The Treasury

Budget 2023 Tax Initiatives Information Release

July 2023

This document has been proactively released by the Treasury, Inland Revenue, Minister of Finance (Hon Grant Robertson) and Minister of Revenue (Hon David Parker) on the Treasury website at:

https://www.treasury.govt.nz/publications/information-release/budget-2023-tax-initiatives

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

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

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;

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

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [33] appearing where information has been withheld in a release document refers to section 9(2)(f)(iv).

Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are **© Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [https://creativecommons.org/licenses/by/4.0/].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

TE TAI ŌHANGA
THE TREASURY

Tax Policy Report: Advice on a wealth tax

Date:	14 March 2023	**Report No:**	T2023/316 IR2023/067
		File Number:	SH-13-5-3-7

Action Sought

	Action Sought	**Deadline**
Minister of Finance (Hon Grant Robertson)	Agree to the recommendations in this report	16 March 2023
Minister of Revenue (Hon David Parker)	Agree to the recommendations in this report	16 March 2023

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**	**1st Contact**
Michael Sherwood	Senior Analyst, The Treasury	[35]	✓
Stephen Bond	Manager, The Treasury		
Phil Whittington	Chief Economist, 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: Advice on a wealth tax

Executive Summary

Purpose

This report provides officials' policy advice on the effectiveness of a net wealth tax (a "wealth tax") in achieving your revenue and distributional objectives, as well as the likely economic costs and other risks associated with the tax.

This report also seeks your final decision on some key design elements of the wealth tax that will have a material impact on the revenue collected, as well as some other design elements that you indicated you were interested in revisiting.

Achieving your revenue and distributional objectives

You have previously indicated that your objectives with this tax are twofold:

1. **Revenue -** The tax should raise revenue to fund personal tax cuts; and

2. **Distributional -** The additional tax should be paid by those with high wealth and therefore high ability to pay. This should address how high-wealth individuals can have relatively light taxation, primarily due to the non-taxation of most capital gains.

The wealth tax will generate revenue in a way that increases the total tax burden for the wealthiest New Zealanders, increasing the progressivity of the tax system. This will also increase the effective tax rate on wealthy New Zealanders, some of whom face low effective tax rates due to holding assets that generate untaxed capital gains. Further information about the estimated distributional impact of the wealth tax is set out in paragraphs 31-42 of this report.

The amount of revenue collected will depend on the rate and entry threshold you choose, as well as your final decision on whether to exempt wealth below the entry threshold. Your decision on these elements will involve trade-offs between your revenue and distributional objectives, as well as the economic impacts of the tax. Officials recommend that you exempt all wealth below the entry threshold from the tax, in order to avoid the economic costs associated with a 'cliff-edge' effect.

The estimated revenue that could be collected by the wealth tax under different permutations of tax rate and entry thresholds (assuming the "exemption" approach is adopted) are summarised in table 1 below. These figures assume a 31 March 2025 application date:

Table 1: Revenue estimates for a wealth tax using an ‘exemption’ approach (fiscal year 2025/26)

		Entry threshold:			
		$3m	**$5m**	**$7.5m**	**$10m**
Tax rate:	**1.00%**	$3.9 b	$2.7 b	$1.9 b	$1.5 b
	1.50%	$5.5 b	$3.8 b	$2.7 b	$2.1 b
	2.00%	$7.0 b	$4.8 b	$3.4 b	$2.7 b

Economic costs and other risks

The wealth tax will incentivise taxpayers to change their behaviour in order to minimise their wealth tax liability. Some of these behavioural changes (which include migrating away from New Zealand and changes to saving and investment decisions) will impose costs on the wider economy.

The wealth tax will also impose a significant compliance cost burden on taxpayers (relative to the compliance burden of most other taxes) and will come with some significant integrity risks.

Assessment

While the wealth tax is likely to meet your revenue and distributional objectives, this will come with economic and integrity costs. While there is uncertainty over the costs of the tax, these could be large. Some of these economic costs are inherent to any tax increase, but some are due to the nature of the wealth tax. Your decision on whether to progress with the wealth tax will depend on the weighting of your distributional objectives.

Officials also note that there are other options that would likely meet your revenue and distributional objectives at lower economic and integrity costs. The options include a capital gains tax and inheritance tax, both of which are common in OECD countries and would raise revenue from high wealth individuals with significantly lower economic costs.

Officials also recommend against progressing the wealth tax as part of Budget 2023. Officials have had an extremely limited timeframe within which to work through possible issues and have not been able to consult with stakeholders. There is high risk that there are unforeseen issues and unintended consequences that could lead to significant economic costs.

If you wish to progress the wealth tax as part of Budget 2023, officials recommend an application date of 31 March 2025, to allow for further consultation.

The Treasury recommends that Ministers align the timing of both the wealth tax and the personal tax reduction elements of your tax package. If Ministers want to progress the personal tax reductions sooner than 1 April 2025, Treasury recommends bringing forward the wealth tax to 31 March 2024 to minimise the gap between revenue reducing and revenue raising measures.

Other design decisions

This report also provides advice on three issues that you indicated you wished to consider further. These issues are:

- The treatment of the family home located on a farm
- Financing for taxpayers who will struggle to pay the wealth tax
- Extending how trusts are taxed
- The application of the wealth tax to defined benefit plans

Next steps

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

Recommended Action

We recommend that you:

a **note** officials' advice on the revenue, distribution, and economic impacts of a wealth tax.

b **discuss** the contents of this report with officials at the Joint Ministers Meeting of 16 March.

c **agree** to not introduce a wealth tax as part of Budget 2023 (***officials' recommendation***).

Agreed/Not Agreed Agreed/Not Agreed

OR

d **agree** to introduce a wealth tax as part of Budget 2023.

Agreed/Not Agreed Agreed/Not Agreed

If you agree to recommendation (d), **EITHER**

e **agree** to the wealth tax applying from 31 March 2025 (***officials' recommendation***).

Agreed/Not Agreed Agreed/Not Agreed

OR

f **agree** to the wealth tax applying from 31 March 2024.

Agreed/Not Agreed Agreed/Not Agreed

Design decisions

Rate and threshold

g **indicate** your desired entry threshold for the wealth tax.

$3m/$5m/$7.5m/other ______ $3m/$5m/$7.5m/other ______

h **indicate** your desired tax rate for the wealth tax.

1%/1.5%/2%/other ______ 1%/1.5%/2%/other ______

i **agree** to adopt the “exemption” approach to wealth below the entry threshold (***officials’ recommendation***).

Agreed/Not agreed Agreed/Not agreed

OR

j **agree** to adopt the “trigger approach to wealth below the entry threshold.

Agreed/Not agreed Agreed/Not agreed

Instalments for payment tax

k **agree** to allow taxpayers with a wealth tax liability to pay that amount in monthly instalments over four months with the first instalment made when they file their return (***officials’ recommendation***).

Agreed/Not Agreed Agreed/Not Agreed

OR

l **agree** to allow taxpayers with a wealth tax liability to pay that amount in monthly instalments over six months with the first instalment made when they file their return.

Agreed/Not Agreed Agreed/Not Agreed

OR

m **agree** to allow taxpayers with a wealth tax liability to pay that amount in monthly instalments over 12 months with the first instalment made when they file their return.

Agreed/Not Agreed Agreed/Not Agreed

OR

n **agree** to publicly consult on a longer-term funding arrangement to allow taxpayers to fund the payment of their wealth tax liability.

Agreed/Not Agreed Agreed/Not Agreed

o **note** that taxpayers who pay an instalment late or not in full will be subject to standard late payment penalties and use of money interest at the standard rates.

Trusts

p **agree** to not expand the application of the wealth tax to more fixed trusts than already agreed (***officials’ recommendation***).

Agreed/Not Agreed Agreed/Not Agreed

OR

q **agree** to broaden the scope of the wealth tax to include all fixed-interest trusts, subject to a lower exemption applied to each trust.

Agreed/Not Agreed Agreed/Not Agreed

r **agree** not to exclude interests in a defined benefit fund from the wealth tax, and officials will consult on how to value them as part of the consultation on valuation.

Agreed/Not Agreed Agreed/Not Agreed

Confirming other design decisions

s **confirm** your previous design decisions for the wealth tax contained in Annex 3 of this report, subject to the change identified in recommendation (r).

Confirmed/Not confirmed Confirmed/Not confirmed

Stephen Bond
Manager, Tax Strategy
The Treasury

Phil Whittington
Chief Economist
Inland Revenue

Hon Grant Robertson
Minister of Finance

_____/_____/_______

Hon David Parker
Minister of Revenue

_____/_____/_______

Tax Policy Report: Advice on a wealth tax

Purpose of Report

1. Officials have provided ongoing advice on the design of a net wealth (a "wealth tax") tax as part of a wider tax package for Budget 2023. Officials' advice on this package as a whole is contained in a separate report (T2023/313; IR2023/095 refers).
2. This report provides officials' final advice on the revenue, distributional and economic impacts of a wealth tax, as well as other risks you should be aware of when deciding whether to progress with the tax. It also contains both Inland Revenue and the Treasury's recommendations about whether to progress with the wealth tax.
3. In this report we:
   - Provide our estimate of the **financial impact** of the wealth tax, as well as seek a decision on the rate and entry threshold for the tax (page 9–13); and
   - Provide analysis of the **distributional consequences** of the wealth tax (page 13–19); and
   - Outline the **economic costs and other risks** associated with the wealth tax (Page 19–27); and
   - Provide officials' **assessment** of the wealth tax (Page 27–31); and
   - Provide further advice on **specific design elements** (Page 31–33).
4. The advice on the impact of the wealth tax has been prepared within a significantly tight timeframe and without the benefit of being able to consult with external stakeholders. There is a significant risk that this advice does not adequately capture all the costs and risks that will arise from the wealth tax. More comprehensive advice on the impact that this accelerated timeframe could have on the quality of our policy advice, as well as the implementation of the tax, is contained in a separate section of this report (paras 105-110).

Context and objectives

Context

5. A wealth tax would impose an annual charge on high-wealth taxpayers, based on their in-scope net worth (assets minus liabilities).
6. We have previously reported to you with our initial policy assessment of a similar tax (a deemed minimum tax). We have also reported to you on the key design elements of the wealth tax.
7. Our advice on the impact of a wealth tax is based on the design decisions you have previously made. These are summarised in Annex 1 of this report.
8. You have also received a copy of Inland Revenue's High-Wealth Individuals (HWI) Research Project. This contains some information about the income and wealth of some of those New Zealand taxpayers at the top of the wealth distribution.

Objectives

9. We understand you are motivated by two main objectives:
   - **Revenue -** you intend for the wealth tax to raise revenue to fund personal tax cuts; and
   - **Distributional** - you intend for the additional tax to be paid by those with high wealth and therefore high ability to pay. You also intend that the tax should at least partially address how high-wealth individuals can have relatively light taxation, primarily due to the non-taxation of most capital gains.
10. A wealth tax could support these objectives but would generate a range of **economic costs** and other **risks**.
11. The outcomes of the tax will ultimately impact on the wellbeing of New Zealanders. In particular, the tax is likely to affect social cohesion, human capability, and New Zealand's stock of financial and physical capital.

Revenue considerations

12. A wealth tax will raise revenue, which is one of your key objectives. The amount of revenue will depend on the choice of rate and threshold for the wealth tax.

Rate and entry threshold for the wealth tax

13. The choice of rate and entry threshold will determine how many taxpayers are subject to the tax, and how much tax those individuals will pay. You can choose a combination of these two design elements that will meet your revenue objective. However, this will require trade-offs with your distributional objective and the economic costs of this tax.
14. Officials do not have a preferred combination of tax rate and entry threshold for the wealth tax. All of the options for these design elements that are included in tables 2 and 3 below will have different revenue, distributional and economic impacts, but none are likely to have materially worse outcomes than the others.
15. The highest wealth tax rate included in tables 2 and 3 below is 2%. A wealth tax rate materially above this rate would be extremely economically costly and raise little extra revenue given expected behavioural effects. Officials can provide further advice if you are interested in progressing a wealth tax rate substantially above 2%.

The entry threshold for the wealth tax will have implications for the compliance costs imposed by the tax, as well as the number of people who pay the tax

16. A lower entry threshold for the wealth tax would increase the size of the group that is subject to the wealth tax. This would increase the revenue from the tax, making it easier to achieve your revenue objective.
17. A lower threshold does however come with trade-offs. As the number of individuals subject to the tax increases, the total compliance cost of the tax increases. A lower threshold will also increase the number of lower wealth individuals who are subject to the tax.

The rate of the wealth tax will have consequences for the progressivity and economic cost of the tax

18. Applying a higher tax rate to the net wealth that is subject to the tax will increase the revenue collected. A higher tax rate will also make the tax more progressive. This is because it will collect more revenue from those taxpayers at the top of the wealth distribution.
19. A higher rate will also increase some of the economic costs of the tax. As more tax is collected, taxpayers will have stronger incentives to reduce their wealth tax liability. Actions that reduce that liability will impose wider costs on the economy (such as migrating away from New Zealand, distorting savings decisions and reducing their level of savings, and reallocating their investment to tax-advantaged assets). These costs are outlined in more detail in a later section of this report.

Trigger vs exemption

20. Officials have previously advised you on the impact of exempting the wealth under the entry threshold from the wealth tax (the exemption approach), or applying the tax to all wealth of people who are above the threshold (the trigger approach) (T2023/279; IR2023/066 refers).
21. We understand that your preference is to adopt the exemption approach. Consistent with the prior report, tax officials recommend adopting the exemption approach.

Financial implications

22. The revenue collected by the wealth tax will depend on the decisions you make on the design elements above. Further, any changes to the design decisions already made, and outlined in Annex 3, could impact revenue.
23. The high-level estimates of the revenue for all the different permutations (different rates, thresholds, and exemption vs trigger approach) are set out below.
24. These revenue estimates are subject to greater uncertainty than a typical tax costing. We have used three different costing methods for the revenue estimates in this report, due to the novelty of the wealth tax and data limitations. There is a significant risk that revenue could be different to what we estimate. Box A outlines the reasons for this uncertainty, as well as the key assumptions and limitations used for these revenue estimates.
25. Table 2 shows estimated revenue for a wealth tax for selected rates and thresholds, using the 'exemption' approach in fiscal year 2025/26.
26. This assumes an initial application date of 31 March 2025. Should you decide on an earlier application date for the wealth tax then we will re-estimate revenue for this earlier date.

Table 2: Revenue estimates for a wealth tax using an 'exemption' approach (fiscal year 2025/26 assuming an initial application date of 31 March 2025)

		Entry threshold:			
		$3m	**$5m**	**$7.5m**	**$10m**
Tax rate:	**1.00%**	$3.9 b	$2.7 b	$1.9 b	$1.5 b
	1.50%	$5.5 b	$3.8 b	$2.7 b	$2.1 b
	2.00%	$7.0 b	$4.8 b	$3.4 b	$2.7 b

27. Table 3 shows estimated revenue for a wealth tax for selected rates and thresholds, using the 'trigger' approach in fiscal year 2025/26.

Table 3: Revenue estimates for a wealth tax using a 'trigger' approach (fiscal year 2025/26 assuming an initial application date of 31 March 2025)

		Entry threshold:			
		$3m	**$5m**	**$7.5m**	**$10m**
Tax rate:	**1.00%**	$6.3 b	$4.5 b	$3.3 b	$2.7 b
	1.50%	$8.7 b	$6.3 b	$4.6 b	$3.8 b
	2.00%	$10.7 b	$7.7 b	$5.7 b	$4.7 b

28. Tables 4 and 5 illustrate how we expect revenue to grow across the forecast period for a wealth tax with a $5 million entry threshold and 1% tax rate, under both the 'exemption' and 'trigger' approaches. Table 4 shows the revenue profile for an initial application date of 31 March 2025, whereas Table 5 shows the revenue profile for an initial application date of 31 March 2024.

29. In the time available, we have only been able to use one of our three costing methods for Tables 4 and 5, so there is more uncertainty for these tables than for Tables 2 and 3.

30. The revenue profile over the forecast period is driven by two competing factors:

    a. Wealth is forecast to grow quickly over forecast period after a 'rebound' in asset prices; and

    b. We are forecasting the behavioural response to increase over forecast period as people engage in increasing behaviour to avoid the tax. This explains the differences in the figures between Tables 4 and 5 for the fiscal years 2025/26 and 2026/27. We have assumed that after 3 years the behaviour responses would be fully phased-in.

Table 4: Revenue estimates for a wealth tax with a $5 million threshold and 1% tax rate (assuming an initial application date of 31 March 2025)

	Fiscal year:		
	2024/25	**2025/26**	**2026/27**
'Exemption' approach	$0.0 b	$2.7 b	$2.9 b
'Trigger' approach	$0.0 b	$4.5 b	$4.7 b

Table 5: Revenue estimates for a wealth tax with a $5 million threshold and 1% tax rate (assuming an initial application date of 31 March 2024)

	Fiscal year:		
	2024/25	**2025/26**	**2026/27**
'Exemption' approach	$2.4 b	$2.5 b	$2.7 b
'Trigger' approach	$4.1 b	$4.2 b	$4.4 b

Box A. Reasons for uncertainty in revenue estimates, and key assumptions and limitations in the costing

These revenue estimates are subject to greater uncertainty than a typical tax costing. There are significant risks of the costing being either a substantial underestimate or overestimate of the actual revenue that will be collected. This level of uncertainty exists due to the following reasons:

a) Forecast revenue has been recognised on the filing date of the associated return. The timing of this may change depending on the outcome of consultation and the final design of the legislation, and/or subsequent audit of the accounting treatment by Audit New Zealand and the Office of the Auditor General.

b) These estimates are based on several experimental methods that we have developed to better estimate wealth at the top of the distribution. These include the experimental capitalisation method and two methods to uplift data from the Household Economic Survey (HES),[1] which are explained in Annex 2. There is some evidence to suggest that wealth is even more concentrated at the top of the wealth distribution than indicated in these experimental methods. This may mean that the revenue could be higher than estimated.

c) The underlying data uses a mixture of market valuations and book values for different assets, which may differ from the final method of valuation that officials will advise on after consultation. We may need to adjust these revenue estimates depending on the final valuation rules following consultation.

d) The Treasury does not typically forecast household net worth and we have needed to develop novel forecasting series for this tax at pace.

[1] See December report (T2022/2703, IR2022/516 refers) and February report (T2023/164, IR2023/030 refers) for more explanation about these methodologies.

e) These revenue estimates assume some behavioural response on the part of the taxpayers that are in-scope of the wealth tax. The assumption we have used is that, for a 1% wealth tax, there will be a 17.5% reduction in the in-scope wealth base, assuming you adopt the exemption approach to the treatment of wealth below the entry threshold. If you choose to adopt the "trigger" approach, we have estimated that the behavioural response will be 50% larger. This estimate of the behavioural response is subject to significant uncertainty.

f) During our quality assurance process for finalising the behavioural responses we found a potential inconsistency in the international literature, which may mean we have underestimated the behavioural response. This creates a risk that our revenue estimates are overestimated by 10% - 30%. We are attempting to resolve this uncertainty but may not be able to within the time available.

Overall, the experimental nature of these methodologies means that the revenue estimates in this report are subject to higher uncertainty than the revenue costs estimated for personal tax cuts (T2023/409; IR2023/094 refers). This means that there is a significant risk that the revenue from the wealth tax may not be adequate to fully fund the personal tax cuts.

Distributional considerations

31. You have indicated that one of your main objectives with the wealth tax is to increase the progressivity of the tax system, including increasing the tax paid by high-wealth individuals who can have relatively light taxation primarily due to the non-taxation of most capital gains.

32. This section outlines our analytical conclusions on who will pay the tax, the impact of the wealth tax on achieving your progressivity and horizontal equity objectives, and the possible impact on perceptions of fairness.

33. These distributions are based on 'in-scope wealth', which we define as total net worth (assets less liabilities) for the entire population, minus any exemptions (e.g., owner-occupied housing, consumer durables and personal assets).

34. These distributions are based on the same experimental data as used for our revenue estimates and are subject to the same limitations and uncertainties discussed in the financial implications section (see above). Further, these distributions can be considered less reliable than the fiscal costings since they involve looking at small subsets of the population above each threshold.

35. We have not adjusted the population figures used in this distributions section to account for likely behavioural responses. This means the distributional figures do not directly correspond to the revenue estimates above, which do incorporate a behavioural response.

Who will pay the wealth tax?

36. Table 6 below provides our estimate of the number of individuals who will be subject to the wealth tax, under different entry thresholds, when wealth is inflated to tax year 2024-25. This assumes the first application date is 31 March 2025. This shows that for these entry thresholds only a small proportion of the New Zealand population will be required to pay the wealth tax.

Table 6: Population above various thresholds in tax year 2024-25 (assuming an initial application date of 31 March 2025)

	Entry threshold:			
	$3m	$5m	$7.5m	$10m
Individuals affected	99,000	46,000	24,000	16,000
Proportion of NZ resident population aged 15+	1.9%	0.9%	0.5%	0.3%
Proportion of total in-scope wealth	49%	35%	26%	22%

Note: these data are based on an average of the three experimental wealth methods we have developed and are subject to high uncertainty. See Annex 2 for more detail on these wealth estimation method and limitations.

37. These distributions are based on 'in-scope wealth', which we define as total net worth (assets less liabilities) for the entire population, minus any exemptions (e.g., owner-occupied housing, consumer durables and personal assets).

38. The population affected can be expected to grow over time, as those just below any given threshold gain wealth and become subject to the wealth tax. This is a similar phenomenon to the 'fiscal drag' that is seen when income growth pushes individuals over personal income tax thresholds.

39. Table 7 shows the average tax that would be paid by those subject to a 1% wealth tax for various thresholds in tax year 2024-25. This assumes the first application date is 31 March 2025. There would also be considerable variation in the average tax paid within the affected population. Those near the entry threshold would pay considerably less tax than the wealthiest individuals.

Table 7: Average tax liability for a 1% wealth tax at different thresholds in tax year 2024-25 (assuming an initial application date of 31 March 2025)

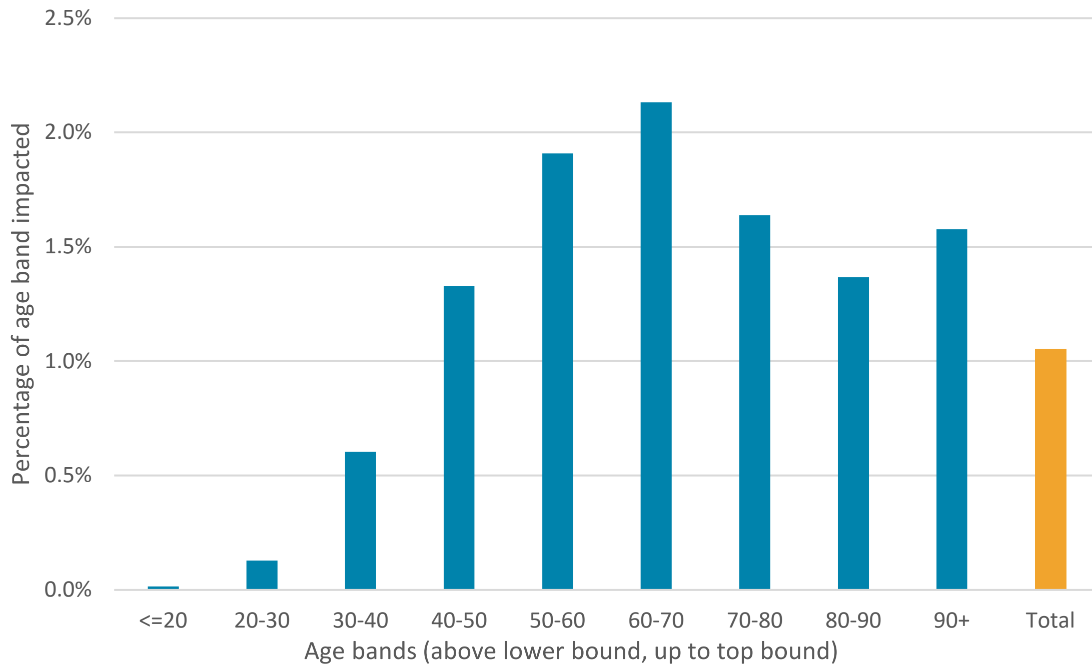
	Entry threshold:			
	$3m	$5m	$7.5m	$10m
Average tax liability with exemption	$39,000	$58,000	$79,000	$92,000
Average tax liability with trigger	$63,000	$98,000	$139,000	$172,000

Note: these data are based on an average of the three experimental wealth methods we have developed and are subject to high uncertainty. See Annex 2 for more detail on these wealth estimation method and limitations.

40. Figure 1 shows the proportion of the population with net worth over $5m across various age bands in tax year 2024-25. Overall, approximately 1.1% of the personal taxpayer population are over a $5 million threshold. However, by age band a greater proportion of the population can be affected. The age band with the

greatest proportion of affected taxpayers is those aged 60 – 70 years, where 2.1% of the population have net worth over $5 million.

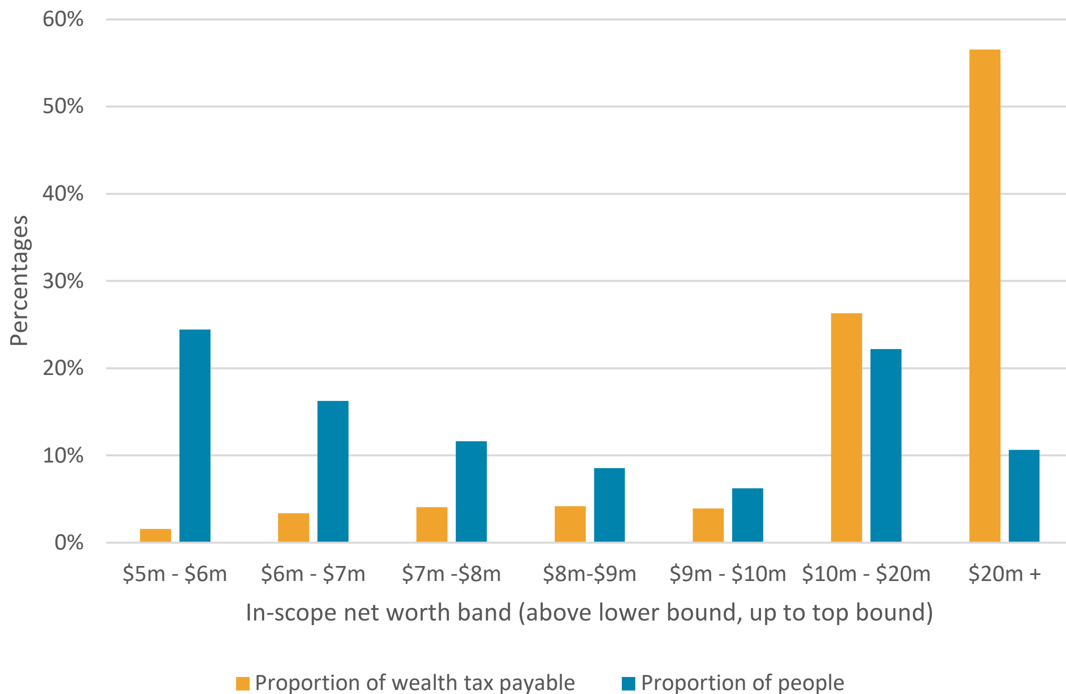
Figure 1: Proportion of age band subject to tax (assuming $5m threshold) in 2024-25



Note: these data are based on the experimental capitalised wealth distribution and subject to high uncertainty. These proportions are not directly comparable to Table D above, because this figure uses the taxpayer population rather than the NZ resident population used in Table D. See Annex 2 for more detail on this wealth estimation method and limitations.

41. Figure 2 shows the distribution of the population and wealth tax liability for a wealth tax, assuming a $5m threshold and exemption and 1% rate in tax year 2024-25. The taxable population is concentrated close to the $5 million threshold, with approximately half the taxable individuals with in-scope net worth of $8 million or less. By contrast, the wealth tax payable is concentrated toward the higher net worth bands, with over half the wealth tax liability falling on those with in-scope net worth over $20 million.

Figure 2: Share of taxable population and wealth tax payable by net worth bands for a wealth tax in 2024-25 (assuming $5m threshold and exemption and 1% rate)



Note: these data are based on the experimental capitalised wealth distribution and subject to high uncertainty. See Annex 2 for more detail on this wealth estimation method and limitations.

42. We have previously reported additional distributional information about high-wealth individuals based on the experimental capitalisation method and HES data (T2022/2703; IR2022/516).

Equity impacts

The wealth tax will increase progressivity of the tax system overall…

43. As shown in the section above, the wealth tax will increase the progressivity of the tax system as a whole. This is because the wealth tax will shift more of the tax burden onto high wealth individuals, with the revenue available for use to fund tax changes that will reduce the tax burden for most taxpayers.

44. The wealth tax will also increase the overall tax paid by the group that most benefits from the non-taxation of most capital gains. This will help to achieve your objective of increasing the tax paid by high-wealth individuals who are currently lightly taxed. However, it will only do this indirectly as it increases the tax on most capital assets uniformly, regardless of whether those assets are earning untaxed capital gains.

… but some aspects of the tax will limit this effect

45. The proposed exemption for the family home and the likely generous valuation treatment for some hard to value assets[2] (such as unlisted businesses) may reduce overall progressivity. Business assets are generally held by the very wealthiest New Zealanders, and so the generous treatment of these assets may reduce the extent which the wealth tax affects the very wealthiest New Zealanders.

46. A recent published study from the United Kingdom concludes that "business income – from either self-employment or from owning and running a company – is much more important in the top 1%, and especially the top 0.1%."[3] This conclusion is consistent with the results in the draft high-wealth individuals research report you have seen (IR2023/051 refers).

47. This may mean that, even though the wealth tax increases the progressivity of the tax system as a whole, it may not necessarily be progressive within the in-scope population.

48. Some taxpayers will attempt to avoid the wealth tax. To the extent they are successful, this will reduce the progressivity benefits achieved by the tax. As outlined in a later section, the extent of this is uncertain but is likely to be material.

The design of the wealth tax will have consequences for horizontal equity

49. There are also some specific design features of the wealth tax that will reduce horizontal equity. These include:

    a. Exemptions for the family home and personal consumption assets reduce the horizontal equity of the tax. Individuals with the same level of total net wealth could have different wealth tax liabilities, if one holds more of their wealth in exempt assets than the other; and

    b. Any opportunities for avoidance will undermine horizontal equity; and

    c. The differential valuation of unlisted companies and private businesses may give owners of these assets better treatment.

There are other factors which are likely to lead to differing perceptions on the fairness of the wealth tax

Wealth providing benefits above income, desire to decrease wealth inequality and increase equality of opportunity

50. Some commentators (one notable example being the 1978 Meade Report on the UK tax structure) have argued that taxes on wealth are fair as wealth provides benefit above and beyond the income it generates. Some of these benefits

---

[2] You have agreed to defer decisions on the specific methods of how to value assets. However, as outlined in paragraph 79 the treatment of business assets is likely to be concessionary with any valuation rules. This is because unlisted business assets are hard to value and there is a plausible range of values for them. Taxpayers are likely to pick the lower end of the plausible range.

[3] Delestre, I., Kopczuk, W., Miller, H. and Smith, K. (2022). Top income inequality and tax policy, Institute for Fiscal Studies Deaton Review of Inequalities. Institute for Fiscal Studies. https://ifs.org.uk/inequality/top-income-inequality-and-tax-policy/

identified by these commentators include security, greater opportunities, independence, influence, and power. However, issues here are complex and there are other scholarly articles which have argued that these other grounds do not conclusively provide a good reason for an independent tax on wealth.[4]

51. The wealth tax may also be perceived as improving the fairness of the tax system by those with a desire to decrease wealth inequality and increase equality of opportunity.

Cashflow and income, impact on savers, and double taxation

52. On the other hand, some may consider it unfair that their tax is unrelated to their income and cashflow. Some of the people subject to the wealth tax may fit into the category of "asset-rich-cash-poor", where their wealth tax liability could make up a large proportion of their income. These people may be required to dispose of their illiquid assets to meet their tax liabilities, which may be perceived as unfair. As discussed earlier in this report, officials are considering ways to manage the issue of some taxpayers struggling to meet their wealth tax liability as it falls due, which may help to manage this perceived unfairness.

53. Some people are also likely to argue that the wealth tax is unfair on savers, as it will tax high-income people who save their income more than those who do not save. People with the same level of income, but different preferences around saving and consumption smoothing, can face different tax liabilities under the wealth tax.

54. There may also be some people who claim the wealth tax is effectively double taxing their income. This argument is not necessarily unique to a wealth tax, as it is a common reaction from some people to taxes on capital in general.[5] The fact that this is a new tax does not mean this should be considered an inherently unfair "double taxation".

Impact on effective income tax rates

55. Box B below provides our analysis of how a wealth tax would change effective tax rates of the very wealthy.

Box B. How does a wealth tax impact effective tax rates?

How a wealth tax would impact effective income tax rates is complex because the base of the tax is wealth rather than income.

However, we can consider how a wealth tax affects the tax rate on the 'normal' return from investments. As we have previously advised a wealth tax, or risk-free return tax is equivalent to a comprehensive income tax on capital income that earns normal returns (T2023/164, IR2023/30 refer).

Table 8 outlines how a 1% wealth tax would increase effective tax rates depending on the assumed risk-free return.

[4] The issues are discussed in Adam and Miller, 2021, 'The economic arguments for and against a wealth tax', *Fiscal Studies*, 42, pp. 471-472. The authors themselves do not take a position but highlight the complexity of the conceptual issues.

[5] The "double taxation" argument here is that taxed labour income is used to fund the purchase of capital assets, which generate income which itself is taxed.

Table 8. Nominal effective income tax rate of 1% wealth tax

	1.5% return	***4.0%* return**	***7.5% return***
Increase in effective income tax rate	67 percentage points	25 percentage points	13.3 percentage points

Note. 4.0% is approximately the average annual return on a 1 and 2 year government bond over the last 25 years which we have used as the average risk-free return rate. However, because risk-free rates differ a lot we have also looked at 1.5% and 7.5% rates of return. Note that actual rates of return will be higher given risky portfolios.

You have also requested information about the long-run average return on risky investment in New Zealand. The long-run (since 1900) return premium on New Zealand listed equities over government bonds has been 4.4%. If the future risk-free return is 4%, and the risk premium is 4.4%, then expected market returns are 8.4%.[6]

You have seen a preliminary estimate from a draft version of the HWI research report that reports a low estimated median family all-income effective tax rate across the project period (2015 to 2021) of approximately 9%[7].

The effective tax rate on wealth subject to the wealth tax would increase by 25 percentage points assuming a 4% normal return. However, this cannot simply be added to the 9% effective tax rate. That tax rate relates to all economic income, some of which is salary income unrelated to the taxpayer's wealth.

Even putting the salary issue aside, adding the 25 percentage points to 9% would tend to overstate the effect, as some international papers have suggested that top earners may be earning significant returns from human capital rather than financial capital. If this is true, the effect of a wealth tax on effective income tax rates will be less.[8]

Officials may be able to revisit this issue using data from the HWI report once it is finalised, to do more sophisticated calculations if you request it.

Economic costs and other risks

56. This section outlines the economic costs and other risks associated with the wealth tax. These negative impacts will need to be weighed against the ability of the wealth tax to achieve your revenue and distributional objectives when deciding whether to implement the tax.

57. Some of these economic costs and other risks are inherent in any tax that is applied to capital. For example, any tax that increases the effective tax rate on capital could have some negative effect on incentives to save and invest.

58. In contrast, some of these costs are specific to a wealth tax. The wealth tax is expected to lead to less efficient investment decisions by in-scope taxpayers, which is in contrast with taxing capital income more comprehensively (such as via a capital gains tax) which would likely reduce at least some distortions. This

---

[6] Dimson, E., Marsh, P., & Staunton, M. (2023). *Credit Suisse Global Investment Returns Yearbook 2023*. Zurich: Credit Suisse Research Institute

[7] All income but not including imputed rent or GST

[8] (Smith, Yagan, Zidar, Zwick, Capitalists in the Twenty-First Century , 2019. The Quarterly Journal of Economics (2019).

behavioural response will impose potentially significant economic costs, relative to the size of the revenue collected.

59. A wealth tax is also expected to impose higher compliance costs relative to other alternatives for achieving your distributional and revenue objectives.

60. Our analysis of the economic costs and other risks is largely based on the international evidence about the consequences of wealth taxes used in other countries. While this evidence is useful in understanding the potential costs of a wealth tax there is considerable uncertainty about how these impacts will translate to the New Zealand specific context.

Economic costs

61. The costs noted above are summarised in Table 9 below. Further detail about these economic costs (and why they arise) are also outlined below (paras 62-101).

Table 9 – Summary of economic costs of a wealth tax

Economic cost	Level of impact	Impact relative to other taxes on capital
Migration	Impact is uncertain, but best estimate is 5% of in-scope population leave with every 1 percentage point of wealth tax.	Expected with any increase in tax on capital, but reason to think the effect is stronger with a wealth tax.
Reduction savings and investment	Expect some small reduction in saving rates and stock of savings. Overall investment likely to be unchanged, but could see reduced investment in areas with limited access to foreign capital (e.g., start-ups).	Some effect on incentives to save and invest from all taxes on capital, but effect is likely to be larger for a wealth tax compared to capital income taxes (which are more efficient due to taxing economic rents).
Less efficient investment decisions	Expect some reduction in allocative efficiency, with more investment in tax-advantaged assets (the main home and unlisted businesses.	Some alternative taxes on capital income (such as a capital gains tax) would have similar effects with a main home exemption, but would also improve the allocation of some investment.
Entrepreneurship and innovation	Expect some reduction in investment in entrepreneurship and innovation. However, some competing effects that may limit this impact.	Expect negative impact with any tax on capital, but some design features of a wealth tax (and the fact that economic rents are not taxed by a wealth tax) could increase the size of this effect.
Compliance costs	Compliance costs of a wealth tax are highly uncertain. A similar methodology to the UK Wealth Tax Commission would suggest that with a 1% tax and $5m threshold compliance costs might be around 20% of revenue collected.	Compliance costs as a % of revenue collected is expected to be high relative to alternatives (e.g. capital gains tax and inheritance tax).

The wealth tax will incentivise some high-wealth individuals to migrate away from New Zealand

62. A wealth tax will likely lead some high wealth individuals to leave New Zealand, and discourage others who might have moved to New Zealand. As the wealth tax will only apply to New Zealand tax residents, individuals can avoid the tax entirely if they leave the country and cease to be tax resident. These individuals will potentially be able to do so while retaining real property such as valuable holiday homes or farms in New Zealand which may make migration an easier option.
63. The international evidence around how taxpayers have responded to wealth taxes abroad suggests that around 3-4 percent of the in-scope population leave the country in response to a 1 percentage point increase in the wealth tax rate[9].
64. For the purpose of estimating the revenue we have assumed that around 5 percent of the in-scope population will leave for every 1 percent of the wealth tax rate.[10] We have elected to use a higher rate as we think there are New Zealand-specific reasons that the migration response may be stronger than in other countries that have imposed wealth taxes.
65. The specific reasons why there is a risk that actual migration response is higher in New Zealand compared to the international evidence include:
    a. The international evidence we are relying on is based on marginal changes in the wealth tax rate. It is possible that introducing a new tax may elicit a larger response than increasing the rate of an existing tax. The compliance costs of a wealth tax may also increase this response; and
    b. New Zealand has a relatively mobile population, with significant ease of moving to Australia.
66. Given this, the migration response estimate is subject to a high degree of uncertainty. There is a real risk that the number of people who leave is higher than estimated, resulting in less revenue collected from the wealth tax than we have forecast and larger economic costs.
67. Those who do migrate may be very wealthy New Zealanders who have substantial business interests in New Zealand. The implication that the migration response to the wealth tax may have on innovation and entrepreneurship is considered in a later section (paragraphs 83-90).

The wealth tax will reduce the incentive to save and invest

Effect on savings

68. The wealth tax will reduce the after-tax return that in-scope taxpayers receive on their savings. In theory, this could reduce their incentive to save and increase their incentive to consume.

---

[9] The response is substantially higher within a country in the case of regional wealth taxes (around 7-8% of the in-scope population move to a different region in the same country for a 1 percentage point increase in the wealth tax rate). This difference in response is likely driven by the fact that moving within a country is simpler and less costly than moving to a different country.

[10] This is the migration response assuming you adopt the "exemption" method for wealth below the entry threshold. If you adopt the "trigger" method, the migration response will be around 50% greater.

69. The total impact that the wealth tax will have on national savings rates in New Zealand is uncertain. However, most international evidence suggests that that any impact is likely to be small.

70. However, there may be a reduction in the stock of savings as a result of some high-wealth individuals migrating away (and moving their savings out of New Zealand at the same time) and others choosing not to move to New Zealand.

Effect on investment

71. Any reduction in saving could potentially have a negative impact on the level of investment in New Zealand. The size of the impact depends on the extent to which domestic savings impact domestic investment. Because New Zealand is a small open economy, we expect the impact on investment to be small in sectors where there is substantial access to foreign capital. In most cases a reduction in investment funded by domestic saving will be offset by an increase in foreign investment.

72. The impact on investment may, however, be larger for some sectors that have limited access to foreign capital (for example, small or unlisted businesses, and in particular start-ups). The flow-on impact that this effect might have on entrepreneurship and innovation is covered in a later section.

The wealth tax will incentivise an inefficient reallocation of investments

73. The wealth tax is likely to have some negative impact on the allocative efficiency of investment. This is because some assets will be tax-advantaged under the wealth tax; either due to being exempt or because they are subject to generous valuation rules.

74. We would expect taxpayers to shift more of their investment into tax-advantaged assets and invest less in assets subject to the wealth tax on their true market value. This will put upward pressure on prices for tax-advantaged assets, and downward pressure on prices for other assets.

75. A reduction in allocative efficiency will reduce productivity in the economy, which will flow through to somewhat slower economic growth over time.

76. The scope of the wealth tax will be relatively broad, which will limit the size of this allocative inefficiency. However, it does contain some limited explicit exemptions. The main exemption that could distort investment is the exemption for the family home. Here it will be adding to existing distortions because investment in a family home is already lightly taxed because of the absence of any tax on imputed rental income or gains on sale.

77. The wealth tax will also be adding to existing distortions for personal consumption assets such as yachts, cars, aircraft or expensive artwork, predominantly because of the absence of any tax on imputed rental income. These personal consumption distortions would also exist with officials' recommended alternative of a capital gains tax[11].

78. The way in which the wealth tax is expected to impact on the housing market specifically is set out in Box C below.

---

[11] This would depend on the treatment of personal items under a capital gains tax, but we might expect that the considerations leading to excluding these from a wealth tax would apply to a capital gains tax.

Box C. How does a wealth tax impact the housing market?

This exemption for the family home will incentivise in-scope taxpayers to purchase more expensive houses as their primary place of residence, as well as invest more in the amenities attached to their home.

This will likely put upward pressure on house prices, particularly at the top end of the housing market.

There will also be some downward pressure on this segment of the housing market due to some high-wealth individuals migrating away from New Zealand (although it should be noted that migration away from New Zealand will not necessarily require sale of any New Zealand property, as wealthy people will often own homes in more than one country).

The wealth tax will also incentivise some in-scope taxpayers to reduce their investment in assets that are taxed at full market value under the wealth tax (including rental properties and holiday homes). This will create some countervailing decrease in demand for housing; limiting the upward pressure on house prices. This incentive is likely to be relatively small, given the relative broad base of the wealth tax.

Due to these countervailing influences, the net effect of the wealth tax on house prices is ambiguous.

79. In addition, hard to value assets (particularly unlisted businesses) will likely be inherently tax-advantaged under a wealth tax, as taxpayers will tend to pick the lower end of plausible values. In other jurisdictions with wealth taxes, valuation rules tend to be somewhat generous in order to minimise the risk of overvaluing these assets. Officials will advise on valuation rules, including rules for unlisted businesses, following consultation.

80. The impact of valuation rules for unlisted businesses on entrepreneurship and innovation is covered in the next section (paragraphs 83-90).

81. Any change in the allocation of investment by in-scope taxpayers will be somewhat mitigated by the ability of those who are not subject to the wealth tax to change what assets they purchase.

82. It is difficult to quantify the exact size of the impact that this allocative inefficiency will have on the economy. Officials believe the size of the effect is highly uncertain but is likely to be material. The exact size will depend on the final decision on valuation rules, which officials will report to you on following consultation.

The wealth tax could negatively impact on entrepreneurship and innovation

83. The combined impact of incentivising some individuals to migrate away from New Zealand, as well as potentially reducing investment in small, unlisted businesses, could lead to an overall reduction in entrepreneurial activity and investment in innovative start-ups in New Zealand.

84. Some of the individuals who migrate in response to the wealth tax may have developed an innovative and successful start-up in New Zealand, or otherwise

would have the potential to do so. Losing these individuals (and as a result, these businesses) will have implications for our future tax base, as well as our productivity growth.

85. These risks are similar to risks with officials' recommended alternative of a capital gains tax. However, there are additional risks with a wealth tax.

86. In addition to the migration response, the wealth tax may also have implications for decisions to invest in start-ups by high-wealth individuals who remain in New Zealand. For example, the wealth tax will potentially discourage investment in areas where cash flow constraints and illiquidity are likely to be large (e.g., start-ups).

87. There are also some specific elements of the wealth tax that could make it harder for start-ups to grow to their full potential. As noted above, the wealth tax could reduce available funding for investment in start-ups given their limited access to foreign capital (especially in the early stages of their development). As a result, these businesses are more reliant on domestic savings, which could reduce as a result of the wealth tax.

88. It is also possible that, if these businesses are subject to rules that result in higher valuations, start-up firms may forgo equity infusions to avoid increasing the wealth tax liability for shareholders. This could further constrain the expansion of some start-ups, preventing them from growing to their full potential. It may, for example, discourage large closely-held firms from becoming listed companies.

89. Running counter to this, it is possible that generous valuation rules for unlisted businesses could incentivise in-scope taxpayers to increase investment in start-ups[12]. To the extent that this effect dominates and overall investment in start-ups increases relative to the status quo, this increased investment should be considered a cost driven by a desire to limit exposure to the wealth tax. This increased investment would come at the cost of less investment in other areas of the economy, such as investment in growing businesses not subject to generous valuation rules.

90. Innovation, entrepreneurship, and investment are identified as key for delivering the Government's Economic Plan to build a high-wage, low emissions, and secure economy. To the extent that introducing a wealth tax disincentivises these activities, doing so will undermine efforts to deliver on the objectives in your Plan.

The wealth tax will increase compliance costs for taxpayers

91. All taxes impose some level of compliance costs on taxpayers. This will also be true for the wealth tax. The main source of compliance costs for a wealth tax will be the cost of valuing the assets that are subject to the tax, but there will also be other sources (including filing costs and the cost of receiving professional tax advice).

92. The compliance costs for a wealth tax are likely to be largely concentrated among a small number of taxpayers with significant wealth. This is different from most other taxes, where the compliance costs are spread over a larger proportion of the population.

93. The international literature suggests that compliance costs for a wealth tax are likely to be high per dollar of revenue raised, relative to most other taxes. A high level of compliance costs effectively increases the size of the tax for taxpayers. If

[12] This incentive is discussed in the previous section on allocation of investment

compliance costs are high, then this will feed into increasing the other behavioural responses already identified, rather than creating new behavioural responses.

Officials estimate of size of compliance costs

94. While officials are confident that the compliance cost of a wealth tax will be large relative to most other taxes, we acknowledge that any estimate of the size of these costs is subject to considerable uncertainty.

95. One method of estimating possible compliance costs is to draw on a recent estimate of compliance costs from the UK Wealth Tax Commission; inferring the New Zealand experience of compliance costs would be similar.[13] To do this we have assumed that the tax is applied at an individual level and the "exemption" method is use for the treatment of wealth below the entry threshold, rather than the "trigger" method.

96. Using this method, we calculate that compliance costs are likely to be about 20 percent of revenue for a 1% wealth tax with an exemption level of $5 million.

97. There is however a very high degree of uncertainty about this estimate. While the UK study attempted to provide a mid-point estimate of compliance costs, this estimate is subject to uncertainty for the UK. Translating this number to the New Zealand context increases this uncertainty.

98. Compliance costs for New Zealand are likely to depend heavily on design decisions. In particular, the size of the compliance costs here will depend on design decisions made in previous reports, as well as final decisions relating to valuation rules.

99. Specifically, there are some reasons why this estimate of likely compliance costs could be too low. As the Commission reports, they take no account of costs such as the opportunity cost of taxpayer's time in filing returns or of the potential costs of disputes with tax authorities. The Commission also assumes that only those with wealth above the threshold will be required to value assets. In practice, many people with wealth close to the threshold but below it will also be required to value assets.

100. On the other hand, the wealth tax being analysed by the Commission is one in which hard-to-value assets are valued annually. Compliance costs can likely be reduced by requiring less frequent or less accurate valuations. But this may mean that the rules have a bigger negative impact on economic efficiency and productivity. Officials will advise you on the exact valuation rules following consultation.

101. As we have also noted previously in this report, there is significant uncertainty around our estimate of revenue that would be collected by a wealth tax. A substantial over or underestimate of revenue would significantly change our estimate of the compliance cost of a wealth tax relative to the revenue collected.[14]

---

[13] The UK estimates assumed that compliance costs for valuing hard-to-value assets were 0.4% of the value of the assets, capping the costs at £50,000. However, this was within a very large range of possibilities varying between 0.1% and 0.8% of the value of these assets. The UK estimate did not take account of compliance costs associated with disputes with tax authorities or of a taxpayer's own time used to value assets. They also assumed that hard-to-value assets were valued annually.

[14] For example, if the revenue estimate is 10% to 30% too high, this would convert into compliance costs per dollar raised being 11% to 43% higher than we are estimating.

Integrity of the tax system

102. A wealth tax will create strong incentives for taxpayers to structure their affairs to avoid or evade the tax. This is a risk that will occur with any attempt to increase the tax paid by high-wealth or high-income individuals. However, the integrity pressures are likely greater for a wealth tax compared with income taxes.

103. International experience with wealth taxes indicate that the integrity risks are significant, and that careful design is vital to minimise these risks. That this tax has been developed in such compressed timeframes elevates the likelihood of design issues that lead to significant integrity risks.

104. There are a range of strategies that taxpayers could undertake to reduce their wealth tax liability. The key strategies are:

    a. **under-reporting the value of their assets** - Taxpayers will have strong incentives to reduce the reported value of their assets. The international experience is that a range of strategies are used to achieve this underreporting. While there are some actions tax authorities can take to limit this, some degree of under-reporting is inevitable as for some asset types there is often a range of acceptable values that could be considered "market value". We would expect taxpayers to gravitate towards the lowest acceptable valuation where the option is available.

    b. **asset-splitting** – While there will be rules to prevent parents/guardians from gifting assets to minor children in order to avoid the wealth tax, there will not be any specific rules to prevent the genuine gifting of assets to others, such as adult children.

    c. **non-reporting of wealth** - Some taxpayers may also respond to the wealth tax by simply not reporting all of their wealth, in order to evade the tax. One way that some taxpayers in other countries with a wealth tax have achieved this in the past is by moving assets overseas.[15]

Timeframes for development of the wealth tax

105. In our initial advice on a minimum tax, we highlighted the fact that the timeframes for progressing that tax were highly challenging and would impact on the quality of both the policy advice you would receive, as well as the design of the tax. The key messages relating to timeframes from the December report were:

    a. Progressing on this timeframe will mean this tax will progress faster than any international example of tax reform we are aware of with similar complexity.

    b. This is a highly compressed timeframe and creates significant risk to the quality of policy design and delivery risk. Officials are not confident that we can advise you on the full risks from the proposal and there is a high risk that there will be unforeseen issues and unintended consequences (including potential legal risks).

106. We remain concerned about the timeframes in which this tax has been developed. Since we provided you with the December report there has been a significant change in the proposed tax, which has meant that officials have had to prepare

[15] While there are exchange of information treaties under which Inland Revenue could request information from other tax authorities, this process would be slower and more difficult than accessing information held domestically.

advice on the policy impact and design of the wealth tax under extremely constrained timeframes.

107. The UK Wealth Tax Commission cited estimates[16] that a comprehensive policy development for an annual wealth tax could take four years from inception to operation. The commission suggested "this timescale could be reduced somewhat". Their "optimistic" timeframe was 24 months, on the basis that the Wealth Tax Commission itself had completed all of "Stage 1 - Considering Options" and some of "Stage 2 - Honing the Preferred Option"[17]. The estimate for the “possible time” (as opposed to “comprehensive time” for the third stage (drafting legislation) was 6-9 months, with two months added to that for publishing and consulting on the legislation. The possible time for implementing the wealth tax after legislating was 6 months.

108. The time we have been working through these issues has been considerably shorter than any of those timeframes, and we expect there are consequent risks and issues that we have not foreseen. In particular, we are concerned that there will have been policy impacts that we have not had time to identify (or would only identify with the benefit of consultation).

109. There is a high risk that these timeframes will result in a sub-optimal design of the wealth tax. There is also a high risk of unforeseen issues or unintended consequences flowing from this design that could create significant economic costs. For example, without consultation officials are still uncertain about the practicality of the proposed wealth tax such as the rules for valuation and trusts.

110. This also means there is high risk of us not identifying integrity risks and that the design of this tax will require significant revision in the years after implementation in order to remedy mistakes made in the design of the tax. This could undermine trust in the stability of the tax system.

Māori interests in communally owned assets

111. Ministers previously agreed to exclude Māori interests in communally owned assets managed by Māori entity structures from the scope of the proposed minimum tax, and this decision was carried over as part of our advice about the scope and application of a proposed wealth tax. This exclusion, and the proposed exclusion relating to charitable trusts, should, in principle, cover most of the interests in Māori entities and collectives that manage communally owned assets. We note that we would be more certain about the application and effect of the proposed exclusion if we had the benefit of insights from public consultation. For example, there may be some groups with Māori interests that do not fall within proposed exclusions.

112. The decision to remove Māori interests in communally owned assets managed by Māori entity structures recognised that, in general, these interests cannot be easily traded, transferred, or attributed to individual Māori. These interests are usually inherited or defined by reference to whakapapa ties. Including these assets would come with disproportionate compliance costs with relatively little revenue or distributional benefits. We consider that the current taxation rules (the Māori

[16] Pope, T. and Tetlow, G., 2020. Delivering a net wealth tax: the role of government. [online] Wealthandpolicy.com. Available at: EP12_Delivery.pdf (wealthandpolicy.com)

[17] The other two stages were *Stage 3 – legislating* and *Stage 4 - implementation*

authority tax rules) that apply to these structures achieve the correct tax policy and distributional outcomes.

Administrative impacts for Inland Revenue

113. Inland Revenue have provided you with a separate report on the administrative burden of the entire tax package, including advice on the specific administrative impact that is related to the wealth tax (IR2023/096 refers).
114. It is important to note that the level of administrative resource that is applied to the enforcement of the wealth tax will have implications for the integrity of the tax. Without sufficient resource, it is likely that there will be higher integrity risks and lower revenue collected from the wealth tax than expected.

Assessment

115. The wealth tax will help achieve Ministers distributional objectives, as well as raise revenue to fund the rest of your tax package. It will increase the progressivity of the tax system and increase the tax paid by those who likely benefit the most from the non-taxation of capital gains.
116. The size of the economic and integrity costs of the wealth tax is subject to considerable uncertainty, but has the potential to be large. While the wealth tax is an improvement over a minimum tax, there could be substantial costs, particularly due to it creating biases in investment, high compliance costs, and the risk that those affected will migrate which could negatively impact entrepreneurship and innovation.

Comparison with other taxes on capital income

117. Some of these economic costs are shared with any tax that would increase the tax on capital income. There are also some areas where a wealth tax will have benefits over other taxes on capital income. For example, a capital gains tax introduces inefficiency through lock-in effects (taxpayers are incentivised to not sell their assets). A wealth tax should not, in principle, create a lock-in effect as the liability is imposed annually, instead of on the sale of an asset. However, this requires accurate and timely valuations for all assets. Without such valuations, lock-in effects can arise with a wealth tax.
118. Achieving your distributional objectives in the short term may also be easier with a wealth tax, as some wealthy taxpayers could potentially avoid paying a capital gains tax for a significant period of time.
119. Despite this our judgement is that, on net, a wealth tax is likely to have greater economic and integrity costs than other options that could achieve Ministers distributional and revenue objectives. However, the exact size of these costs is subject to significant uncertainty.
120. Two options that officials would recommend exploring further are a capital gains tax or inheritance tax. These would both raise revenue from high wealth individuals with likely significantly lower economic costs than a wealth tax. Our specific reasons for preferring a capital gains tax (which tax officials have given

considerable thought to in the past as part of the Tax Working Group process) are summarised in Box D below.

Box D. Summary of officials' reasons for preferring a capital gains tax to a wealth tax

- Capital gains taxes are common around the world. Many of the issues surrounding these taxes have been identified and explored internationally.
- There has also been considerable consideration about how a capital gains tax would work in New Zealand by the 2018 Tax Working Group. In contrast, the wealth tax has only been considered for a short period of time by a small group of policy officials, with no external consultation.
- Capital gains taxes around the world have proved to be relatively stable tax reforms.
- In contrast, the number of OECD countries with a wealth tax has fallen from 12 to three since 1990. All the countries that have removed their wealth tax have capital gains taxes, and some of them also have inheritance taxes.
- Capital gains taxes are more consistent with, and can improve the integrity of, our existing income tax system.
- Capital gains taxes provide more flexibility to increase the top personal income tax rate, because the ability to shelter income in companies is reduced if the sale of the shares in the company is taxed. This would create more flexibility to make the tax system even more progressive by reducing the integrity risks from increasing the top personal rate.
- A wealth tax is expected to have a negative impact on the allocative efficiency of investment. In contrast, a capital gains tax would lead to some improvements in allocative efficiency of investment (by removing the current distortion that incentivises investments that generate untaxed capital gains), as well as more effectively taxing economic rents.
- The compliance costs for a wealth tax as a percentage of revenue collected are expected to be considerably larger than most alternative options, including a capital gains tax.
- There is also some reason to think that some elements of the wealth tax could make the migration risk and other economic costs high relative to some other taxes on capital income.

Potential wellbeing impact of a wealth tax

121. A wealth tax will ultimately affect the wellbeing of New Zealanders. For example, it could impact:

    - **Social cohesion.** The impact of the wealth tax on social cohesion will depend on the competing considerations across progressivity, horizontal equity, integrity, and perceptions of fairness of the tax. There are likely to be differing views about the fairness of the tax across the population. Increasing the taxation of those who can have relatively light taxation due to the non-taxation of capital gains could be seen by some as improving fairness. Others may perceive it as unfair due to imposing a higher tax liability on people who save, compared to those with similar incomes but spend more of that income. The compressed timeframes for developing and implementing this tax increases the chance of integrity risks, which may also undermine social cohesion.

- **Financial and physical capital.** The economic costs of the wealth tax will impact financial and physical capital. These economic costs will have implications for the Government's economic strategy, in particular the goal to support entrepreneurship and innovation.
- **Human capability**. The wealth tax will likely lead to some high-wealth and high-skill people leaving New Zealand. This may negatively impact our human capability.

Progressing a wealth tax, relative to the status quo

122. When the OECD reviewed the evidence about the impacts of a wealth tax in 2018[18], it concluded that broad-based capital income taxes tend to be a more efficient and less administratively costly way of taxing capital, relative to a wealth tax. This is consistent with officials' recommendation above.
123. However, the OECD also concluded that where the tax burden on capital is low (e.g., where the tax on capital gains is low or where inheritance taxes are not levied), the case for introducing a wealth tax is stronger.
124. Quantifying the size of the competing impacts of a wealth tax is challenging and the weighting of distributional objectives requires value judgements. Much of this report has pointed out the costs of the wealth tax and has pointed to a capital gains tax as an option that may have lower costs. If that option is not possible, the decision to implement a wealth tax depends on whether the progressivity objectives that Ministers want to achieve are worth the costs. Treasury and Inland Revenue do not have a view on that question.
125. This judgement about the merits of a wealth tax relative to the status quo is an in-principle assessment, based on an assumption of the tax being progressed on a timeframe that allowed for sufficient time to design and implement the tax in a way that minimised the risk of unforeseen impacts that could lead to significant economic costs.

Impact of timeframes on officials' assessment

126. The highly compressed timeframe that is necessary to progress the tax as part of Budget 2023 increases the economic costs and risks associated with the wealth tax. Officials have had an extremely limited time to work through possible issues and have not been able to consult with stakeholders and so there is high risk that there are unforeseen issues or unintended consequences that could lead to significant economic costs.
127. Given our concerns about the compressed timeframes under which this policy has been developed, officials recommend that the wealth tax is not introduced as part of Budget 2023.
128. If you wish to progress the wealth tax as part of Budget 2023, officials recommend an application date of 31 March 2025, to allow for further consultation.
129. The Treasury recommends that Ministers align the timing of both the wealth tax and the personal tax reduction elements of your tax package. If Ministers want to progress the personal tax reductions sooner than 1 April 2025, Treasury

[18] OECD (2018), The Role and Design of Net Wealth Taxes in the OECD, OECD Tax Policy Studies, No.26, OECD Publishing, Paris.

recommends bringing forward the wealth tax to 31 March 2024 to minimise the gap between revenue reducing and revenue raising measures.

Design of the wealth tax

Confirming earlier decisions

130. You have previously made decisions about the design of the wealth tax. Annex 3 contains a summary of all these decisions.

131. Our analysis of the revenue, distributional and economic impacts of the wealth tax are based on the design choices you have already made. If you wish to deviate from the design as outlined in Annex 1, these impacts will potentially change in a material way.

Further advice on specific design elements

132. You have requested further advice on some specific design elements of the wealth tax. This section contains our responses to these requests.

Ensuring family homes located on farms are not unfairly treated

133. In the 13 February report (T2023/164; IR2023/030 refers), we advised that there are existing apportionment rules that could be used to exclude a family home on a farm for minimum tax purposes. We consider these existing rules could also be leveraged for the purposes of a family home exemption from wealth tax, and would provide a fair and reasonable basis for excluding the value of a family home situated on a farm and its curtilage.

Financing for taxpayers who will struggle to pay the wealth tax

134. You have asked us to provide advice on any financing arrangements we can provide to taxpayers who have a liability under the wealth tax but do not have the cashflow to make those payments due to their asset portfolio being illiquid or the cashflow from those assets not being sufficient to fund the payment of the tax

135. We note that providing concessionary financing arrangements to taxpayers who have sufficient assets to be liable to a wealth tax may have equity and consistency issues compared to other taxpayers who are subject to normal sanctions for non or late payment of tax. Due to these equity concerns we generally recommend against providing concessions in this area, specifically concessionary rates of use of money interest.

136. In addition, any concessionary financing arrangement would need to be offered to all taxpayers liable to the wealth tax (i.e., not just those with illiquid assets). It is not possible to have some application process which taxpayers could use to opt-in to the arrangement as all taxpayers would opt-in. This means that any financing arrangement would have wider scope than what may be intended.

137. However, if Ministers wish to provide some time for taxpayers to pay the wealth tax this could be done by allowing an extended period of time for taxpayers to pay the liability. In our previous report (IR 2023/066, T2023/279 refers) we discussed taxpayers paying the liability over four months. However, to give taxpayers more time to obtain financing and fund the payments two alternative options could be to extend this to six or 12 months.

138. Under those options taxpayers would file their wealth tax return and make their first payment with additional monthly payments due on the last day of the following five (or 11) months[19]. These extended timeframes should be sufficient for taxpayers to fund the tax payable.

139. The longer the "interest-free" payment period is set the larger the equity and consistency issues with tax owing by other taxpayers so our preference would be for the shorter period.

140. Late payment penalties and use of money interest would only apply to any instalments that were not paid in time or in full. That would be at the standard use of money interest rate to reduce the perceived equity issues over taxpayers' subject to other taxes.

141. As previously advised, given that there is no uncertainty around these instalments we do not consider tax pooling should be available to pay the wealth tax other than on reassessments. Allowing tax pooling would also complicate the system design of the tax.

142. However, if you continue to prefer some kind of concessionary longer-term funding arrangement, we recommend consulting with external parties (such as tax pooling intermediaries) on potential lower cost of funding solutions to enable taxpayers to spread the cost over a longer term as part of the ultimate implementation of the wealth tax.

Widening scope of application of the wealth tax to trusts

143. Officials have previously reported to you with our recommendation on how the wealth tax should apply to assets held in trusts. Annex 1 contains a summary of how what you have agreed to will work.

144. You have indicated that you are concerned that fixed-interest trusts could still be used to allow a wealthy person to divest themselves of assets to reduce the amount of wealth subject to the regime. You suggested perhaps broadening the scope to also include all fixed-interest trusts, subject to a lower exemption applied to each trust. Officials have a number of concerns with this approach.

Easily avoidable by using complete gifts instead

145. If a person were to transfer, say, $4 million of assets to their adult children through a fixed trust, and we were to apply the wealth tax to the trust subject to a low exemption, they could still achieve a reduction of wealth subject to the regime by making intervivos gifts to their children instead.

Also avoidable by using multiple trusts

146. Another way to avoid the regime is to use multiple trusts, each settled with an amount below the trust exemption amount. It is possible to have some anti-avoidance rules to address this, although this would add more complexity to the regime. In contrast with a trust exemption or de minimis, officials' proposal has no exemption for assets in a fixed trust provided that the total wealth of a beneficiary (including the wealth in the trust allocated to the same beneficiary) is above the exemption threshold.

---

[19] Excluding December which would move to 15th January.

Bringing middle income families into the regime

147. Another risk of applying the regime to fixed trusts with a lower exemption is the possibility of bringing middle-income families into the regime. For example, if the trust de minimis were $500,000 (instead of $3 million), trusts with more than $500,000 could be subject to the regime. This would reduce the targeting of the regime to high-wealth individuals. It would be a wealth tax on those with wealth over the threshold, plus a trust tax levied at (e.g.) 1% of net wealth in trusts.

148. Given these risks and other issues, officials do not recommend expanding the application of the wealth tax to more fixed trusts than already agreed (as described in Annex 1).

Application to interests in defined benefit funds

149. In our report on the minimum tax dated 13 December 2022 (T2022/2703; IR2022/516) we recommended that interests in defined benefit funds[20] be excluded from the minimum tax. This was partly because it was difficult to know how much tax the fund paid on income earned to finance the payment of defined benefits to particular members of the fund. You agreed to this recommendation.

150. Under the wealth tax, it is not necessary to know how much income tax was paid by the fund in relation to a member's benefits. We therefore consider that it is no longer necessary to exclude an interest in a defined benefit fund, and it would improve the integrity of the regime to include the interest to ensure there are as few ways as possible to own income-generating assets that are not subject to the wealth tax. We recommend that interests in defined benefit funds be included in the regime, and that we consult on ways to value them in the consultation on valuation issues.

Next Steps

151. Further advice on progressing the wealth tax (including the proposed legislation process) as part of your Budget 2023 revenue package is contained in the overarching report on the package (T2023/313; IR2023/095 refers).

152. We recommend you discuss this report with officials at the Joint Ministers Meeting of 16 March. We can also provide additional material to assist with making a near-final decision at Budget Ministers 4.

---

[20] A defined benefit fund is a superannuation fund which pays a guaranteed amount of income to a member of the fund regardless of the fund income earned on the amount they contributed. This is in contrast to a defined contribution fund, where a member receives whatever amount of income was earned on their contribution to the fund (less fund expenses).

Annex 1 – Summary of how the wealth tax will apply to trusts

General approach to trusts

The following describes how we proposed to incorporate trusts into the wealth tax and the reasons for this approach.

Discretionary trusts

We consider discretionary trusts to be economically similar to the settlor continuing to own and control the trust assets since the settlor has not made a completed gift to the beneficiaries. Depending on the terms of the trust and relationship between the settlor and the trustee, the settlor retains some amount of formal and informal control of the trust assets, while the beneficiaries have no definitive right to trust income or assets until they receive a distribution as decided by the trustee. For this reason, we have proposed that the threshold for determining if the settlor and trust are subject to the wealth tax be determined by combining the wealth of the trust and the settlor for determining if both are subject to the regime. If they are subject to the regime, only the settlor (an individual) may claim the exemption to the amount of wealth they hold below the threshold.

Intervivos gifts and fixed interest trusts

If an individual makes a gift to any person (other than a minor child) we have proposed that no adjustment be made to how the regime applies to the donor. This is because the donor has given up all legal rights to the gifted assets, so they are no longer owned by the donor for the wealth tax. We did not propose an exception to this for gifts to adult children since they still are independent to the donor in legal terms.

We have also proposed that settling a trust which provides for definite fixed entitlements to beneficiaries be treated as a completed gift by the settlor, so the settlor would not take those settled assets into account to determine if they are subject to the wealth tax. Since the beneficiaries would have a certain entitlement to some or all of the trust assets, the portion of assets to which each beneficiary is entitled must be combined with the beneficiary's other wealth to determine if the beneficiary and the trust (to the extent of those assets) (if so elected by the beneficiary) are subject to the wealth tax.

Minor children

Because minor children (up to age 16) have limited legal rights to control their own assets and parents/guardians retain some control, we have proposed that the wealth of minor children be combined with the wealth of the parent or guardian with the most assets for purposes of determining the parent/guardian's wealth tax liability. This is subject to a $100,000 de minimis.

How these rules work in practice

Assume the individual exemption / threshold amount is $3 million. The individual ("Parent") has $6 million and four children.

Parent retains $6 million

If Parent retains $6 million, they would be subject the wealth tax on $3 million ($6 million less a $3 million exemption).

Parent settles a discretionary trust for the benefit of their children with $4 million

If Parent settles a discretionary trust with $4 million, Parent would have $2 million and the trust would have $4 million. Those two are combined to determine whether both exceed the threshold and are subject to the regime. Since the combined amount is $6 million, both Parent and the trust are subject to the regime.

Parent is allowed a $3 million exemption. Since Parent's wealth is $2 million, the exemption would apply to all of Parent's wealth, and Parent would have no wealth tax liability.

The trust is also subject to the regime, but is not entitled to use any of the $3 million exemption. This means that the trust is subject to the wealth tax on its $4 million of assets. As a result, the total amount of wealth subject to the regime is $4 million. The rules therefore disincentivise people from holding wealth in trusts, up to the amount of the exemption.

Note this result will apply regardless of whether the children/beneficiaries are minors or adults.

Parent gifts $1 million to each of their four minor children, or settles a fixed trust with $4 million, with each beneficiary entitled to $1 million of assets

In the case of giving assets to minor children, the $4 million of assets of the minor children (including their share of the assets of a fixed trust) are attributed to Parent. Since Parent is deemed to have $6 million, Parent must pay wealth tax on $3 million of assets ($6 million less a $3 million exemption). This is the same result as if the Parent had not made the gift or settled the trust.

Parent gifts $1 million to each of their four adult children, or settles a fixed trust with $4 million, with each beneficiary entitled to $1 million of assets

This is the same as the above example, except the children are adults. In this case, whether the assets are transferred directly, or through a fixed interest trust, Parent has disposed of all of their interest in the assets. Parent has a remaining net wealth of $2 million, which is below the $3 million threshold, so Parent is not subject to the regime.

Each of the adults would have at least $1 million of net wealth (gifted to them directly or indirectly through a fixed interest trust). Whether or not each beneficiary/adult child is subject the regime depends on the extent of their other wealth. If they are subject to the regime, they could either comply with the wealth tax including their entitlement of the trust assets, or they could elect that the trustee instead complies with the wealth tax for their share of trust assets.

Annex 2 – Data limitations for revenue estimates

The Household Economic Survey (HES) is usually considered the best data source for the distribution of wealth. However, HES is thought to undercount wealth at the top of the distribution. To account for this likely undercount of wealth we have also used three experimental data sources for calculating indicative revenue figures in this report:

- **Scaled HES 2021 data estimates:** asset totals are scaled up to match the aggregates recorded in Stats NZ's Household balance sheet. This assumes that wealth under-reporting is uniform across the wealth distribution, but still results in significant uplifts for top wealth groups.
- **Capitalised wealth estimates for 2020:** personal taxable income data is multiplied to match aggregate wealth data contained in the Stats NZ Household Balance sheet, inferring the underlying wealth distribution (T2020/2965 refers). The Treasury is currently drafting on a working paper that will present the capitalisation method and explore its various assumptions and results.
- **Calibrated HES 2021 data estimates:** this uses an adjusted version of HES that up-weights the high-wealth individuals to agree with the capitalisation results. This means that the number of high-wealth individuals aligns, but that the results are still based on survey wealth data from HES.

The revenue figures in this report were based on an averaging technique that incorporates all three of these sources. When averaging we gave the capitalised wealth estimates a double weighting because the other two sources both use HES data.

These data sources face several limitations and are subject to high uncertainty:

- HES was not designed to estimate the top of the wealth distribution, so these data are based on small samples and subject to very large sample errors.
- The capitalised wealth data relies on personal tax returns that were not intended to provide distributional wealth information. By design, those with high capitalised wealth will also have high taxable capital income. The capitalisation method is also limited to estimating wealth on an individual basis, which means we must rely upon HES data for estimating how these figures might be uplifted for family units.
- The scaling method and capitalisation method both rely on Stats NZ's Household Balance Sheet to accurately provide net worth totals. This is an experimental series and subject to change. It uses a mixture of market valuations and book values for different assets, which may differ from the final method of valuation that officials will advise on after consultation.

We did not use any data from the HWI Research Project in the costings for this wealth tax.

Note that 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. 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.

Annex 3 – Summary of design decisions already made

Design elements	Proposal
Is tax calculated on family or individual basis	Wealth tax is applied on an individual basis, except for some assets held by minor children and some trusts which are aggregated
Applying the tax to trusts	Whether the wealth tax applies to a trust will be determined by combining trust assets with either the principal settlor's assets (in the case of a discretionary trust) or the assets of the beneficiaries (in the case of fixed income trusts) If a trust's assets are subject to the tax, the trustee will be required to pay (discretionary trust) (rather than the settlor or beneficiary). In the case of a fixed trust where trust assets are aggregated with beneficiaries' assets to determine if the regime applies, either the beneficiary may apply the regime to their share of the trust assets, or they may elect that the trustee comply.
NZ residents only	The wealth tax will only apply to New Zealand tax residents
Assets subject to tax	Most assets included, other than: family home; consumer durables (e.g. cars, boats), small amounts of cash, and defined benefit funds; Māori interests in communally owned assets managed by Māori entity structures; and personal assets such as art and collectables
Foreign assets	Foreign assets, including shares in a controlled foreign company (CFC) will be subject to the tax (except for Transitional Residents).
Valuation rules	Open market value used for all assets, with power delegated to Commissioner of Inland Revenue to prescribe valuation methods for specific assets. Officials will consult on proposed valuation methods
Asset splitting/gifting	No specific rules be in place to prevent gifting of assets between adults, but assets held by minor children (above a de minimis threshold) will be treated as being held by their parent/guardian
Applying the tax to farms	No specific concession for farms, but officials will work on rules to ensure family homes located on a farm are not unfairly treated
Transitional residents	Transitional residence rules be extended to the tax, which would exempt foreign assets held by qualifying migrants for four years