The Treasury

Budget 2023 Tax Initiatives Information Release

July 2023

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POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Wealth tax — Further advice

Date:	27 February 2023	**Priority:**	High
Security level:		**Report number:**	IR2023/066 T2023/279

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations **Discuss** the contents of this report	1 March 2023
Minister of Revenue	**Agree** to recommendations **Discuss** the contents of this report	1 March 2023

Contact for telephone discussion (if required)

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27 February 2023

Minister of Finance
Minister of Revenue

Tax policy report: Wealth tax — Further advice

Purpose

1. On 17 February 2023 (T2023/217, IR2023/067 refers), we said we would report to you on design choices that must be reconsidered now that you have asked us to consider a wealth tax rather than a minimum tax.

2. This report sets out those choices, which are:

    2.1 Switch versus exemption approach to wealth below the entry threshold;

    2.2 Individual versus family basis for applying the wealth tax;

    2.3 How the wealth tax would apply to trusts;

    2.4 Valuation approach for unlisted businesses; and

    2.5 Administrative implications.

Switch versus exemption approach to wealth below the entry threshold

Previous reporting

3. In our December 2022 report (T2022/2703, IR2022/516 refers), you agreed to our recommendation that once the entry threshold is passed, wealth below the entry threshold is included when calculating deemed income (the "switch" approach). For example, if the entry threshold were $5 million, a taxpayer with net wealth of $5.1 million would calculate the deemed income from their *total* net wealth, rather than just from the $0.1 million above the entry threshold. This contrasts with an "exemption" approach, where wealth below the threshold is excluded from the tax.

4. Our recommendation of the switch approach was finely balanced. A key reason was that the exemption approach was much more complex for a minimum tax that needed to be integrated with the existing income tax and would result in disproportionate compliance costs for those slightly above an exemption threshold. However, the switch approach also came with an undesirable "cliff-edge" incentive effect that the exemption approach would avoid. Since a taxpayer with $5.1 million in net wealth would be subject to the minimum tax on their total wealth, rather than just $0.1 million, they would face a strong incentive to keep their wealth below $5 million. The switch approach was therefore highly distortionary for taxpayers near the entry threshold.

New recommendation

5. We now recommend an exemption approach, which excludes wealth below the entry threshold in calculating the wealth tax liability. For a taxpayer with $5.1 million wealth, the wealth tax would only apply to $0.1 million of wealth, rather than the whole $5.1 million. This is the approach used in Norway and most other countries that have had wealth taxes.

6. Since applying an exemption approach to a wealth tax is much simpler than with a minimum tax, we consider the simplicity benefits of the switch approach are now reduced and outweighed by the undesirable "cliff-edge" effect.

7. The switch approach does have the advantage of increasing the revenue[1] and distributional effects of the tax. However, as the wealth tax is much simpler compared to the minimum tax, it is likely that those revenue and distributional benefits will be achieved more effectively by lowering the entry threshold or raising the tax rate, rather than using the switch approach.

8. We have not had time to quantify the exact size of the revenue impact of moving to the exemption approach. However, we have been able to estimate how much wealth would be subject to the tax at different thresholds under both the switch and exemption approaches, as set out below in Table 1. These figures are sourced from the experimental capitalisation method[2] and are highly uncertain. They are not a substitute for the forthcoming revenue costing. No attempt has been made to model how wealth may grow in the future or to account for behavioural responses to a net wealth tax.[3] The final costing will depend on the exact design of the wealth tax.

9. As a rough guide, we expect that halving the entry threshold when moving to the exemption approach would collect a similar amount of revenue.

Table 1. Indicative impact of exempting wealth below the threshold (2020, capitalised wealth data, individual basis)

Threshold	Population in scope	Wealth in scope (switch approach)	Wealth in scope (exemption approach)
$3m	57,000	$460b	$290b
$5m	27,000	$350b	$210b
$7.5m	15,00	$270b	$160b

10. In moving to an exemption approach, you could also increase the tax rate that is applied to the wealth that is in scope. As a rough estimate, the exemption approach with a 1.6% tax rate would collect a similar amount of revenue as the switch approach with a 1% rate. Under this exemption approach, significantly less tax would be paid by those near the bottom of the entry threshold, while more tax would be paid by those at the top of the wealth distribution.

Individual versus family basis

Consequences of moving from switch to exemption approach

11. Our December report recommended that partners' and minors' wealth be combined in determining if the entry threshold is met. We then recommended that if the entry threshold for the minimum tax is met, each individual in the family would perform the deemed income calculation separately. That is, under the switch approach, we effectively recommended the *entry threshold* be assessed on a family basis, while *liability for the minimum tax* itself would apply on an individual basis. This was

[1] In our December report (T2022/2703, IR2022/516 refers), we estimated that the exemption approach would reduce the wealth that was subject to the tax by roughly 40 percent (assuming a $5 million threshold).

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

[3] While the switch approach brings more wealth into scope, we expect that it would also create a much more substantial behavioural response, particularly from those not significantly above the threshold. Therefore, while we would still expect it to raise more revenue, it would be less than the additional wealth covered would imply.

achievable because the switch approach ignores the entry threshold once a person is in the regime.

12. As discussed in the previous section, we now recommend using the exemption approach to the wealth tax instead of the switch approach. This merges the entry threshold with the exemption.

The exemption approach would be difficult to apply on a family basis

13. To apply the exemption approach on a family basis, the family would likely have to be jointly liable for tax. In New Zealand, the family unit is not a legal entity, and tax liabilities are imposed on individual taxpayers.[4] We understand that Norway allows or requires couples to be taxed together for both wealth tax and income tax. However, this is not an existing feature of New Zealand's income tax system.

14. Alternatively, the tax could be imposed on individuals with the exemption apportioned between family members, but this would add complexity. If a couple wants the benefit of a higher combined exemption, they can achieve this themselves by legally transferring some assets from the higher-wealth partner to the lower-wealth partner. The ability to transfer assets among themselves does provide a benefit to a couple that is not available to a single person (see **Example 1** below). However, since people can enter into and out of relationships, having different exemption thresholds for single individuals and couples could lead to undesirable behavioural responses (for example, disincentivising people from cohabiting or marrying). We therefore recommend having a single lower, individual exemption than a higher, family one.

Example: Individual versus family exemption

Andrew and Barbara are married. Andrew's net wealth is $2 million, Barbara's is $4 million (total $6 million).

With a $5 million family wealth exemption, the family's taxable wealth would be $1 million ($6 million – $5 million).

With a $2.5 million individual wealth exemption, the combined taxable wealth would be $1.5 million (Andrew: $0 as his wealth is below the exemption; Barbara: $4 million – $2.5 million = $1.5 million).

If Barbara transfers $0.5 million of assets to Andrew, the combined taxable wealth would be $1 million, the same as under the $5 million family wealth exemption (Andrew: $2.5 million – $2.5 million = $0; Barbara: $3.5 million – $2.5 million = $1 million).

Recommendation: Individual exemption approach with anti-avoidance rule for minors

15. We recommend having a single exemption that applies at the individual level. Our recommendation for using an individual basis applies regardless of whether the switch or exemption approach is taken but is stronger under the exemption approach. An individual exemption is simpler and increases certainty. In addition, we now consider any risks from asset splitting are likely lower than we had

[4] We have considered the option of making family members jointly and severally liable for a "family's" tax liability, but there are no situations in current tax law where a person can become liable for their partner's tax without consent. There is therefore a high risk of unintended consequences. For example, where partners have entered a pre-nuptial agreement or otherwise do not share finances, there could be considerable unfairness and practical difficulties in imposing a tax obligation on a partner who does not own the assets and has no ability to pay the tax. We note that in New Zealand, spouses do not have to enter pre-nuptial agreements to not share finances. The default in the Property Relationships Act is that separate property acquired before the relationship commenced remains separate property unless it is intermingled with relationship property.

previously anticipated. This is based on modelling in the UK which indicates that the revenue risks from asset splitting for a net wealth tax in the UK are relatively small. Their analysis indicated that if families fully split their assets between family members, the revenue would only reduce by around one to three percent (for wealth tax thresholds between £1–10 million).[5]

16. The revenue generated under an individual exemption would not be exactly the same as dividing a family threshold in two, as family wealth is often held disproportionately by the partners, not everyone is in a relationship and behavioural responses will differ under each approach. The exact size of the exemption would be a judgement call. It would be very difficult to cost the change of a family threshold to an individual threshold with any certainty.

17. To prevent people transferring wealth to minor children to avoid the tax, we propose that any parent or guardian be treated as holding the wealth held by a minor (aged under 16 years) for whom they are responsible. Where more than one parent or guardian is responsible for a minor, the minor's wealth would be treated as being held by the parent or guardian with greater wealth, to prevent double counting. A *de minimis* of $100,000 per minor could still apply, per our earlier advice.

Trusts

18. In our report on 2 February, we reported on how trusts would be included in applying the entry threshold on a family basis. We consider that largely the same approach would apply to a wealth tax except, in accordance with our recommendation to apply the threshold amount individually, the trust assets would be combined with individuals (and their minor children) and not with their partners.

19. As we recommended earlier, if it is determined that trust assets are subject to the tax, the trustee would comply with the tax, rather than the settlor or beneficiary including the trust assets in their individual tax filing. This is because the trustee would have the best knowledge of the trust assets and their value and will have the cashflow from those assets to pay the tax.

20. The following summarises how we propose to apply the wealth tax to different types of trusts (and their settlors and beneficiaries):

    20.1 **Discretionary trust with a living settlor**. The assets of the trust would be combined with the assets of the principal settlor (and relevant minor children and other trusts in scope) in determining if the total assets are large enough to bring the settlor and relevant trusts into the regime.

    20.2 **Discretionary trust with deceased settlor**. The assets of the trust would be combined with the assets of other discretionary trusts settled by the same person in determining if the regime applies to the trusts.

    20.3 **Fixed income interest trust**. If the trust provides for fixed income interest beneficiaries, the trust assets apportioned to those interests is combined with those beneficiaries' assets in determining if the trust and those beneficiaries are subject to the regime.

De minimis and exemption

21. Each trustee of a trust owning assets subject to the regime must comply with the wealth tax on behalf of the trust. In order to simplify compliance and prevent duplication of exemptions, we continue to propose that no individual *de minimis* apply to trusts. If you agree with our above recommendation to adopt the

[5] Advani, Hughson, and Tarrant. *Revenue and distributional modelling for a UK wealth tax*. Fiscal Studies, 2021.

exemption approach, we recommend that no part of the exemption be allowed for trusts (only individuals may claim the exemption as discussed in our earlier reports).

Valuation approach for unlisted businesses

22. In our 2 February report (IR2023/009, T2023/74 refers) we recommended an open market valuation approach for all assets including investments in unlisted businesses.

Norwegian approach

23. You have asked us to model the design of a wealth tax on the Norwegian wealth tax. Under that model Norway uses a more compliance-friendly approach to the valuation of unlisted businesses. They use the tax book values of the company for the prior tax year as the basis for the value of the entity at the wealth tax assessment date.

24. The reason for this choice of valuation method is that the market value of shares in unlisted companies often is not known, as opposed to shares in listed companies, and it would be difficult in practical terms if the wealth tax value of the unlisted shares was to be determined based on the shares' open market value.

25. However, this means that goodwill in an unlisted company is not included in the valuation of the shares. As a result, the most substantial source of value in some companies, for example an IT company, may not be reflected in the value of the shares when wealth tax is calculated.

26. This may undervalue some companies, which will reduce the revenue collected from the wealth tax and lead to some economically inefficient reallocation of investment towards unlisted businesses. This undervaluing of some businesses may also run counter to your distributional objectives, as it would reduce horizontal equity, as well as potentially reducing the tax paid under the wealth tax by those at the very top of the wealth distribution who hold a large share of business wealth.

27. The Norwegian valuation method is based on the tax values returned by the company in its tax return from the previous year. This results in the value of unlisted businesses effectively being a year in arrears compared to other assets, with the trade-off being a significant reduction in compliance costs as the value can be calculated reasonably simply and quickly.

28. Investments in unlisted offshore companies can be treated in the same way if the taxpayer has access to the tax filing information for the investment. Otherwise, an alternative method would have to be used.

Implications for timelines

29. Using the Norwegian approach to valuing non-listed shares will mean that revenue from the wealth tax can be recognised in the 2024–25 fiscal year. This would allow for the following implementation timeline (we explain the reasons for the particular dates given in the "Administrative implications" section below):

Timeline under Norwegian approach, with revenue recognised in 2024–25 fiscal year

- First assessment date on 31 March 2025.
- File return on 31 July 2025.
- Payments due over four months with first instalment due on 31 July 2025.

30. Using an open market value approach and the same initial assessment date would delay revenue recognition to the 2025–26 fiscal year. Revenue may still be recognised in the 2024–25 year if the initial assessment date were accelerated to 31 March 2024, but we do not recommend doing this. An initial assessment date of 31 March 2025 will give Inland Revenue sufficient time to design and implement the new tax in its systems and allow taxpayers enough time to understand and calculate the new tax. Accelerating the initial assessment date increases implementation risks.

Timeline under open market valuation approach, with revenue recognised in the 2025–26 year

- First assessment date on 31 March 2025.
- File return on 31 March 2026.
- Payments due over four months with the first instalment due on 31 March 2026.

Accelerated timeline under open market valuation approach, with revenue recognised in 2024–25 year (not recommended)

- First assessment date on 31 March 2024.
- File return on 31 March 2025.
- Payments due over four months with the first instalment due on 31 March 2025.

Recommendation

31. While the Norwegian valuation approach is simple and has compliance cost savings, it also comes with revenue, distributional and efficiency costs. For this reason, we continue to recommend using open market value as a starting principle for valuing assets and undertaking public consultation on possible methods for particular assets. We can then report back to you after the consultation on the most appropriate valuation method for unlisted businesses.

Administrative implications

32. The administrative aspects of the wealth tax flow directly from design choices, particularly around the complexity of valuing certain types of assets. As explained above, if assets can be valued using methods that are less complex, it will take less time to calculate the tax liability and complete and file the tax return.

33. The associated administration costs for the implementation of the wealth tax are still being worked through and we will report on those in a later report.

Assessment date

34. We recommend aligning the "assessment date" for the wealth tax with the end of the standard tax year (31 March). This is for several reasons but if you opted for the Norwegian model of valuing unlisted businesses, this would be the last date for filing the unlisted company's tax return for the prior year (no matter what the balance date of the company is). That prior year's tax return would contain the "tax values" to be included in the wealth tax calculation.

35. Even under an open market value approach we would still recommend a single wealth assessment date. Allowing different assessment dates for taxpayers who have non-standard balance dates could create variances purely due to timing. In addition, a taxpayer who has multiple investments in unlisted companies could have multiple different balance dates for different companies, so using 31 March as a

standard assessment date is likely to be just as suitable and simpler. In addition, most unlisted companies will have a standard 31 March balance date.

Filing returns

36. Under the Norwegian model, the fact that the wealth tax return for unlisted businesses is always a year in arrears means the taxpayer has all the information to complete their wealth tax return on 1 April. Taxpayers could file the wealth tax return reasonably soon after that date.

37. However, after working through the peak workflows for taxpayers and Inland Revenue we recommend that the wealth tax return be due on 31 July of the year of assessment (that is, for an assessment date of 31 March 2025, the return will be due on 31 July 2025). This would avoid peak workflows and give taxpayers sufficient time to calculate their tax liability. This date would be for all taxpayers, regardless of whether they have a tax agent.

38. Under an open market value model for unlisted businesses, the date for filing will need to be longer to allow valuations to be undertaken. Given this timeframe, we would recommend that returns due for 31 March 2025 be filed along with the person's income tax return on 31 March 2026. For taxpayers who do not have a tax agent this will be some time after the taxpayer's filing due date for income tax. However, it is likely that taxpayers subject to the wealth tax will have a tax agent and therefore an extension of time for income tax.

Tax payments

39. Due to the nature of a wealth tax and the complexities around provisional tax, we do not recommend making the wealth tax subject to provisional tax. Provisional tax is designed to bring those taxpayers who earn income that is not taxed at source in line with those taxpayers who have PAYE income and pay their tax throughout the year. In the case of the wealth tax, that comparison is not relevant. However, we do recommend making the tax payable in instalments which will have a similar cashflow effect as provisional tax.

40. We recommend that the tax be due and payable on the date that the person files their wealth tax return, but they be able to spread the payment of that amount over four months, beginning with the filing date.[6]

41. We recommend this treatment to give taxpayers time to fund payments of the tax which could be significant in some cases. This is particularly relevant for those taxpayers who have illiquid assets. Interest or penalties would only be charged on the payments if a taxpayer misses a payment.

42. Tax pooling would not be available to pay these instalments as the tax amounts are certain (unlike provisional tax). However, tax pooling could be used for reassessments.

Next steps

43. We recommend that you discuss these design decisions with us at the next Joint Ministers' meeting.

[6] For example, if a taxpayer files their wealth tax return on 31 July 2025, owing $80,000 in wealth tax, they would pay that amount over four instalments – the first instalment of $20,000 on 31 July 2025, and the following three $20,000 instalments on 31 August, 30 September and 31 October.

44. We will report to you again in mid-March on any final design decisions that will need to be made ahead of Budget 2023.

Recommended action

We recommend that you:

Switch versus exemption approach

a) **Agree** that when the entry threshold is met, the wealth tax should only apply to the wealth above the threshold (exemption approach, not switch).

Agreed/Not agreed Agreed/Not agreed

Individual versus family basis

b) **Agree** that the wealth tax and entry threshold be applied on an individual basis (subject to recommendations (c) to (e) below).

Agreed/Not agreed Agreed/Not agreed

c) **Agree** that a parent or guardian should be treated as holding the wealth held by a minor for whom they are responsible.

Agreed/Not agreed Agreed/Not agreed

d) **Agree** that where more than one parent or guardian is responsible for a minor, the minor's wealth would be treated as being held by the parent or guardian with greater wealth.

Agreed/Not agreed Agreed/Not agreed

e) **Agree** that recommendations (c) and (d) would not apply where the minor's wealth is below a $100,000 *de minimis*.

Agreed/Not agreed Agreed/Not agreed

Trusts

f) **Agree** that the wealth tax should apply to trusts in the manner as previously agreed for the design of the minimum tax.

Agreed/Not agreed Agreed/Not agreed

Valuation method

g) **Agree** that all assets will be taxed on their open market value and that officials will consult on the valuation methodology for different assets, including for unlisted businesses (the approach agreed to in the 2 February report) (**recommended**).

Agreed/Not agreed Agreed/Not agreed

OR

h) **Agree** that the valuation method for unlisted businesses be based on the tax values of the investment for the prior income year (the Norwegian approach) (**not recommended**).

Agreed/Not agreed Agreed/Not agreed

i) **Note** that after the consultation referred in recommendation (g), officials will report back on whether open market value is an appropriate valuation approach for unlisted businesses, or whether a simpler rule (such as the Norwegian approach) is more appropriate.

Noted Noted

j) **Note** that agreeing to recommendation (g) (officials' recommended approach) would likely result in revenue first being recognised in the 2025–26 fiscal year, although revenue could be recognised in the 2024–25 fiscal year if an accelerated timeline is adopted.

Noted Noted

k) **Note** that agreeing to recommendation (h) (the Norwegian valuation approach) would make it more likely that revenue would be recognised in the 2024–25 fiscal year.

Noted Noted

Administrative implications

l) **Agree** that the date of assessment be 31 March each year.

Agreed/Not agreed Agreed/Not agreed

m) **Agree** that the wealth tax will not be subject to provisional tax.

Agreed/Not agreed | Agreed/Not agreed

n) **Agree** that payments for the wealth tax can be spread out over four instalments, payable monthly starting from the date the wealth tax return is filed.

Agreed/Not agreed | Agreed/Not agreed

o) **Discuss** this report with officials.

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