023 tax initiatives, including the potential for Inland Revenue to partially self-fund the capital and/or operating impacts of these initiatives;

p Note that MSD is able to implement a mid-year benefit increase, however this will require trade-offs and additional funding for implementation costs.

Fiscal costs and final advice

q **Note** that officials will provide final fiscal costs and implementation advice after Budget Ministers 4.

Stephen Bond Manager The Treasury	**Kerryn McIntosh-Watt** Policy Director Inland Revenue
Hon Grant Robertson Minister of Finance / / 2023	**Hon David Parker** Minister of Revenue / / 2023

Purpose of Report

1. This report provides further policy advice to support your decisions on personal tax relief measures for Budget 2023. The main option considered is a tax-free threshold. It also presents officials' recommended option, reflecting the Treasury and Inland Revenue's overarching advice, to balance your distributional goals with the efficiency benefits of personal tax changes.

2. The report provides high, medium and low packages within the range of the revenue raised by the net wealth tax, to help illustrate how a personal tax relief package could be sized once the revenue available for a tax switch is confirmed. The advice includes:

   - analysis of the costs and benefits of the options
   - advice on accompanying measures, including an increase to main benefit rates, and withdrawal of the Independent Earner Tax Credit (IETC)
   - information about flow-on implications, including consequential changes to other tax types
   - implementation advice.

3. You have separately received advice on cross-cutting issues relevant to the overall package of tax measures under consideration for Budget 2023.

Policy context

4. We understand that your overarching objectives for the overall package of tax measures under consideration for Budget 2023 are:

   - **Progressivity**: Increase the progressivity of the tax system
   - **Income support**: Increase the after-tax income of the majority of New Zealanders.

5. Personal tax relief options can support both objectives, although other measures will have a greater impact on the progressivity of the tax system as a whole.

6. We understand that you are particularly interested in the option of a tax-free threshold, to provide support to the greatest number of taxpayers. This report considers this option, alongside an alternative option that officials consider would support your objectives, while providing greater efficiency benefits.

7. The two main options for personal tax changes considered in this report are:

- **Tax-free threshold** – this provides a gain to the greatest possible number of taxpayers, and ensures the full gain is achieved at a very low level of income.

- **Officials' recommended alternative option: increasing the $14,000 threshold, with a small increase in the $48,000 threshold** – this is expected to have greater efficiency benefits, while providing gains to most individuals.

8. Other combinations of changes are possible, as noted in our recent advice [IR2023/038 / T2023/303 refers].

Summary of officials' personal tax recommendation

9. Officials recommend against introducing a tax-free threshold. This is because:

   - Introducing a tax-free threshold undermines the integrity of the personal tax system and introduces additional complexity;
   - While a tax-free threshold benefits a greater number of taxpayers at lower individual incomes than any other option, the transfer system is a much more targeted and cost-effective mechanism to target lower income households;
   - A tax-free threshold will deliver smaller economic benefits than alternative options, as it has less impact on work incentives at the margin.

10. Officials' recommended option is to increase the $14,000 threshold, combined with a small increase in the $48,000 threshold, which balances providing gains to those with low individual incomes with delivering greater economic benefits. If you are concerned with overall distributional impacts, this option could be accompanied by lower cost changes to provide additional relief to households through the transfer system (increasing main benefits [33]

11. Table 1 summarises the high-level impacts of the two approaches.

Table 1: Summary of approaches and impacts

	Approach 1 Tax-free threshold	**Approach 2** Raise the $14,000 threshold, with a small increase in the $48,000 threshold
Most earners receive a gain	✓	✓
Most earners receive the maximum gain	✓	✗
Potential to improve work incentives	✓	✓
Supports progressivity as incomes grow	✗	✓
Supports the integrity of the tax system	✗	✓

Note: Darker shade of green indicates more significant impact.

Fiscal cost

12. We have modelled low, medium, and high packages of changes to support you in deciding on your final preferred tax switch package: each includes a personal tax relief option, consequential changes to other taxes, an option to increase main benefits, and withdrawal of the IETC.

13. The estimated cost of the proposed personal tax reduction options and accompanying measures is as follows.

Table 2: costings of low, medium, and high personal tax options

Low Package - $7.5k TFT	Increase (decrease) in operating balance ($billions)				
	2023/24	2024/25	2025/26	2026/27 & Outyears	4 yr total
Personal Tax Changes incl flow-ons	(1.8)	(3.1)	(3.2)	(2.9)	(11.0)
Optional Main Benefits Increase	(0.3)	(0.3)	(0.3)	(0.3)	(1.3)
Removal of IETC from 1 April 2024	0.0	0.1	0.1	0.1	0.4
Total package	**(2.1)**	**(3.3)**	**(3.4)**	**(3.1)**	**(11.9)**

Low Package - Alternative Option	Increase (decrease) in operating balance ($billions)				
($14k --> $23k ; $48k --> $50k)	2023/24	2024/25	2025/26	2026/27 & Outyears	4 yr total
Personal Tax Changes incl flow-ons	(1.7)	(2.9)	(3.0)	(2.7)	(10.4)
Optional Main Benefits Increase	(0.2)	(0.2)	(0.2)	(0.2)	(0.9)
Removal of IETC from 1 April 2024	0.0	0.1	0.1	0.1	0.4
Total package	**(1.9)**	**(3.0)**	**(3.1)**	**(2.8)**	**(10.9)**

Medium Package -$8.5k TFT	Increase (decrease) in operating balance ($billions)				
	2023/24	2024/25	2025/26	2026/27 & Outyears	4 yr total
Personal Tax Changes incl flow-ons	(2.0)	(3.5)	(3.6)	(3.3)	(12.4)
Optional Main Benefits Increase	(0.3)	(0.4)	(0.4)	(0.4)	(1.5)
Removal of IETC from 1 April 2024	0.0	0.1	0.1	0.1	0.4
Total package	**(2.3)**	**(3.8)**	**(3.9)**	**(3.5)**	**(13.5)**

Medium Package - Alternative	Increase (decrease) in operating balance ($billions)				
($14k --> $25k ; $48k --> $50k)	2023/24	2024/25	2025/26	2026/27 & Outyears	4 yr total
Personal Tax Changes incl flow-ons	(2.0)	(3.3)	(3.4)	(3.1)	(11.8)
Optional Main Benefits Increase	(0.2)	(0.2)	(0.2)	(0.2)	(0.9)
Removal of IETC from 1 April 2024	0.0	0.1	0.1	0.1	0.4
Total package	**(2.2)**	**(3.4)**	**(3.5)**	**(3.2)**	**(12.3)**

High Package - $10k TFT	Increase (decrease) in operating balance ($billions)				
	2023/24	2024/25	2025/26	2026/27 & Outyears	4 yr total
Personal Tax Changes incl flow-ons	(2.4)	(4.1)	(4.3)	(3.8)	(14.6)
Optional Main Benefits Increase	(0.4)	(0.5)	(0.5)	(0.5)	(1.7)
Removal of IETC from 1 April 2024	0.0	0.1	0.1	0.1	0.4
Total package	**(2.7)**	**(4.4)**	**(4.6)**	**(4.2)**	**(16.0)**

High Package - Alternative Option	Increase (decrease) in operating balance ($billions)				
($14k --> $25k ; $48k --> $52k)	2023/24	2024/25	2025/26	2026/27 & Outyears	4 yr total
Personal Tax Changes incl flow-ons	(2.4)	(3.9)	(4.1)	(3.7)	(14.0)
Optional Main Benefits Increase	(0.2)	(0.2)	(0.2)	(0.2)	(0.9)
Removal of IETC from 1 April 2024	0.0	0.1	0.1	0.1	0.4
Total package	**(2.5)**	**(4.1)**	**(4.2)**	**(3.8)**	**(14.5)**

14. Final costings will be undertaken after Budget Ministers 4. These costings incorporate a combination of Treasury costings from its TAWA model for tax changes, benefit

changes, and flow-on impacts, and IR costings of tax consequentials. Treasury modelling of these changes has been cross-checked with IR and MSD modelling for consistency. Final costings will also require input from the Ministry of Education on student support.

Analysis of personal tax options

15. The following analysis considers the impacts of a $10k per annum tax-free threshold and an alternative option of lifting the $14,000 threshold to $25,000 and the $48,000 threshold to $52,000. These are the tax options for the 'high' packages. A summary is provided in Table 3 (showing forecast numbers for the 2024/25 fiscal year).

16. We have also modelled smaller options on similar principles to support final decisions on the package as a whole. Further detail and statistical analysis for all option variations is provided in Appendix A.

Table 3: Summary: $10k tax-free threshold and alternative raised thresholds option

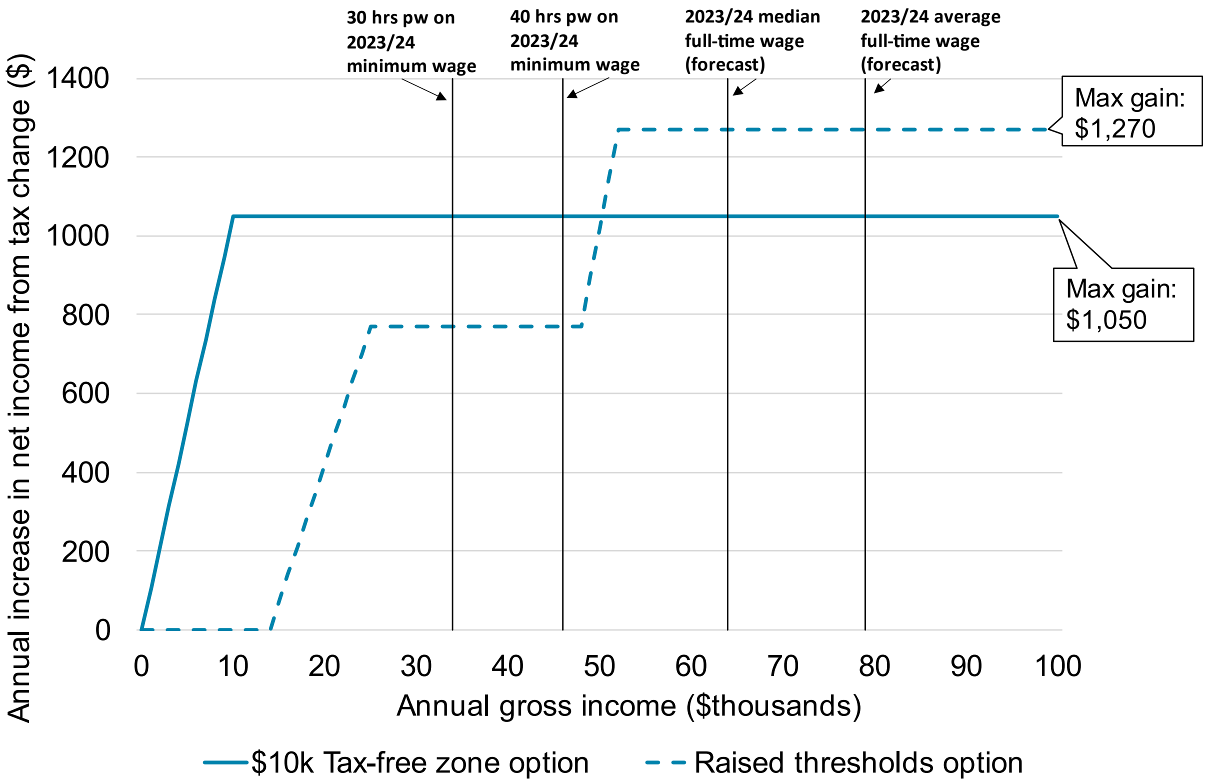
	$10k p.a. Tax-free threshold	**Raised thresholds**
Tax-Free Zone	$10,000	0
Current $14,000 threshold	$14,000	$25,000
Current $48,000 threshold	$48,000	$52,000
Gain starts from	0	$14,000
Maximum gain p.a.	$1,050 at $10,000	$770 at $25,000 $1,270 at $52,000
Estimated number who gain / who gain the full amount from tax change	4.1m / 3.2m	3.5m / 1.5m
Size of optional main benefit increase	$20 per adult	$10 per adult
Fiscal impact of full package in 2024/25	($4.4 b)	($4.1 b)
Fiscal impact of full package over the forecast period	($16.0 b)	($14.5 b)

Distributional impacts

Individuals

17. Figure 1 shows the impact on net annual income for individuals from the options.

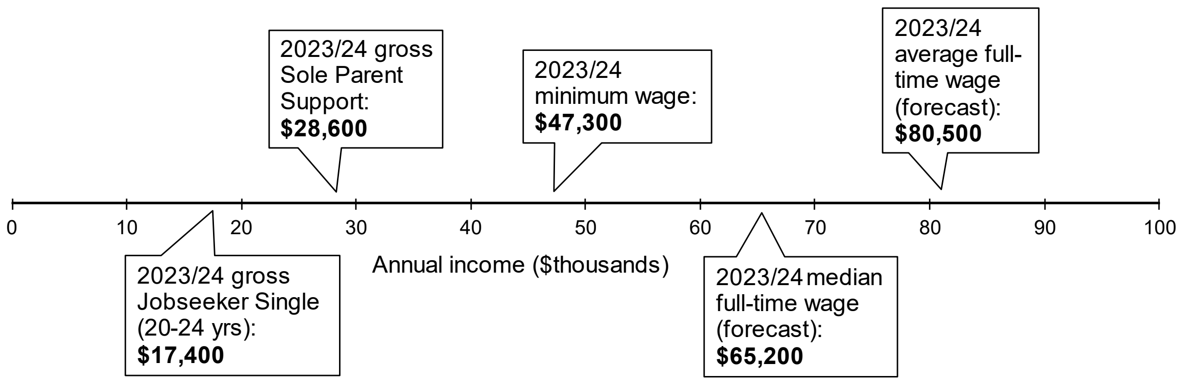
Figure 1: Impact of tax changes on net income for individuals



18. A tax-free threshold of $10,000 p.a. will give a benefit to approximately 600,000 more people than an option to raise the $14,000 threshold, which provides no gain to those with income below the threshold. However, the data suggests that the majority of individuals with income under $14,000 would not be a key target for income support objectives. A table summarising the characteristics of this group is included at Appendix B.

19. Figure 2 shows the annual income levels for some key wage and benefit rates in the 2023/24 year.

Figure 2: Key income levels in 2023/24[1]



[1] The Jobseeker, Sole Parent Support and minimum wage levels are based on rates agreed by Cabinet, while the median and average full-time wage levels are estimates based on Treasury forecasts.

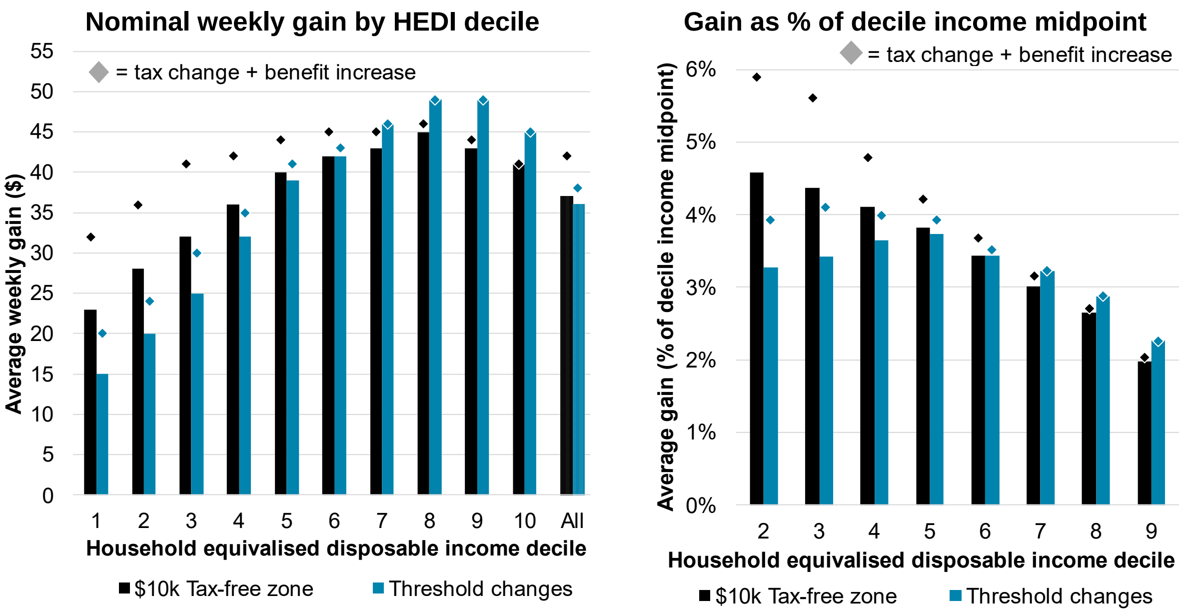
20. Income data from the 2022 Household Labour Force Survey show that all industries except for Retail, Trade and Accommodation have a median annual wage of more than $52,000, meaning the median worker in all of these industries would immediately receive the full gain from the raised thresholds option.

21. Individuals with income from main benefits only would not see a direct gain under either option, owing to the way in which main benefits are calculated. Instead, there will be a lagged indirect impact, via higher than otherwise wage indexation in April 2024.

Households

22. Figure 3 shows the impact of the policy options by household equivalised disposable income (HEDI) decile, in both nominal terms and as a % of the decile income midpoint. The bars show the impact of the main tax change. The diamond markers show the combined impact of the tax change and an accompanying decision to increase main benefit rates in line with the options modelled for this report.

Figure 3: Impact of tax changes and benefit increases by HEDI decile



23. Both options provide the greatest nominal gain at HEDI decile 8, which includes households with equivalised disposable income of between $80,400 and $97,000.

24. When including both the main tax change and the accompanying increase to main benefits, both options provide the largest gains as a % of decile income to the lower deciles.

Impacts on Māori and Pacific Peoples

25. Although time constraints have not allowed for a full distributional analysis based on ethnicity, income data from Stats NZ provide an indication of how policy impacts may differ for Māori and Pacific Peoples. In 2022, median weekly incomes from wages and salary were 9% below the population median for Māori, while incomes for Pacific Peoples were 11% lower. These lower earnings suggest that a larger proportion of Māori and Pacific Peoples would prefer the tax-free zone option over the threshold

changes compared to the overall population. However, annualising these weekly earnings suggests the median full-time worker among both Māori and Pacific Peoples would earn around $56,000 per year, and would therefore receive the full gain from the threshold changes and be better off compared to the tax-free zone.

Progressivity

26. On an individual income basis, a $10k tax-free threshold increases progressivity between the lowest and middle/higher earners. However, it has significantly less impact on progressivity elsewhere in the system – for example, between middle and higher income earners, where fiscal drag has reduced the progressivity of the system over time.

Efficiency impacts

27. Marginal and average tax rates are both relevant to work incentives. Marginal tax rates (MTRs) matter the most for individuals choosing whether to earn additional income (such as recipients of main benefits transitioning to work). Average tax rates (ATRs) matter the most for individuals making a decision on whether to work at all (such as potential secondary household earners deciding whether or not to take a standard part-time or full-time job).

28. Officials' view is that threshold adjustments will make a more significant difference to MTRs and ATRs at the point in the income distribution where they are more likely to be meaningful. For example:

- A tax-free threshold of $10k would lower MTRs for those with income under $10k. This is not expected to include a high proportion of individuals making marginal decisions about work. Many individuals at this very low income range (up to around 8.5 hours per week on the 2023/24 minimum wage for a non-beneficiary) will not be wage/salary earners or are likely to have part-year income only. It would not improve work incentives for those in the benefit system.

- Raising existing thresholds reduces MTRs at an income range more consistent with decisions about work for moving from part-time to full-time work. This option improves the return from work for individuals with combined income from main benefits and wages. It also has the potential to reduce effective marginal tax rates (EMTRs) for Working for Families (WfF) recipients who are subject to abatement of their entitlement.

- Both options reduce ATRs, but threshold changes lead to a more significant reduction at income levels consistent with part-time or full-time work.

29. Table 4 updates material provided in previous advice on the impacts of the options on people working while also receiving a main benefit on an annual basis [IR2023/038 / T2023/303 refers]. Raising the $14,000 threshold increases the returns from work, whereas a tax-free threshold has little or no impact. This is because the tax-free threshold only affects the marginal rates paid at main benefit levels, rather than on the extra income from work.

Table 4: After-tax income gain for three beneficiary scenarios on 1 September 2023 if no accompanying benefit increase

Income sources	**Tax-free threshold** (max gain of $20.19 per week, $1,050 per annum)	**Raised thresholds** (max gain from of $14.81 per week, $770 per annum)
Scenario 1: Main benefit only (Jobseeker Single 25+)	No change	No change
Scenario 2: Main benefit (unabated) plus 5 hours work at the minimum wage ($113.50pw gross)	No change	$7.24 extra per week, $376.40 per annum
Scenario 3: Main benefit (abated) plus 15 hours work at the minimum wage ($340.50pw gross)	$1.58 extra per week, $82.12 per annum	$14.81 extra per week, $770.00 per annum.

Integrity and structure of the tax system

30. Relative to changes to existing thresholds, a $10k tax-free threshold has a greater risk of income-splitting behaviour between non-wage and salary earners, which could have negative impacts on public confidence in the tax system and on revenue.

31. A tax-free threshold of $10k also has implications for the ongoing structure of the personal tax system. Under this option, the 10.5% tax rate would apply to income between $10,001 and $14,000, i.e. a tax band of $4k. This may raise the question of whether the 10.5% band should be extended further up the income scale (at a fiscal cost, unless offsetting measures are taken) or removed, leading to a steep increase in the marginal tax rate (from zero to 17.5%).

Administration and compliance

32. A number of tax types and rates are based on the personal income tax system. Under both options, consequential changes would be needed to maintain consistency.

33. Changes are more significant for the tax-free threshold option, as zero-rates would need to be added to several tax types such as Resident Withholding Tax (RWT), Portfolio Investment Entity tax (PIE tax), Employer Superannuation Contribution Tax (ESCT), Fringe Benefit Tax (FBT) and Retirement Scheme Contribution Tax (RSCT).

34. The one-off administration and compliance costs for introducing a tax-free threshold will therefore be higher. Further detail is provided in the implementation section and Appendix C.

Option to provide increase to main benefits

35. Main beneficiaries' income will not automatically adjust in the same way as New Zealand Superannuation recipients, as main benefits are set net of tax.

36. The tax changes will have an indirect impact via indexation on the rates of main benefits from 1 April 2024. However, that indirect impact will be less than the equivalent impact of the tax change.

37. Given this, you could increase main benefit rates, and the modelling in this report includes increases in line with your previous feedback. When deciding on any change, you should consider:

- The impacts on child poverty and your broader distributional objectives, and
- The indirect impacts of the tax package on benefit indexation on 1 April 2024.

38. There are different approaches available to determine the size of the benefit increase. We have modelled different approaches for the different tax changes. For simplicity and ease of implementation, we recommend against providing an increase equivalent to the gain from the tax changes (approach 1 below) if selecting the raised thresholds option for the main tax change.

	Tax-free threshold	**Alternative threshold option**
Approach 1: An increase equivalent to the gain from the tax changes for each benefit type if earned as salary and wages	As all benefit types are above the proposed tax-free threshold of $10k, which means all rates would increase by the maximum gain of $20 per adult (rounded to the nearest dollar). – **Modelled**	Providing an equivalent increase to match the gains from the tax changes would result in smaller increases to some benefit rates such as couple rates ($4 to $9 increase) and youth rates ($1 to $7 increase) compared to higher benefit rates such as Sole Parent Support ($15 increase) – **not recommended**
Approach 2: An increase of a fixed dollar amount which could be larger or smaller than under Approach 1	Ministers could choose to increase benefit rates by a smaller amount such as $5, $10 or $15 per adult, given the compounding impact of indexation.	We have modelled an increase of $10 per adult which is the average gain across benefit types under approach 1. It is the equivalent gain for someone earning wages of $21,500. It is likely to be simpler to have a flat dollar increase – **Modelled**

Poverty impacts

39. The tax changes, if progressed in isolation, risk increasing the number of children in poverty on the before-housing costs moving line measure which is counter to your child poverty reduction targets (Table 5). This is because the tax changes lift the income of the median household, and it is a relative measure of poverty.

40. By accompanying the tax changes with a benefit increase, the package is more likely to lead to a small reduction in the number of children in poverty on the BHC50 measure, though this impact remains within the margin of error.

Table 5: Impact of tax package of child poverty with and without benefit adjustment ($10,000 TFT option)

	Impact on BHC50 poverty	**Impact on ACH50 poverty**
Impact of tax changes alone	Increase the number of children in BHC50 poverty by around 3,000 to 4,000. Note that this impact is within the margin of error.	Decrease the number of children in AHC50 poverty by 12,000 to 13,000.
Impact of tax changes and benefit increase (retaining IETC)	Decrease the number of children in BHC50 poverty by 1,000 to 2,000. Note that this impact is within the margin of error.	Decrease the number of children in AHC50 poverty by: 20,000 if introducing a tax-free threshold, or 16,000 if adjusting thresholds.

Impact of tax package on indexation at 1 April 2024

41. The combined impact of indexation and a separate benefit increase would result in larger gains for beneficiaries compared to others with wage income only. You could consider this impact when setting any increase to main benefits alongside a tax change. Table 6 shows the comparative impacts.

Table 6: Projected gains from tax changes [2]

	Projected increase on 1 April 2024 under status quo (SQ)	**Tax-free threshold**	**Alternative threshold option**
Jobseeker – Single 25+ *Indirect impacts only*	+$16.61 Assumes wage growth is 4.92%	+$22.62 **($6.01 above SQ)**	+$23.88 **($7.27 above SQ)**
Jobseeker – Single 25+ *Indirect impact of main benefit increase*	+$16.61 Assumes wage growth is 4.92%	+$43.96 Includes $20 increase **($27.35 above SQ)**	+$34.58 Includes $10 increase **($17.97 above SQ)**
40 hours on minimum wage	+$38.28 (If minimum wage increases to $24/hr)	+$58.48 **($20.19 above SQ)**	+$57.71 (**$19.42 above SQ)**
Half married rate of NZ Super	+$18.80 Based on CPI forecast of 4.93%	+$39.95 **($21.15 above SQ)**	+$31.30 **($12.50 above SQ)**

[2] This table assumes the minimum wage would increase to $24 on 1 April 2024 to illustrate comparative impacts: it does not change the conclusion of the analysis.

Related decisions

Student Support

42. There are two components to student support – student allowance and student loan living costs. Student allowance is set gross in legislation and so unlike main benefits, the net payment would automatically increase in the absence of further decisions. This means students receiving student allowance will gain from the tax changes based on their gross income. There will also be a consequential change to student loan entitlements.

43. Even if Ministers decide against providing an increase to main benefits, there still may be a policy rationale to ensure students benefit from the tax changes. Student allowance is not indexed to wage growth (it is indexed to CPI) so will not gain from the same indirect effect of the tax changes as main benefits.

44. The full fiscal impact of an increase to student support has not yet been modelled. An increase to student allowance is included in the overall costings for the tax options (via the automatic increase) but has not been modelled separately. The fiscal impact of the consequential change to student loan entitlements has not yet been modelled, though only part of the policy cost will need to be counted within the fiscally neutral tax switch. Assuming you wish to extend the increase to students, we will engage with the Ministry of Education to model these impacts and confirm the fiscal management approach.

45. If you decide to raise thresholds for the main tax change, we recommend increasing the student allowance (and consequentially student loans) by a fixed dollar amount rather than the automatic increase which will give those on a lower rate of student allowance a smaller increase (as with main benefits).

Minimum Family Tax Credit (MFTC)

46. Changes to tax and benefit settings have flow-on impacts to the level of the MFTC and require consequential changes to the threshold. The MFTC is a tax credit within Working for Families that is received by around 3,000 families with children. Families are entitled to this payment where their after-tax family income is less than $34,216 per annum or $658 per week (from 1 April 2023). The MFTC tops up a family's combined after-tax weekly income to $658. The amount is targeted primarily at sole parent families who must work at least 20 hours to be eligible. This amount is just higher than what the family would receive while on a main benefit, on average.[3]

47. Consequential changes to the MFTC threshold will cost between $10 and $30 million over the forecast period and have been incorporated into the fiscal modelling.

48. If the main tax change (and any accompanying increase to main benefits) is implemented mid-year, officials recommend that the threshold for the MFTC is also adjusted at that time. This would ensure that families receiving the MFTC had an increase in their after-tax incomes immediately, which is consistent with the overall policy intent. Depending on the tax change and scale of any accompanying main benefit increase, the threshold would increase by around $20 to $30 per week.

[3] However, recent decisions to increase main benefits by the increase in CPI (rather than wage inflation) means that the MFTC threshold is lower than it should be.

49. The IETC was introduced in 2009. It provides a maximum entitlement of $520 per year. In the 2020-21 tax year around $212 million was paid to 493,400 recipients. There have been no significant changes to the tax credit since its implementation in 2009.

50. The fiscal cost of IETC has been reducing by around $10 - $15 million a year due to income growth causing fewer and fewer people to be eligible. By 2024/25 the number of eligible people is expected to have reduced to 313,000.

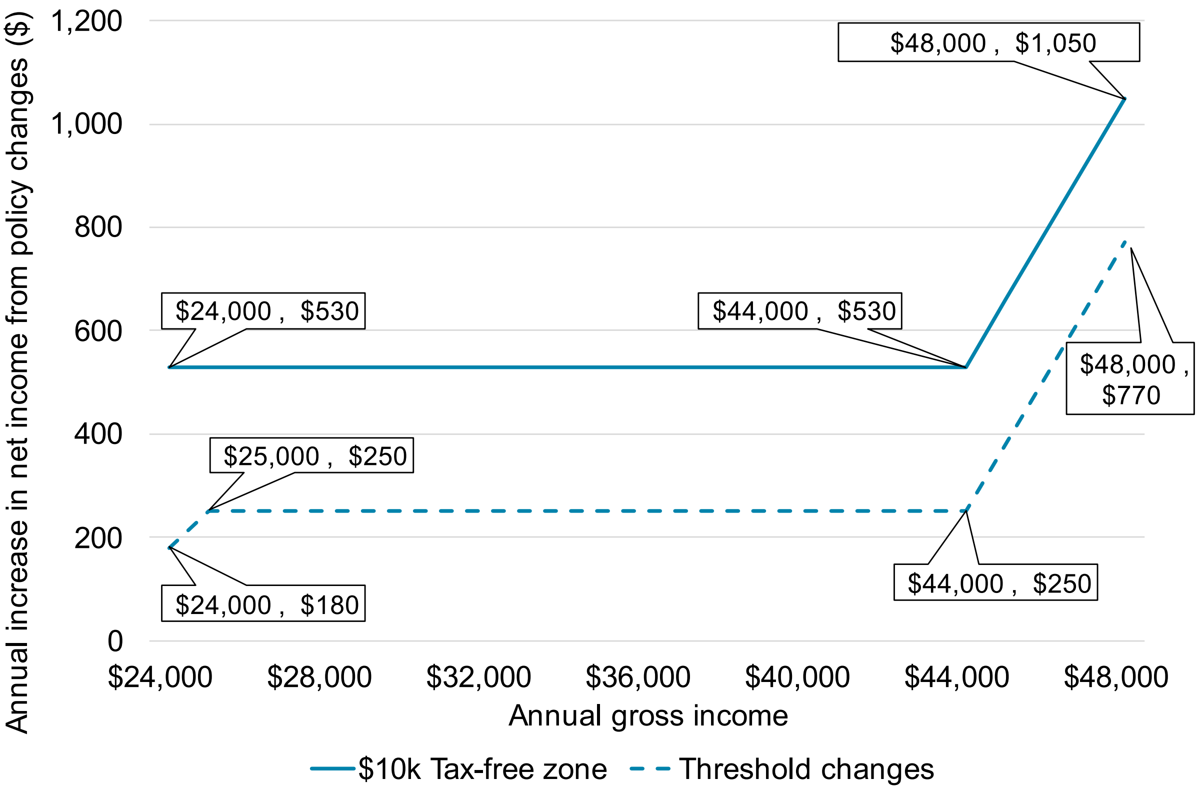
51. As previously noted [IR2023/038 / T2023/303], the IETC is now providing a gain at a different level of the income distribution than originally intended and is not well targeted. For example, around a third of all expected IETC recipients for 2024/25 have partners earning more than $70k.

52. Officials recommended removing the IETC in 2017 (report reference T2017/164) and continue to consider that the best approach is to remove the IETC. This can best be achieved as part of measures such as the current proposals

53. As the earliest feasible date for withdrawal of the IETC is 1 April 2024, recipients would receive the full gain available from the tax relief options in the current tax year, assuming an application date for the options of September 2023.

54. From 2024/25 (or 2025/26 for later application dates), withdrawal of the IETC would offset some of the benefit from the tax change, but recipients would still have a net gain. Figure 4 shows the net gain for these scenarios, with further detail in the Appendix on the net gain from the smaller tax relief options in combination with withdrawal of the IETC.

Figure 4: Overall impact of tax relief options and IETC removal



55. Withdrawing the IETC would result in fiscal savings of around $121 million in 2024/25 (if removed from 1 April 2024) and around $130 million in 2025/26 and 2026/27.

56. If the IETC is left unchanged, the fiscal cost is expected to reduce over time as the number of people within the eligible income band decreases due to income growth.

Implementation

Recommended application dates

57. As noted in the Treasury and IR's cross-cutting advice [T2020/313 IR2023/095 refers], Treasury and IR recommend deferring implementation of both elements of the tax switch, if you choose to proceed with it, until 1 April 2025.

58. If you decide to implement the net wealth tax earlier, then officials would recommend that personal tax changes should apply from 1 April 2024 as this aligns with the start of the tax year and would be the most efficient implementation date.

59. You have indicated a preference that the personal tax changes take effect within the 2023/24 tax year. Inland Revenue officials consider that the personal tax changes for PAYE could be implemented from 1 September 2023. However, the removal of IETC and the flow-on changes to other associated tax types such as FBT, ESCT, RWT, and PIE could not be implemented until 1 April 2024.

60. Further detail on the consequential changes needed under each option is provided in Appendix C.

61. We have previously recommended that a mid-year change would most simply be implemented on 1 October. Implementing the PAYE changes from 1 September does give less time for development and implementation than 1 October. However, Inland Revenue is undertaking an essential update to its core tax system, START, in October which will severely restrict its ability to undertake any change activity. Therefore, having considered the impacts in more detail, we would recommend implementation from 1 September 2023.

Implications of a mid-year application date

62. If the PAYE changes are implemented from 1 September, salary and wage earners will see the impact of the tax changes in their first pay day on or after 1 September. There will be additional complications where a pay period spans the implementation date.

63. Under both main tax options, changes to the calculation of provisional tax payments due after 1 September 2023 will be required for taxpayers using the AIM accounting method and may be required for those using the standard/uplift method or GST ratio method if the reduction in residual income tax from these changes is material.

64. As noted above, consequential changes to other tax types could not be implemented until 1 April 2024:

- For ESCT and RSCT, implementation from 1 April 2024 will mean that employers will continue to deduct these tax types at the current rates for the remainder of the 2023/24 tax year, rather than amended rates that reflect the tax reductions. As a result, there will be no increase in net contributions that are passed onto the scheme providers. This would only affect individuals with income lower than the level at which the tax change is made (i.e. under the new tax-free threshold, or under $14,000 for the alternative option). There is no mechanism available to refund ESCT or RSCT in this situation.

- For FBT, implementation from 1 April 2024 will mean that current rates and thresholds will continue to apply until that time. The impact on employees is expected to be minimal, given that changes are focused on the low-mid income range, where earners are less likely to be receiving fringe benefits.

- For PIE income, investors select a PIR for a tax year based on their previous two years' income. The amended thresholds would not need to apply until the 2024/25 tax year. The adjustment to PIE rates and thresholds would not apply until 1 April 2024. Investors would continue to use the existing rates for the 2022/23 tax year and the end of PIE tax calculation would also use these rates

- RWT is automatically included in an individual's income for the year and the end of year income tax assessment process will ensure that the correct tax has paid. Any over deduction in 2023/24 would be refunded.

65. A change to tax rates or thresholds during the year would also require composite tax rates to be applied for the end-of-year square-up calculation, for the 2023/24 tax year. Composite rates are an average of the tax rates or thresholds that applied across the tax year. The rate would be weighted to reflect the length of time each rate or threshold applied during the tax year.

66. The use of composite rates for the year means that some people may be over- or undertaxed because of when they earned their income during the year. For example, if a person enters the workforce in October 2024, they will have PAYE deducted based on the new rates or thresholds. However, when Inland Revenue completes their income tax assessment for the 2023/24 tax year, the composite rate will apply. These rates will be lower than the rates that were applied to their wages from October, potentially resulting in a debit assessment. Conversely, if a person earns their wage income in the period before the new rates or thresholds apply, they may end up with a credit because the composite rate will be higher than the rates that applied when their PAYE was deducted.

Independent Earner Tax Credit (IETC)

67. If you wish to remove the IETC, this would be implemented from 1 April 2024 at the earliest, given the complexity and scale of change required. This would involve the removal of the ME and ME SL tax codes, which are used to deliver the tax credit during the year through PAYE income, as well as complex system and business process changes that impact both the administration of the tax credit during the year, and the end-of-year income tax assessment.

Minimum Family Tax Credit (MFTC)

68. If you choose to amend the MFTC threshold from 1 September 2023, Inland Revenue will reassess the entitlement for all current MFTC recipients according to the new threshold. Recipients will receive a notice advising them of their new entitlement.

69. The increased threshold will mean some families with income between the current threshold and the new threshold will become newly entitled to the MFTC.

70. Composite rates for the year will not apply for mid-year changes to Working for Families (WFF) tax credits. Instead WFF will be reconciled according to the threshold that applied for each period during the year. The period for 1 April 2023 - 31 August will

be assessed based on the threshold that applied for that period and the period 1 September 2023 – 31 March 2024 will be assessed based on the amended threshold.

Main benefits increase

71. MSD has determined it is feasible to implement an accompanying benefit increase on 1 September 2023 and to manage the interactions of this increase with other forms of assistance, subject to trade-offs with other projects as noted below.

Administrative implications

Inland Revenue

72. Inland Revenue has completed an initial assessment for the administration costs associated with a tax-free threshold. This initiative will require up to $13 million of operating and capital funding. This will be a mix of Crown Budget 2023 funding and Vote Revenue self-funding to be agreed as part of the Budget 2023 process.

73. The cost estimates assume an implementation date of 1 September 2023, which requires two system builds and implementations, and two customer impact periods. The costs do not include any allowance for a specific communications or advertising campaign. It also does not include the costs related to removing the IETC and assumes only the PAYE changes will apply from 1 September 2023, with all other changes taking effect from 1 April 2024.

74. You have separately received advice from Inland Revenue on the overall revenue, expenditure, and capacity impacts of all proposed Budget 2023 tax initiatives, including the potential for Inland Revenue to partially self-fund the capital and/or operating impacts of these initiatives.

Third party compliance impacts

75. Changes to personal tax rates and/or thresholds will also have impacts on the private sector, with payroll service providers, employers, banks, portfolio investment entities (PIEs), share registries and other withholding taxpayers needing to make changes to their systems, communicate the changes, and update their reference material. A part-year change would reduce the time available to the private sector to make the changes that they would need to make. Based on previous experience, for example with the introduction of the 39% tax rate, it is likely that the private sector would not have sufficient time to make and communicate all the required amendments for a September implementation date. For this reason, we consider that it would not be feasible for any changes other than PAYE changes to be implemented before 1 April 2024.

76. For the intended benefits of the changes to be delivered effectively, payroll providers will need to apply the PAYE changes in time for the first pay period that occurs on or after 1 September 2023. The short lead-in time for delivery will be challenging for software providers and may be a risk.

MSD

77. To implement changes to the main benefit rate by 1 September, MSD would need to reduce project resource on some current work programme items. MSD will provide further advice to the Minister for Social Development and Employment on trade-offs with the following projects:

- Work on [33]
- Work on [33]

- Implementing actions from the Emergency Housing Review [33]

78. MSD have begun work on costing the implementation of these changes. Preliminary analysis indicates that it will include up to $3 million for IT changes as well as one-off funding to cover the operational effort to manage exceptions on go-live.

Consultation

79. There has been no wider consultation on the proposals due to Budget secrecy requirements. Given this we have not undertaken the usual engagement processes, including with the Māori Advisory Panel.

Next steps

80. We propose that you discuss the contents of this report with officials at the Joint Ministers meeting on 16 March 2023. Following this, officials will finalise slides to support your decisions on final options at Budget Ministers 4 on 20 March 2023.

Appendix A: Options and high-level impacts

Modelled options for tax changes

1. The tax relief options modelled for the low, medium and high packages are set out in Table A1. Options are based on tax-free thresholds of $7.5k, $8.5k and $10k p.a., with alternative raised threshold options at a similar fiscal cost. Gains under each option are summarised in Table A2 for the 2024/25 year.

Table A1: Summary of policy options modelled

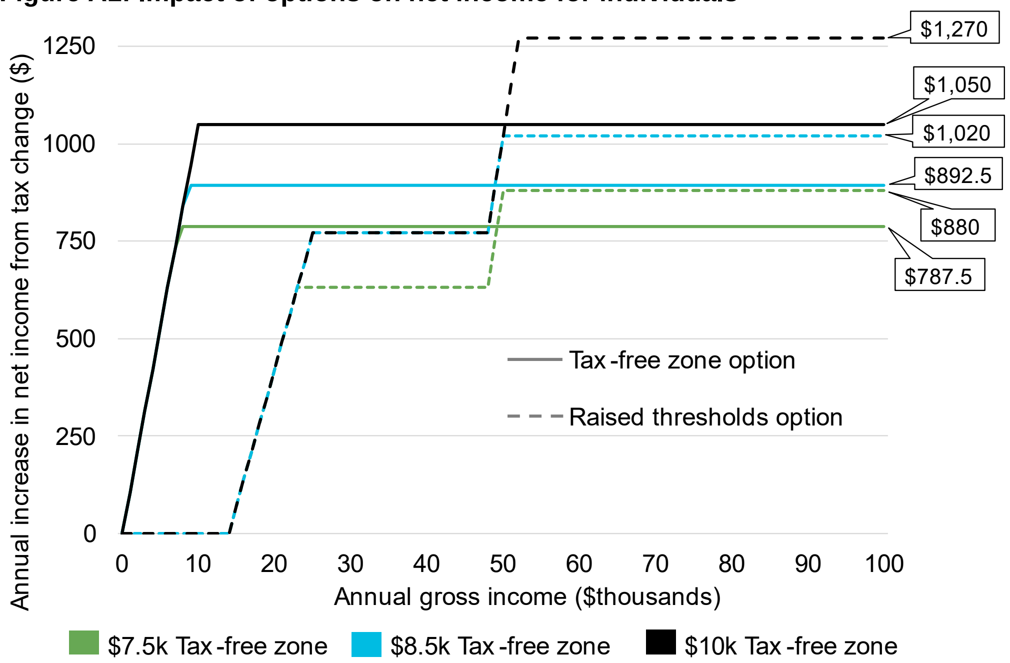
Marginal tax rate	0%	10.5%	17.5%	30%	33%	39%
Status quo	NA	≤$14k	≤$48k	≤$70k	≤$180k	>$180k
‘Low’ options						
$7.5k p.a. Tax-free threshold	**≤$7.5k**	≤$14k	≤$48k	No change		
Alternative thresholds option	NA	**≤$23k**	**≤$50k**			
‘Medium’ options						
$8.5k p.a. Tax-free threshold	**≤$8.5k**	≤$14k	≤$48k	No change		
Alternative thresholds option	NA	**≤$25k**	**≤$50k**			
‘High’ options						
$10k p.a. Tax-free threshold	**≤$10k**	≤$14k	≤$48k	No change		
Alternative thresholds option	NA	**≤$25k**	**≤$52k**			

Table A2: Summary of impacts of tax changes

	'Low' options		'Medium' options		'High' options	
	1a – Tax-Free Threshold	1b – IR/TSY recommended	2a – Tax-Free Threshold	2b – IR/TSY recommended	3a – Tax-Free Threshold	3b – IR/TSY recommended
Tax-Free Zone	**$7,500**	0	**$8,500**	0	**$10,000**	0
Current $14,000 threshold	$14,000	**$23,000**	$14,000	**$25,000**	$14,000	**$25,000**
Current $48k threshold	$48,000	**$50,000**	$48,000	**$50,000**	$48,000	**$52,000**
Gain starts from	$0	$14k	0	$14k	0	$14k
Maximum annual gain	$787.50 at $7.5k+	$630 at $23k+ $880 at $50k+	$892.50 at $8.5k+	$770 at $25k+ $1,020 at $50k+	$1,050 at $10k+	$770 at $25k+ $1,270 at $52k+
Estimated number who gain / who gain the full amount from tax change	4.1m / 3.3m	3.5m / 1.6m	4.1m / 3.3m	3.5m / 1.6m	4.1m / 3.2m	3.5m / 1.5m

2. Figure A1 shows the impact of the options on net annual income for individuals. Solid lines show the tax-free threshold options and dashed lines show the alternative raised thresholds options, with colours indicating low, medium and high. The tax-free zone options provide a greater increase in income for those earning below around $50k p.a., and the alternative raised thresholds option provide a greater increase for those earning above $50k p.a. This income is equivalent to working 42.2 hours per week on the 2023/24 minimum wage.

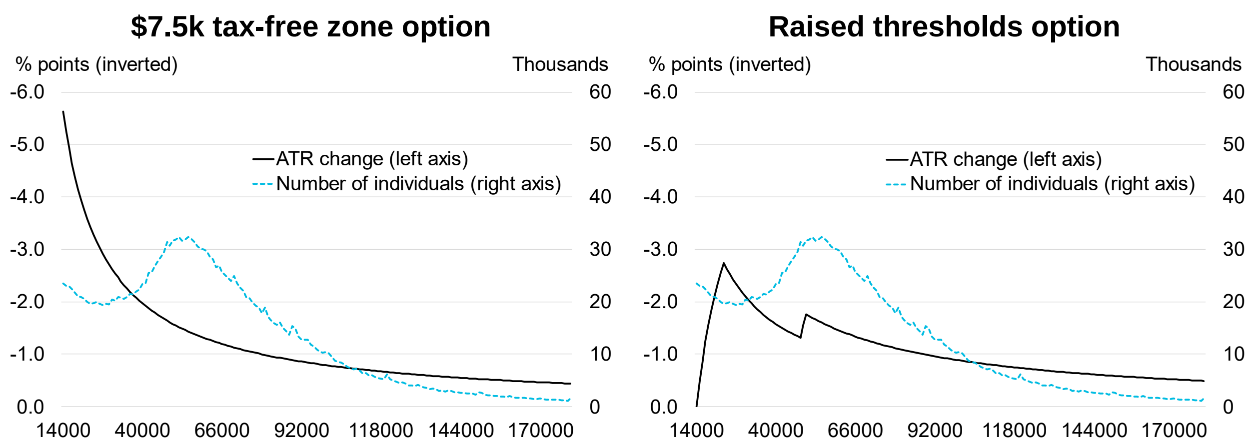
Figure A1: Impact of options on net income for individuals

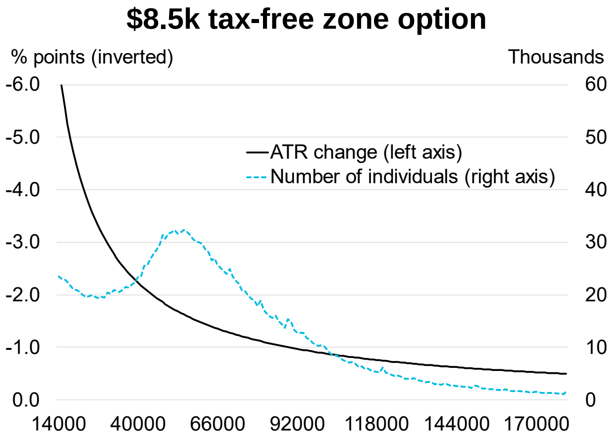


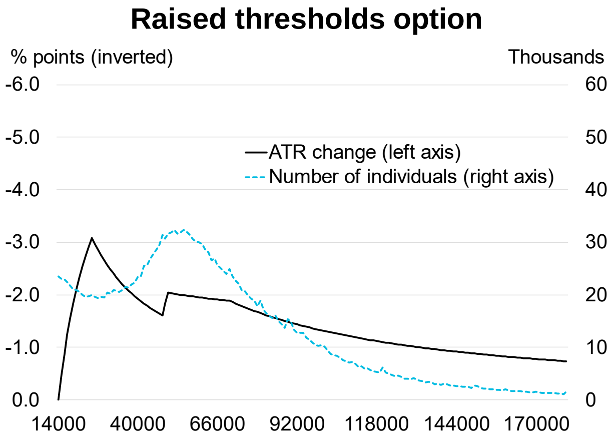
Efficiency

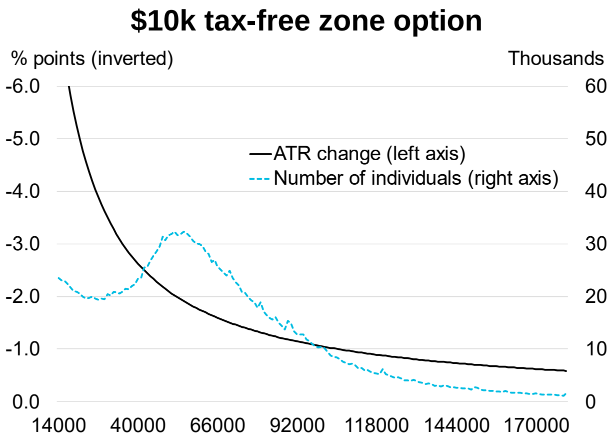
3. The charts in Figure A2 below plot the income distribution of wage/salary earners against the average tax rate (ATR) impact of the options. This lets us compare the income levels where each approach is having the largest relative impact against how many individuals earn at that level of income. A design that provides larger benefits at the denser parts of the income distribution might be expected to have a larger impact on overall productivity/efficiency in the labour market.

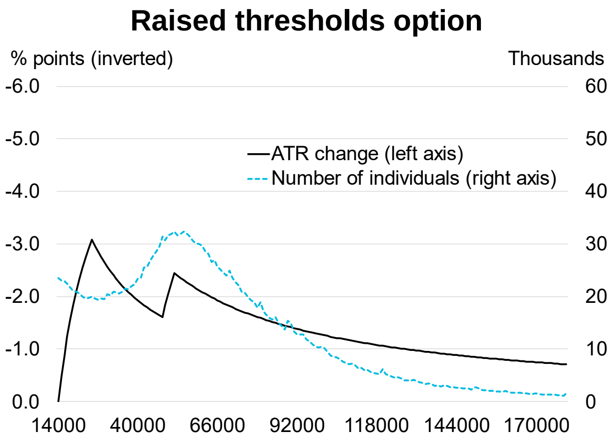
Figure A2: Distribution of wage earners vs. average tax rate (ATR) impact by annual gross income







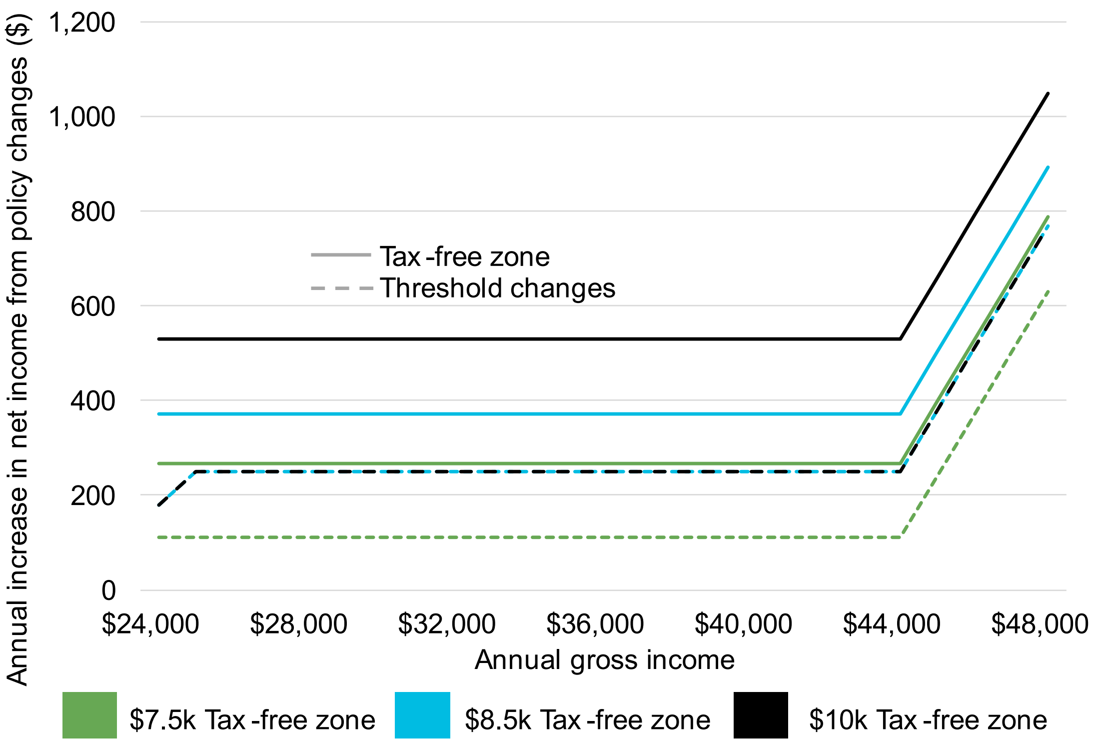




Withdrawal of the IETC

4. From 2024/25, withdrawal of the IETC would offset some of the benefit from the main tax change, but recipients would still have a net gain. As shown in Figure A3, this will be smallest under the 'low' variation of the raised thresholds option.

Figure A3: Overall impact of tax relief options and IETC removal



Appendix B: Characteristics of taxpayers with taxable income under $14,000

1. Excluding children under 15 years and those with annual income under $100, there are around 313,000 individuals with taxable income under $14,000, based on analysis using the TAWA model.[4]

2. Previous advice included data on characteristics of this group and partner income, reproduced in Table B1 (refer IR2023-037/T2023-157; IR2023-038/T2023-303). The analysis shows that 77% of the people in this group are either temporarily on low incomes (i.e., students) or are supported by someone with a higher income (i.e., are a dependent child or have a partner with income greater than $14,000). The remaining individuals may have received a part-year income or were financially supported by others in a household.

3. Of the 313,000 individuals in the group, 15% received a core benefit during that year. If benefits were their sole source of income, they would not receive a direct gain from any tax policy change. Individuals with a full year of income from main benefits, or from a combination of main benefits and wages, will have income over $14,000.

Table B1: Characteristics of individuals aged 15+ with taxable income between $100 and $14,000

Characteristic	**Number**	**% of total**
Student	130,000	42%
Is a dependent child	10,000	3%
Partner with income >$14,000 *and* family income <$70,000	46,000	15%
Partner with income >$14,000 *and* family income >$70,000	56,000	18%
Single with no children	51,000	16%
Other	20,000	6%
Total	313,000	100%

[4] Using data from the 2020/21 Household Economic Survey to develop an estimate for the 2024/25 tax year.

Appendix C: Consequential changes to other tax types

1. There are a number of tax types and rates that are based on the personal income tax system. To maintain consistency between these tax types and personal tax rates, it is recommended that a number of consequential changes are made.

2. Changes would be necessary across the same tax types for a tax-free threshold or changes to existing thresholds, but are more significant for the tax-free threshold option, as zero-rates would need to be added for Resident Withholding Tax (RWT), Employer Superannuation Contribution Tax (ESCT), Fringe Benefit Tax (FBT), Retirement Scheme Contribution Tax (RSCT), and Portfolio Investment Entity (PIE).

3. Consequential changes are summarised in Table C1.

Table C1: Consequential changes to other tax types from the main tax options

Tax type	Tax-free threshold	Raised thresholds	Third party and taxpayer impacts
PAYE	New secondary tax code Amended PAYE calculation for income below threshold (new PAYE tables) Amended extra pay calculations Recalculation of tailored tax code	Amended PAYE calculations for altered thresholds (new PAYE tables) Amended extra pay calculations Recalculation of tailored tax code	**Software developers** – software updated to include amended calculations and new tax code (new tax code for tax free threshold only) **Employers** – deduct PAYE at the new rates and amend tax codes for employees as required **Individuals** – check and potentially amend tax code
Provisional tax	Accounting income method: update provisional tax calculations in software GST ratio and standard: reduce ratio calculation/uplift percentage if significant change	Accounting income method: update provisional tax calculations in software GST ratio and standard: reduce ratio calculation/uplift percentage if significant change	**Software developers** – update required packages **Tax agents and individuals**– consider if estimates are still accurate or whether to change to estimation
RWT	New tax rate and calculation for income below new threshold/rate	Change to calculations for altered thresholds	**Banks other payers** - need to provide new 0% rate option (for TFT only) or amended information about which rate apply (for TFT and amended thresholds) **Individuals** – check their rate and changes with payer if required
ESCT/RSCT	New ESCT rate and calculation for income plus employer KiwiSaver contributions below new threshold/rate	Change to calculations for altered thresholds	**Employers (ESCT) and retirement scheme contributors (RSCT)** – include new 0% rate (TFT option only) and amended thresholds for calculation **Software providers** – update packages to include new 0% rate (TFT option only) and amended thresholds
FBT	A new rate Amendment to calculations	Amendment to calculations.	**Software developers** – software updated to include new 0% rate (TFT option only) and take account of new rate and thresholds
PIE	New PIE rate and calculation for income below new threshold	Change to calculations for altered thresholds	**Banks other payers** - need to provide new 0% rate option (for TFT only) or amended information about which rate apply (for TFT and amended thresholds) **Individuals** – check their rate and changes with payer if required

Appendix D: Caveats and disclaimers (TAWA/IDI/costing assumptions)

1. These results are not official statistics. They have been created for research purposes from the Integrated Data Infrastructure (IDI) which is carefully managed by Stats NZ. For more information about the IDI please visit https://www.stats.govt.nz/integrated-data/. The results are based in part on tax data supplied by Inland Revenue to Stats NZ under the Tax Administration Act 1994 for statistical purposes. Any discussion of data limitations or weaknesses is in the context of using the IDI for statistical purposes, and is not related to the data's ability to support Inland Revenue's core operational requirements.