The Treasury

Budget 2023 Tax Initiatives Information Release

July 2023

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[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

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Inland Revenue
Te Tari Taake

Policy and Regulatory Stewardship
Kaupapa me te Tiaki i ngā Ture
55 Featherston Street
PO Box 2198
Wellington 6140
New Zealand

T. 04 890 1500

Briefing note

Reference:	BN2023/159
Date:	16 May 2023
To:	Revenue Advisor, Minister of Finance – Claire McLellan Revenue Advisor, Minister of Revenue – Jason Batchelor Private Secretary, Minister of Revenue – Helen Kuy Revenue Advisor, Associate Minister of Revenue – Harper Burtenshaw
From:	Carl Harris, Senior Policy Advisor
Subject:	**Behavioural response to the 39% personal tax rate, and insights from HWI project**

Background

1. In December 2020, the Government decided to introduce a new top personal tax rate of 39% for the 2021–22 and later income years.

2. Inland Revenue and the Treasury recommended also increasing the trustee tax rate to 39%. Cabinet decided to defer making a decision on whether to increase the trustee tax rate, pending whether there was a behavioural response of trusts being used to circumvent the new personal tax rate.

3. Before the introduction of the 39% top personal rate, both the trustee and top personal rates were aligned at 33%; there was no tax advantage to earning income through a trust as trustee income. After the introduction of the 39% personal rate, taxpayers could obtain a tax advantage by earning income through a trust due to the 33% trustee rate being a final tax. Income treated as trustee income could be later distributed to beneficiaries tax-free.

4. The introduction of the 39% top personal tax rate had two potential consequences:
   - Companies paying out dividends to trusts and individual shareholders before the 39% personal rate came into effect so that income could be taxed at the 33% trustee or personal tax rates.
   - Trustees treating more income as trustee income so it could be taxed at 33%.

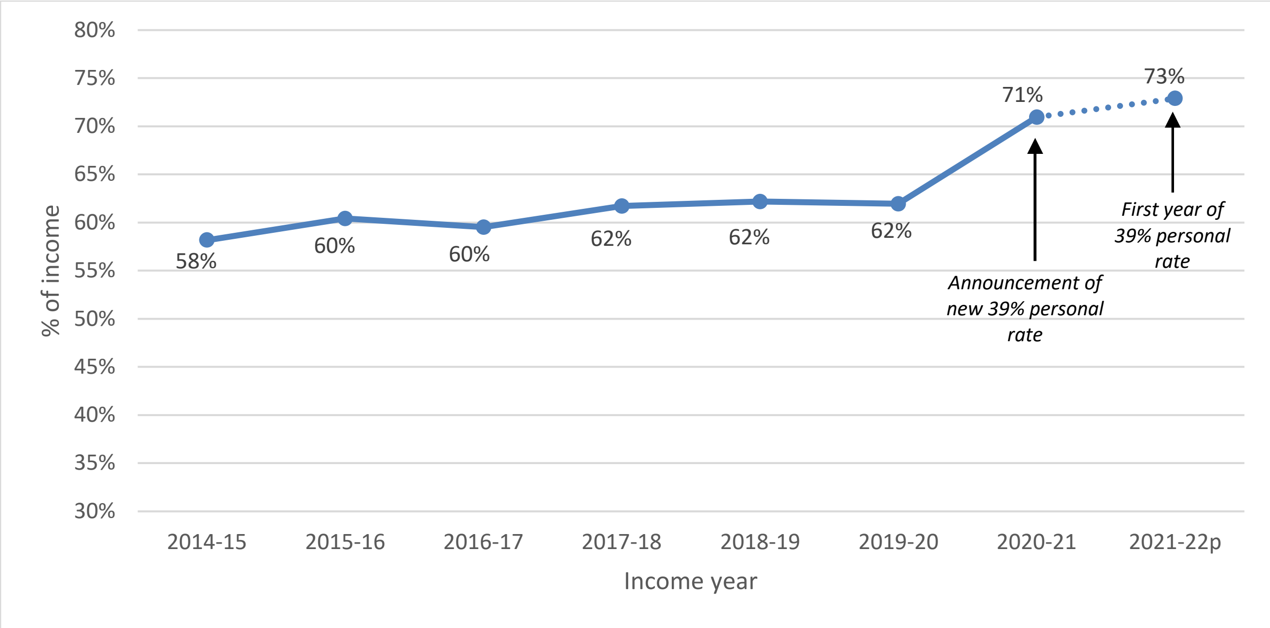
Ratio of trustee to beneficiary income

5. Figure 1 shows that prior to the announcement of the 39% personal tax rate, trustees of trusts and estates were treating 58% to 62% of their total taxable net income as trustee income (after expenses and losses).

6. Figure 1 also shows that during the income year in which the 39% personal rate was campaigned on by Labour and enacted in December 2020, and the first income year that the 39% rate applied, trustees have treated a higher percentage of total taxable income as trustee income: from 58–62% to 71–73%.

Figure 1: Income allocations by trusts and estates

Percentage of income treated as trustee income (after expenses and losses). Data extracted on 15 May 2023; filing for 2021-22 is still incomplete.



Trustee income derived by trusts

7. In advance of the 39% top personal rate taking effect, companies paid out higher than usual dividends in the 2020–21 income year so that income could be taxed at the 33% personal or trustee rate. This resulted in a spike in dividend and trustee income.

8. Filing for the 2021–22 income year is still incomplete (partially due to late tax return policing being turned off in response to the North Island flooding events). Despite this, Figure 2 shows that the amount of trustee income is significantly higher in the 2021–22 income year ($13 billion) than the 2019–20 income year ($10 billion). 2021-22 was the first year the 39% personal rate applied and 2019–20 was the year before the announcement of the 39% personal rate.

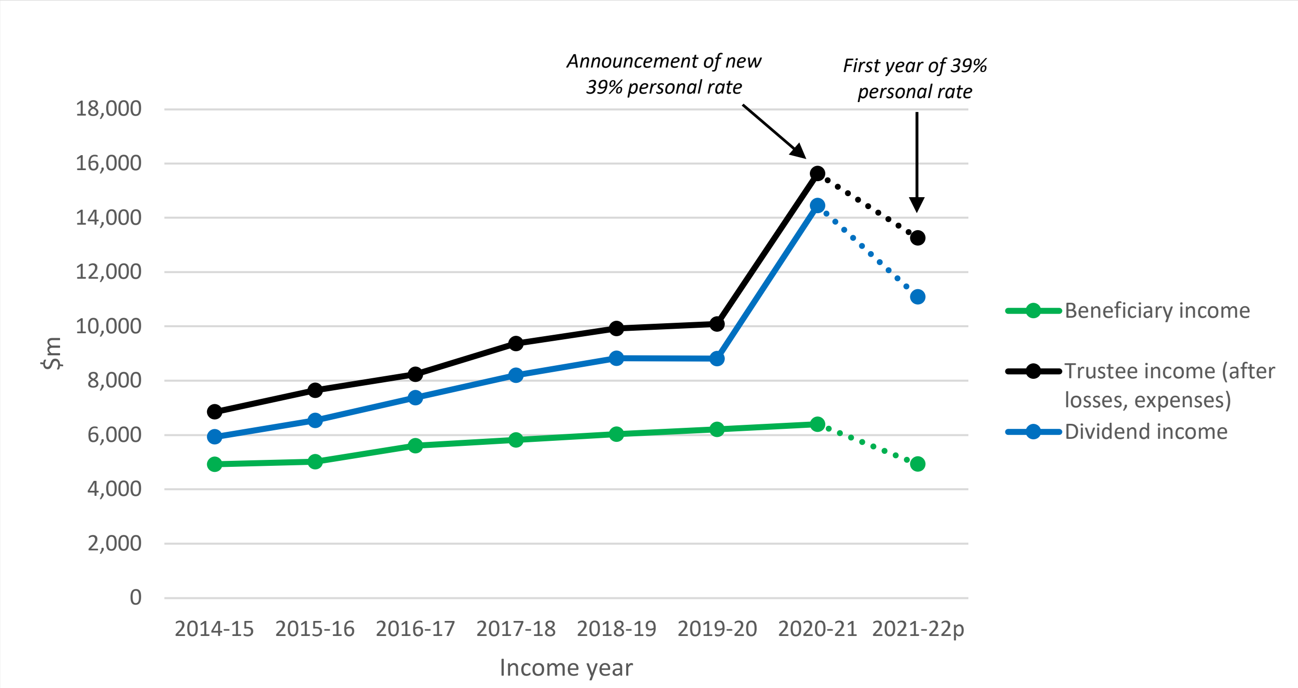
9. The decrease in dividend and trustee income from the 2020–21 to 2021–22 income years may reflect that companies have paid out their retained earnings before the 39% personal rate applied. The 2021–22 income year may be a "new normal" in terms of the amount of income.

10. Considering the two graphs together, Figure 1 shows that trustees have made income allocation decisions in response to the 39% personal rate to treat a greater proportion of taxable income as trustee income. Despite the change in amount of income derived by trustees in the 2020–21 to 2021–22 income years in Figure 2, trustees have maintained this allocation ratio.

11. The increased amount of trustee income derived by trustees in the 2020–21 and 2021–22 income years supports the policy proposal to increase the trustee tax rate to 39%. The increased personal rate has likely resulted in more taxable income derived by trustees being treated as trustee income (in terms of both the total amount and as a percentage of income). A significant portion of that trustee income is likely to be income that would be distributed to taxpayers on the 39% personal rate (or would be if they received that income as beneficiary income).

Figure 2: Income derived by trusts and estates

Extracted 15 May 2023; filing for 2021–22 is still incomplete.



Insights from HWI work

12. Over the project period of the HWI study, 45% of the tax paid on income was trustee tax (43% of total tax when including GST), suggesting that getting the trustee tax rate right is important.

13. The following table sets out the amount of personal and trustee tax paid by the HWI population over the project period, and how much tax would have been paid if the same amount of taxable income had been returned but the top personal and trustee rates had been 39% over the period.

Current state	Average rate	Value of tax
Personal	31.8%	$ 706m
Trustee	33.0%	$ 1,005m
Personal + Trustee	32.5%	$ 1,711m
Revised tax		
Personal	36.8%	$ 817m
Trustee	39.0%	$ 1,187m
Personal + Trustee	38.1%	$ 2,005m
Difference		
Personal	5.0 ppts	$ 111m
Trustee	6.0 ppts	$ 183m
Personal + Trustee	5.6 ppts	$ 293m

Please note that the above table excludes trading trusts. This was amended in a later briefing note.

Consultation with the Treasury

14. The Treasury was informed about this briefing note.

Carl Harris
Senior Policy Advisor
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