The Treasury

Budget 2024 Information Release

September 2024

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Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

TE TAI ŌHANGA
THE TREASURY

Tax Policy Report: Options for delivering personal income tax relief

Date:	15 December 2023	**Report No:**	T2023/2125 IR2023/294
		File Number:	MS-9-1

Action Sought

	Action Sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Note** the contents of this report.	None
Hon David Seymour **Associate Minister of Finance**	**Note** the contents of this report.	None
Hon Simon Watts **Minister of Revenue**	**Note** the contents of this report.	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Robert O'Hara	Analyst, Tax Strategy, The Treasury	[39]	[35]	✓
Jean Le Roux	Manager, Tax Strategy, The Treasury			
Maraina Hak	Policy Lead, Inland Revenue			
Paul Young	Principal Policy Advisor, Inland Revenue			

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Tax Policy Report: Options for delivering personal income tax relief

Executive Summary

1. This report responds to the Minister of Finance's request for high-level approaches and considerations for delivering personal income tax relief, in line with the commitment made in the National-ACT coalition agreement to:

   "Ensure the concepts of ACT's income tax policy are considered as a pathway to delivering National's promised tax relief, subject to no earner being worse off than they would be under National's plan."

2. This is initial advice. Officials will provide more fulsome policy advice when seeking final decisions on the changes to personal income tax rates and thresholds.

3. We understand that any alternative to National's tax plan should be implementable in the same timeframes and for a similar fiscal cost.

4. This report includes an indicative costing of ACT's income tax policy, as well as an illustrative alternative to ACT's tax plan that can be achieved at a lower fiscal cost while achieving ACT's objective of simplifying the personal income tax system by reducing the number of tax rates and thresholds.

5. Both the ACT and alternative plans can be delivered in combination with a Low- and Middle-Income Tax Credit (the tax offset) to ensure no earner is made worse off by the changes to tax thresholds and rates.

6. However, this approach would be significantly more costly than the National plan, would be unlikely to meet your desired implementation timeframes, and would come with significant downsides including:

   a. The change would be difficult to communicate to individual taxpayers and the tax offset could have unintended consequences such as leading to more end-of-year tax bills. This would also place additional burden on some taxpayers who would have to apply for tailored tax codes.

   b. Introducing the tax offset would add complexity to private and public sector payroll systems and Inland Revenue's system and these changes would be unlikely to be implementable by 1 July 2024.

7. It would be possible to exactly replicate the National plan through a combination of the tax offset and changes to thresholds and rates, for approximately the same fiscal cost. Given that this would increase the complexity of the personal income tax system without providing any additional benefit, we do not recommend using a tax offset to deliver the same effective tax relief as under the National plan.

8. The National tax plan can also be phased or scaled to reduce the overall fiscal cost while still delivering approximately the same level of tax relief over the longer term (see Appendix 3). Officials can provide further advice on this if and when directed to.

Next steps

9. Officials are available to meet with you to discuss the different approaches to personal income tax rate and threshold changes that could be progressed for Budget 2024. Once we have feedback on options you would like further advice on, we will prepare more fulsome policy advice to support final decision making in early 2024.

Recommended action

We recommend that you:

a **note** the contents of this report.

Jean Le Roux
Manager, Tax Strategy
The Treasury

Maraina Hak
Policy Lead
Inland Revenue

Hon Nicola Willis
Minister of Finance

/ /2023

Hon David Seymour
Associate Minister of Finance

/ /2023

Hon Simon Watts
Minister of Revenue

/ /2023

Tax Policy Report: Options for delivering personal income tax relief

Purpose

1. This report responds to the Minister of Finance’s request for high-level approaches and considerations for delivering personal income tax relief, in line with the commitment made in the National-ACT coalition agreement to:

   “Ensure the concepts of ACT’s income tax policy are considered as a pathway to delivering National’s promised tax relief, subject to no earner being worse off than they would be under National’s plan.”

2. This is initial advice. Officials will provide more fulsome policy advice when seeking final decisions on the changes to personal income tax rates and thresholds.

Comparing the National and ACT income tax policies

3. The income tax changes proposed by National and ACT are set out in Table 1 below.

   a. The ACT policy is phased in over several years, with the final policy in Table 1 being implemented from 1 April 2026. The changes are combined with a Carbon Tax Refund to return ETS revenues to taxpayers and a Low- and Middle-Income Tax Credit (the tax offset) to compensate for a higher bottom tax rate.

   b. The National policy would be effective from 1 July 2024 and also includes an expansion to the Independent Earner Tax Credit (IETC).

Table 1: National and ACT income tax policies

Marginal rate	Current thresholds	National policy	ACT policy (final)
10.5%	$0-14,000	$0-$15,600	n/a
17.5%	$14,001 - $48,000	$15,601 - $53,500	$0 - $60,000
30%	$48,001 - $70,000	$53,501 - $78,100	$60,001 - $180,000
33%	$70,001 - $180,000	$78,101 - $180,000	$180,001 +
39%	$180,001 +	$180,001 +	n/a

4. We understand that key objectives for the ACT policy include:

   a. encourage work, saving and investment (including by reducing the top tax rate)

   b. flatten and simplify the personal income tax system by reducing the number of tax rates and thresholds.

5. We understand that key objectives for the National policy include:

   a. compensate for the impact of inflation on average tax rates

   b. increase after-tax incomes for New Zealanders, particularly for those with moderate or middle incomes, and

   c. ensure there is a greater financial return from work.

6. The Treasury has prepared an indicative costing of the phased threshold adjustments in the ACT policy. The cost totals $15.11 billion over the forecast period, significantly larger than the $10.15 billion total cost of the National policy (including the $0.74 billion cost of the IETC expansion). Table 2 shows the phasing and annual costs of the ACT plan relative to the status quo.

Table 2: ACT Party tax policy

<table>
<tr><th>Up to</th><th>Status quo</th><th>2024/25</th><th>2025/26</th><th>2026/27</th><th>2027/28</th></tr>
<tr><td>$14,000</td><td>10.5%</td><td colspan="4" rowspan="3">17.5%</td></tr>
<tr><td>$48,000</td><td>17.5%</td></tr>
<tr><td>$60,000</td><td rowspan="2">30%</td></tr>
<tr><td>$70,000</td><td>30%</td><td colspan="3" rowspan="2">30%</td></tr>
<tr><td>$180,000</td><td>33%</td><td>33%</td></tr>
<tr><td>+</td><td>39%</td><td colspan="2">39%</td><td colspan="2">33%</td></tr>
<tr><td>Fiscal cost</td><td>-</td><td>$0.5 billion</td><td>$3.0 billion</td><td>$5.5 billion</td><td>$6.1 billion</td></tr>
</table>

7. This cost difference is largely owing to the removal of the 39% tax rate in the ACT plan, which increases the cost by approximately $2 billion per year in 2026/27 and 2027/28. This does not include the cost of reducing the trustee tax rate to 33%, which would likely be progressed in conjunction with reducing the top personal income tax rate and would be expected to cost around $350 million per year.

8. The above costing of the ACT policy is indicative only and does not include the cost of the tax offset for low- and middle-income earners. The tax offset is explored on page 6, including a preliminary estimated cost of around $600 to $800 million per year.

Using the concepts of ACT's policy to deliver tax relief

9. We have developed an illustrative alternative option that can be achieved at a lower fiscal cost while achieving ACT's objective of simplifying the personal income tax system by reducing the number of tax rates and thresholds.

10. The indicative fiscal cost for this alternative plan is $10.62 billion over the forecast period, which is closer to the National tax plan cost of $10.15 billion. However, further work would be needed to produce a final costing of the alternative plan, and this could differ. The cost for the alternative plan does not include the extension to the IETC.

Table 3: Alternative plan

Marginal rate	Thresholds
14.5%	$0 - $53,500
32.5%	$53,501 - $180,000
39%	$180,001 +

11. The alternative plan combines the first two thresholds under a 14.5% rate and the next two thresholds under a 32.5% rate, leaving three tax thresholds overall. This option retains the 39% top tax rate.

12. This option would satisfy the following objectives of both National and ACT's plans:

    a. reduce the number of tax rates and thresholds

    b. increase after-tax incomes for middle-income earners, and

    c. ensure there is a greater financial return from full-time work.

13. Under the ACT and alternative plans, net rates of superannuation would reduce on 1 July 2024 for the remainder of the tax year, given the higher first marginal rate. Over time, superannuitants would be expected to gain from the tax changes via the link to the net average wage. To compensate for the initial impact in 2024/25, we have incorporated a compensating increase to ensure net rates do not reduce as a result of the tax change, with a fiscal cost of around $200 million. This compensating increase has not been included in the cost of the ACT plan, and would increase the cost in 2024/25 by around $600 million. Main benefit rates would not be impacted by the tax changes as they are set net in legislation and will now be indexed to CPI.

Using a tax offset to ensure no earner is worse off

14. The ACT and alternative plans increase the legislated marginal tax rates for lower-income earners. Without a tax offset, this would result in some individuals and households having reduced disposable income compared to the status quo (Table 4). Some of these individuals are likely to be students or secondary earners.

Table 4: Individual and household impacts of ACT and alternative threshold changes

Year ending 31 March 2027	**ACT plan (thresholds only)**	**Alt plan (thresholds only)**
Income level where individuals pay more tax compared with the status quo	Under $55,840 (Equivalent to around 47 hours on minimum wage)	Under $32,667 (Equivalent to around 28 hours on minimum wage)
Number of individuals aged 15+ with reduced disposable income compared to the status quo	1.111 million	0.656 million
Proportion of losing individuals that lose by more than $10 per fortnight	~75% of losing individuals	~40% of losing individuals
Average reduction in individual disposable income per fortnight	~$24 per fortnight	~$8 per fortnight
Share of all households that lose by more than $10 per fortnight	13.2% of households	2.8% of households

15. We have not yet formally costed the tax offset for the ACT and alternative plans. However, understanding the extent of losses caused by the threshold changes can help to quantify the tax offset required to fully compensate those losses and ensure no individuals are worse off compared to the status quo. Larger offsets would be needed to ensure no one was worse off compared with the National plan.

16. Multiplying the number of individuals losing by the average loss can provide a preliminary estimate of the total cost of compensating these individuals. This can serve as an approximation of the cost of a tax offset that would ensure no individual is worse off, as shown in Table 5. These figures are useful to provide a ballpark indication only. The specific design parameters will influence the cost. Officials can formally model the fiscal and distributional impacts of specific options for tax offsets if and when directed to.

Table 5: Summary of fiscal impacts of ACT and alternative plans

	ACT plan	**Alternative plan**
Preliminary estimate of annual cost of ensuring no earner is worse off	$0.6 - $0.8 billion p.a.	$0.1 - $0.2 billion p.a.
Indicative cost of threshold changes over forecast period (2024/25 to 2027/28)	$15.1 billion	$10.6 billion
Preliminary estimate of the combined cost over forecast period (2024/25 to 2027/28)	$17.5 - $18.3 billion	$11.0 - $11.4 billion

Challenges with introducing a tax offset

17. Although a tax offset could be used to ensure no earner is made worse off by the threshold adjustments in the ACT and alternative plans, there are likely to be issues with introducing a tax offset that need to be considered:

    a. It is unlikely that all third parties would be able to update their payroll software to incorporate a new tax offset in time to allow successful implementation by 1 July 2024 (officials are currently testing this with payroll software providers).

    b. Taxpayers at the lower end of the income scale may believe they had suffered a tax increase with the removal of the 10.5% rate, even if the tax offset fully compensated. This may require a comprehensive communication campaign.

    c. Using an offset would increase the likelihood that people with more than one source of earnings would need to use a tailored tax code. If they were unaware of this, they could receive significant tax bills or refunds. This would involve repeated effort for individual taxpayers as tailored tax codes need to be applied for on an annual basis.

    d. Consequential changes would be needed for other products which reflect personal income tax thresholds and rates including Employer Superannuation Contribution Tax (ESCT), Fringe Benefit Tax (FBT), and Portfolio Investment Entity (PIE) income tax. Assuming the first marginal rate is also removed for these tax types, a significant number of customers would have more ESCT deducted and pay a higher rate of tax on PIE income.

18. For the same fiscal cost as the National plan, it would not be possible to deliver greater tax relief at some parts of the income spectrum while also using a tax offset to ensure no earner is worse off. The only way to deliver a package that includes a tax offset at the same fiscal cost would be to effectively replicate the National plan through a combination of the tax offset and changes to thresholds and rates.

19. Given that this would increase the complexity of the personal income tax system without providing any additional benefit, we do not recommend using a tax offset to deliver the same effective tax relief as under the National plan.

Summary of options

20. Table 5 assesses the options explored in this report against some illustrative criteria. Considering the National plan against the ACT plan and the alternative plan, there are trade-offs to be made between the different criteria. These trade-offs will need to be considered when deciding which approach to take.

Table 5: Summary of options against illustrative criteria

	Fiscal cost similar to National plan	No losers relative to status quo[1]	Deliverable by 1 July	Simpler income tax system	Reduce top tax rate
National plan	✓	✓	✓	—	✗
ACT plan - thresholds only	✗	✗	✓	✓	✓
- include offset	✗	✓	✗	✗	✓
Alternative plan - thresholds only	✓	✗	✓	✓	✗
- include offset	✗	✓	✗	✗	✗

[1] Some earners may be slightly worse off even with an offset owing to impacts on consequential tax types.

Economic impacts

21. Reducing rates of personal income tax by increasing thresholds has economic benefits through decreasing distortions to labour supply, investment and savings decisions.

22. The increases to personal income tax thresholds in the National plan would be expected to have a small but positive impact on work incentives, which would support overall labour supply and the productive capacity of the New Zealand economy.

23. The largest effects on labour supply come from increasing the incentive to enter the labour force. The most relevant factor is therefore the income gained by transitioning into work. Tax changes that significantly reduce the tax paid at income levels consistent with active employment would therefore be expected to have the largest positive impact on work incentives.

24. Under the ACT plan, tax would be significantly reduced for earners on higher incomes, which would be expected to have positive work incentives for higher-skilled jobs. The removal of the 39% rate would have a relatively larger impact per dollar of fiscal cost, but the limited population affected would mitigate the benefits.

25. If not combined with a tax offset, the alternative plan may have some negative impacts for entering part-time work as it would increase tax for earners below $32,667 per annum. However, similar to the ACT plan, reduced tax for higher incomes would increase incentives to enter full-time work and for higher-skilled jobs.

26. Increases to ESCT and PIE tax resulting from higher marginal tax rates under the ACT and alternative plans could have some negative impact on saving and investment.

27. Considered in isolation, tax relief would be expected to put upward pressure on inflation. However, the impact should be considered in the context of the overall Budget 2024 package. You will receive further advice on the economic impacts of the overall Budget 2024 package in due course.

Next steps

28. Officials are available to meet with you to discuss the different approaches to personal income tax rate and threshold changes that could be progressed for Budget 2024. Once we have feedback on options you would like further advice on, we will prepare more fulsome policy advice to support final decision making in early 2024.

Appendix 1: Fortnightly income change relative to status quo for individuals under National plan and ACT/alternative plans without the use of a tax offset

The following table sets out the gains/losses at different income levels relative to the status quo under the three tax plans without using a tax offset. Shading indicates where gains under the ACT and alternative plan are less or greater than the National plan (including the IETC extension) for each income level.

* *Indicates where the tax offset would be available (i.e., individuals would be no better or worse off)*

^ *Indicates where individuals would be better off if they were not eligible for the IETC*

	Annual income	National + IETC ext.	ACT – no offset	Alt. – no offset
	$10,000	$0	**-$27***	**-$15***
	$15,000	$3	**-$38***	**-$20***
	$20,000	$4	**-$38***	**-$15***
Current IETC	$25,000	$4	**-$38***	**-$9***
	$30,000	$4	**-$38***	**-$3***
	$35,000	$4	**-$38***	$3
	$40,000	$4	**-$38***	$8
IETC Extension	$45,000	$9	**-$38***	$14
	$50,000	$34	**-$28***	**$30^**
	$55,000	$51	**-$4***	**$49^**
	$60,000	$51	$20	**$44^**
	$65,000	$51	$20	**$39^**
	$70,000	$31	$20	$35
	$75,000	$37	$26	$36
	$80,000	$40	$32	$37
	$85,000	$40	$37	$37
	$90,000	$40	$43	$38
	$95,000	$40	$49	$39
	$100,000	$40	$55	$40
	$105,000	$40	$60	$41
	$110,000	$40	$66	$42
	$115,000	$40	$72	$43
	$120,000	$40	$78	$44
	$125,000	$40	$83	$45
	$130,000	$40	$89	$46
	$135,000	$40	$95	$47
	$140,000	$40	$101	$48
	$145,000	$40	$107	$49
	$150,000	$40	$112	$50
	$155,000	$40	$118	$51
	$160,000	$40	$124	$52
	$165,000	$40	$130	$53
	$170,000	$40	$135	$54
	$175,000	$40	$141	$55
	$180,000	$40	$147	$56
	$185,000	$40	$158	$56
	$190,000	$40	$170	$56
	$195,000	$40	$182	$56
	$200,000	$40	$193	$56

Appendix 2: Fortnightly impacts relative to status quo on dual-earner households with different income splits without the use of a tax offset

The gain for households will vary based on family type and composition of earners. The material in National's 'back pocket boost' assumed that a dual earner family would have a 50%/50% income split. The income split has a material impact on the gains, and therefore we have also presented the gains for families with an income split of 67%/33% (e.g., one full time and one part time earner).

The scenarios for children all assume the $25 per week increase to the In-Work Tax Credit (IWTC) progresses. Shading indicates where gains under the alternative options are less or greater than the National plan for each income level.

The scenarios do not include a tax offset. Including an offset would mean no households would be worse off than the status quo, and would also change the overall gains for some families.

Income split: 50%/50%

	No children			2 children (incl. increase to IWTC)		
Family income	National + IETC ext.	ACT – no offset	Alt. – no offset	National + IETC ext.	ACT – no offset	Alt. – no offset
$40,000	$9	-$75	-$29	$59	-$25	$21
$60,000	$9	-$75	-$6	$59	-$25	$44
$80,000	$9	-$75	$17	$59	-$25	$67
$100,000	$68	-$56	$59	$78	-$6	$109
$120,000	$102	$40	$88	$102	$40	$88
$140,000	$61	$40	$69	$61	$40	$69
$160,000	$80	$63	$73	$80	$63	$73
$180,000	$80	$86	$77	$80	$86	$77
$200,000	$80	$109	$81	$80	$109	$81
$220,000	$80	$132	$85	$80	$132	$85

Income split: 67%/33%

	No children			2 children (incl. increase to IWTC)		
Family income	National + IETC ext.	ACT – no offset	Alt. – no offset	National + IETC ext.	ACT – no offset	Alt. – no offset
$40,000	$4	-$74	-$27	$54	-$24	$23
$60,000	$9	-$75	-$6	$59	-$25	$44
$80,000	$54	-$50	$43	$84	$0	$93
$100,000	$52	-$18	$39	$85	$32	$89
$120,000	$44	-$6	$45	$44	-$6	$45
$140,000	$58	$9	$55	$58	$9	$55
$160,000	$90	$50	$91	$90	$50	$91
$180,000	$91	$98	$88	$91	$98	$88
$200,000	$88	$113	$85	$88	$113	$85
$220,000	$75	$132	$85	$75	$132	$85

Appendix 3: Options to reduce the cost of the National income tax policy

Phasing, scaling or deferring the implementation of the National plan could help to reduce the short-term fiscal cost without constituting fundamental changes to the manifesto threshold amounts. For example:

- Increasing the 17.5% threshold in 2024, the 30% threshold in 2025, and the 33% threshold in 2026 would reduce the cost by approximately **$1.7 billion** over forecast.
- Increasing all thresholds by 50% of the manifesto amount in 2024, to 75% in 2025, and 100% in 2026 would reduce the cost by approximately **$1.3 billion** over forecast.
- A small delay to 1 September 2024 (two months) or 1 October 2024 (three months) would reduce the cost by approximately **$0.4 billion** or **$0.6 billion**. This would also allow for a Budget Day announcement while still likely giving employers sufficient time to update their payroll systems.

These options would reduce the cost of personal tax changes over the forecast period but would have no impact on the long-term fiscal cost. Officials can provide further advice on cost-saving options, including options to reduce the long-term cost, if and when directed to.

Small reductions to the threshold increases in the National plan could result in relatively large cost savings in the long term while still delivering comparable tax relief to individuals.

Not proceeding with the expansion of the IETC would reduce the cost by approximately **$0.7 billion** over the forecast period. This would be a more permanent cost saving, though the saving would reduce over time as incomes grow beyond the eligibility range.

Disclaimer for distributional outputs from the Treasury's TAWA model

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