The Treasury

Budget 2024 Information Release

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Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

TE TAI ŌHANGA
THE TREASURY

Tax Policy Report: Personal Income Tax – results of modelling request

Date:	25 January 2024	**Report No:**	T2024/130 IR2024/021
		File Number:	SH-13-5-2-5-1

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**
Laura Browne	Senior Analyst, The Treasury	[39]	[35]	✓
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Maraina Hak	Policy Lead, Inland Revenue			

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

Return the signed report to Treasury and Inland Revenue.

Note any feedback on the quality of the report	

Enclosure: No

Tax Policy Report: Personal Income Tax – results of modelling request

Purpose of Report

1. This report responds to a request from Minister Seymour for modelling of two Personal Income Tax scenarios based on ACT principles. This request was provided by Minister Seymour to officials during a meeting held on 20 December 2023.

2. The Minister of Finance has asked officials to develop a Personal Income Tax package for Budget 2024. This advice supports a wider request from the Minister of Finance to officials 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" as per the National and ACT Party Coalition Agreement.

The scenarios

3. Two scenarios are presented in this report, based on the commissioning. These scenarios are based on ACT election policy.

    a **Scenario 1** increases the current 10.5% rate to 17.5% and lifts the threshold for the current 30% rate from $48,000 to $60,000 from 1 July 2024. It also includes the introduction of an offset to provide compensation to taxpayers who might be worse off as a result of the introduction of the changes of rates and thresholds.

    b **Scenario 2** builds on scenario 1, however also reduces the 33% rate to 30% from 1 April 2026.

4. We have also included modelling results for a variation of scenario 1 which excludes the introduction of the offset (**Scenario 0**). This is useful when comparing the distributional impacts.

5. The parameters for rates and thresholds for these scenarios are summarised in the table below:

Table 1 – Rates and thresholds for the two scenarios

	Rates		
Thresholds	**Status Quo**	**Scenarios 0 and 1** (from 1 July 2024) **Scenario 2** (between 1 July 2024 – 31 March 2026)	**Scenario 2** (from 1 April 2026)
$0 - $14,000	10.5%	17.5%	17.5%
$14,001 - $48,000	17.5%		
$48,000 - $60,000	30%		
$60,001 - $70,000	30%	30%	30%
$70,001 - $180,000	33%	33%	
$180,001 +	39%	39%	39%

6. The design parameters of the offset for scenarios 1 and 2 are as follows:

   a phases in at 10 cents for every dollar earned between $1,000 and $11,000, up to a maximum offset of $1,000,

   b remains at $1,000 between $11,000 and $48,000, and

   c abates at 10 cents for every dollar earned between $48,000 and $58,000.

Fiscal cost

7. Table 2 presents the cost of scenarios 0, 1 and 2, while table 3 provides notes on the modelling approach and key assumptions for each component. The modelling assumes there are no changes to the Independent Earner Tax Credit or the In Work Tax Credit.

8. These costings should be read in conjunction with recent advice [T2023/2125 and IR2023/294 refers] which summarises the fiscal costs of the Minister of Finance's current option based on the National manifesto commitment. Appendix One provides a summary of these costs.

Table 2 – Summary of costs for the scenarios

Component	**Scenario 0**	**Scenario 1**	**Scenario 2**
A. Increasing the 10.5% rate to 17.5% and lifting the 30% threshold to $60,000	+	+	+
B. Introducing an offset	-	+	+
C. Reducing the 33% rate to 30% from 1 April 2026	-	-	+
Fiscal cost over the forecast period	**$2.28 billion**	**$6.07 billion**	**$12.15 billion**
Fiscal cost in 2027/28	*$0.84 billion*	*$1.75 billion*	*$4.97 billion*

9. Scenario 1 costs $6.07 billion over the forecast period, which is less than the $10.15 billion cost of the National plan ($9.41 billion excluding the IETC expansion). The cost of scenario 1 is also lower in 2027/28 ($1.75 billion vs $2.69 billion). This is largely because the maximum gains are lower under scenario 1:

   a The maximum gains under scenario 1 are $10 per week for people earning above $60,000.

   b The maximum gains under the National plan are $20 per week for people earning above $78,100. People earning between $53,500 and $70,000 will gain by around $15 per week.

10. Scenario 2 costs $12.15 billion over the forecast period, which is a higher fiscal cost than the National plan. There is a more significant difference in costs when looking at 2027/28 due to the reduction in the 33% rate ($4.97 billion vs $2.69 billion). The maximum gains under scenario 2 (from 1 April 2026) are around $73 per week for people earning above $180,000.

Table 3 – Notes on the modelling approach

Component	Notes on the modelling approach
A. Increasing the 10.5% rate to 17.5% and lifting the 30% threshold to $60,000	A mid-year implementation date means that net rates of New Zealand Super (NZS) will reduce between 1 July 2024 and 1 April 2025. Providing a discretionary increase to ensure that NZS recipients do not see a reduction in their net incomes would increase the overall cost by an estimated $600 million (not currently included). This cost includes the flow-on impacts to Employer Superannuation Contribution Tax (ESCT) and Portfolio Investment Entity tax (PIE Tax).
B. Introducing an offset	Introducing the offset adds $3.79 billion across the forecast period. The cost of the offset is highly dependent on the design parameters. For the purposes of modelling, eligibility for the offset was based on total taxable income. We have assumed that the offset is not included when working out the rates of transfers inclusive of tax. We have assumed that individuals with only transfer income (e.g., NZS or main benefits) are ineligible. Including this cohort could increase the cost of the offset by up to $3 billion over the forecast period. However, we have assumed that individuals with a combination of wage and transfer income would remain eligible for the offset.[1] We expect that the parameters for the offset would need to be further refined to avoid unintended consequences.
C. Reducing the 33% rate to 30% from 1 April 2026	Reducing the 33% rate to 30% increases the cost by $6.08 billion over the forecast period. Due to implementation timing, only three months of the policy change is accounted for in the 2025/26 financial year. Therefore, $5.54 billion of the marginal cost falls in the 2026/27 and 2027/28 financial years.

Distributional impact – individuals

11. The following section provides analysis of the distributional impact of the different scenarios for individuals. The analysis focuses on tax year 2027 for two reasons:

    a Tax year 2027 is when the 33% rate reduction is in place for comparison purposes between scenarios 1 and 2.

    b The tax changes will have flow-on implications for the indexation of NZS. These changes result in the net rate of NZS being approximately $0.23 per week lower than under the status quo in tax year 2026. Focusing on tax year 2026 masks some of the broader effects of the changes.

[1] As noted, the current modelling approach calculates entitlement for the offset based on total taxable income (i.e., wage and transfers combined). This means that:
- Main beneficiaries with more than $11,000 in total income, but less than $11,000 in wage income may receive the full offset,
- New Zealand Superannuitants with wage income below $58,000, but total income above $58,000 may not be entitled to the offset.

12. Table 4 shows the impacts of these policy changes for individuals. This does not capture the impact of consequential tax types which are discussed later in this report.

Table 4 – Impact on individuals for tax year 2027

	Scenario	Number of individuals gaining compared to status quo	Average weekly gain	Number of individuals losing compared to status quo	Average weekly loss
A	Scenario 0	2.617 million	$10 per week	1.078 million	$12 per week
A+B	Scenario 1	3.560 million	$9 per week	175,000	$2 per week
A+B+C	Scenario 2	3.561 million	$23 per week	175,000	$2 per week

13. The introduction of the offset significantly reduces the number of individuals losing from the changes. 175,000 individuals lose when the offset is introduced under scenario 1 and 2 under current modelled parameters. Of this group, only around 15,000 lose by more than $5 per week.

14. There are two main cohorts that give rise to losses:

    a Cohort one: Part-year transfer recipients that are ineligible for the offset, and

    b Cohort two: People on very low incomes that will need to pay more tax.

Cohort one: Part-year transfer recipients that are ineligible for the offset

15. The first cohort of losing individuals are people that receive transfers such as a main benefit or NZS for only part of the year and have no other source of income (e.g., market income). Around 40% of these individuals are in households that are also worse off as a result of the changes. There are:

    a Around 45,000 individuals that only have benefit income and lose by an average of $3 per week, and

    b Around 12,000 individuals that only have NZS income and lose by an average of $6 per week.

16. These individuals lose because they will need to pay more tax than under the status quo and are not eligible for the offset. Transfer payments are set at a level to ensure that people will receive the correct amount on an annual basis, however part-year recipients will be worse off compared with the status quo as currently part-year recipients benefit in full from the lowest threshold (in effect allowing them to receive more per week than the intended amount). This gain may be received via an end of year tax refund under the status quo.

17. As noted above, there is an option to extend the offset to individuals with only transfer income. If eligibility were extended, these cohorts would not be worse off after the implementation of the changes, however there would be a significant fiscal cost associated (approx. $3 billion over the forecast period).

18. If the offset were extended to individuals with transfer income only, then 256,000 individuals with benefit income only would gain by an average of $18 per week as the offset would be paid in addition to the transfer payment. The average gain for individuals with NZS income only would increase from $8 per week to $23 per week.

Cohort two: People on very low incomes that will need to pay more tax

19. The second cohort of losing individuals are people with very low incomes that are not receiving transfer income. Around 15-20% of these individuals are in households that are also worse off as a result of the changes. There are around 119,000 individuals who receive the offset that lose by an average of $1 per week.

20. These losses arise from the design parameters of the offset. For people on very low incomes, the amount of offset they will be entitled to may be less than the additional tax they will need to pay. Individuals with taxable incomes under $3,333 will have lower after-tax incomes compared with the status quo. As an example:

    a An individual with a gross income of $2,000 will pay $210 in tax under the status quo – giving them an after-tax income of $1,790.

    b Under the proposed changes, the same individual would pay $350 in tax, and be entitled to an offset of $100, giving them an after-tax income of $1,750.

21. There are a range of reasons why people may have very low incomes. This could include people aged under 18, those earning for only part of the year, and/or self-employed people who may choose to pay themselves a very low wage. There may also be potential issues with the data that give rise to these individuals appearing in the modelling as losers.

Distributional impact – households

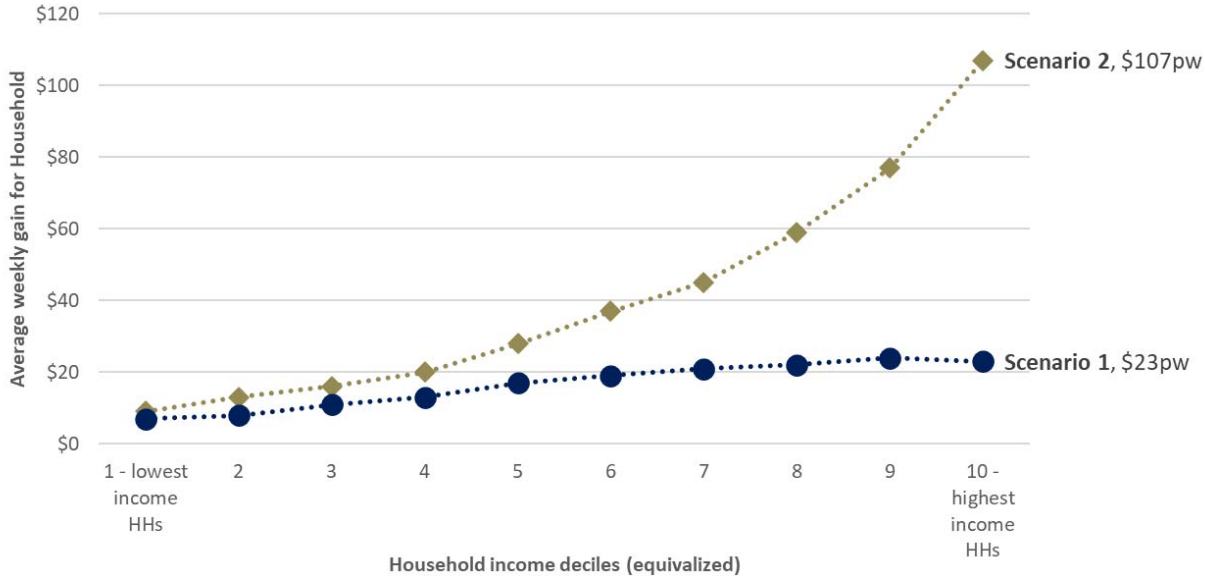
22. As noted, a small number of households (HH) will be made worse off under scenarios 1 and 2. These are largely as a result of the impacts described above. These are shown below in table 5.

Table 5 – Impact on households for tax year 2027

	Scenario	**Number of HH gaining compared to status quo**	**Average weekly gain**	**Number of HH losing compared to status quo**	**Average weekly loss**
A	Scenario 0	1.343 million **68% of HH**	$16 per week	522,000 **26% of HH**	$15 per week
A+B	Scenario 1	1.857 million **93% of HH**	$17 per week	32,000 **2% of HH**	$3 per week
A+B+C	Scenario 2	1.860 million **94% of HH**	$43 per week	29,000 **1% of HH**	$3 per week

23. The most significant difference is the increase in the average gains with and without the reduction of the 33% rate. Chart 1 below show how the gains are significantly higher in higher income decile households. This aligns with the policy design, whereby the largest gains are for individuals earning $180,000 and above. The top 10% of households (by equivalized income) have an average gain of $107 per week, compared to an average gain of $9 per week for the bottom 10% of households.

Chart 1 – Impact of scenario 1 and 2 on average weekly gains by household deciles in TY27



Impact on financial incentives to work

24. The financial incentives to work present in the tax and transfer system can be quantified using effective marginal tax rates (EMTRs). EMTRs show the combined effects of taxation and the abatement of benefits. They quantify the incentive to work more (i.e., they measure the share of an additional unit of family taxable income that would be forgone due to taxes, levies, and the abatement of tax credits and transfers). A smaller EMTR represents increased work incentives.

25. The Treasury has recently implemented functionality to estimate the distribution of EMTRs[2] across the New Zealand population. The impact of changes to thresholds/rates and the introduction of the offset (scenario 1) on EMTRs varies among different families, depending on factors like their levels and sources of income. Further analysis could also look at the impact of reducing the 33% rate (scenario 2).

[2] In these results, an individual's EMTR is the annual increase in family disposable income resulting from a $1 increase each week in their wage/salary income, divided by 52.

26. The overall effect on EMTRs is thus complex to summarise, but preliminary analysis for tax year 2026 suggests that:

    a For most people (around 2,800,000) there is no change.

    b Around 210,000 people have reduced EMTRs and therefore increased work incentives. There are around 75,000 people with low taxable incomes (where the tax offset is phasing in) and around 130,000 people who would have a marginal tax rate that reduced from 30% to 17.5%.

    c Around 250,000 people would have increased EMTRs and therefore decreased work incentives. They are people with taxable incomes between $0-$1k or $11k-$14k, which would be subject to a higher marginal tax rate than under current policy settings, and people who have variable incomes (receiving a combination of wages and either NZ superannuation or benefits over the year).

27. As noted above, further policy work would be needed on the design of the offset. Under the modelling approach used for the offset, there are potentially unintended consequences for around 760,000 superannuitants and beneficiaries who do not work and would experience a “cliff edge”. Earning one dollar would make these people newly eligible for the tax offset so their disposable income would increase by much more than the dollar they earned. See Appendix Two for chart of EMTR distributions.

28. The overall effect of these changes in financial incentives requires fuller analysis, particularly as EMTRs only provide a partial view on work incentives, and we could provide a more complete analysis of EMTR distributions and how they affect work incentives in a subsequent report if required.

Consequential tax types

29. You requested further information on situations where removal of the 10.5% tax rate would have a flow-on impact on other tax types that use the personal income tax rates. The offset would not be applied against the income now being taxed at 17.5% for the types of income that do not get included in a person’s taxable income. These include Employer Superannuation Contribution Tax (ESCT) and Portfolio Investment Entity tax (PIE Tax).

30. For both of these tax types, the deduction of additional tax results in lower investment balances and reduces future income on their investments. Removal of the 10.5% rate would also impact employers that pay fringe benefit tax (FBT) based on the attribution method. We are unable to estimate the additional cost to employers of this change as they do not provide individualised information with their FBT returns.

31. Currently, approximately 538,000 people have ESCT deducted at 10.5%. The change to 17.5% would mean that an additional $3.5 million would be deducted from their superannuation contributions per annum.

32. Approximately 337,000 people use the 10.5% Portfolio Investor Rate for their PIE income. The change to 17.5% would result in an additional $9.5 million that would be deducted from their PIE income.

Practical considerations – Implementation

33. Introducing an offset would be complicated to implement and would not be possible by 1 July 2024.

34. If the changes are announced on Budget Day then it is likely that the changes would be able to be successfully implemented from 1 September or 1 October depending on the complexity of the changes. If a pre-Budget announcement was possible then an earlier implementation date would also be possible.

35. While changes at the start of the tax year are preferred, the main calculations that Inland Revenue would need to change are used in year-end processing. Other private and public sector organisations would be likely to need more notice to enable them to update their systems and successfully implement the changes.

36. During initial consultation with payroll software suppliers, we received an explanation of the lead times that they need for changes. They noted that they ask for three months for basic changes as they need to update and test their software product before they provide it to their customers. They provide the updated software to their customers six weeks before the changes come into effect so that when their customers prepare their payroll information in advance of the payday, they are putting the information into the updated software.

37. The addition of a tax offset would be a larger change and more testing would be required. A change involving a tax offset may therefore require a bit more notice (potentially up to four months rather than three months). Payroll service providers also indicated that they would need a similar amount of time to update their systems and test them before the implementation date.

38. We also note that public sector organisations such as the Ministry of Education, the Ministry of Health, ACC and the Ministry for Social Development have large and complex payrolls and would be likely to need as much time as the payroll software providers and the payroll service providers.

Recommended Action

We recommend that you:

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

Jean Le Roux
Tax Strategy Manager, The Treasury

Maraina Hak
Policy Lead, Inland Revenue

Hon Nicola Willis
Minister of Finance

_____/_____/_____

Hon David Seymour
Associate Minister of Finance

_____/_____/_____

Hon Simon Watts
Minister of Revenue

____/_____/_____

Appendix One – fiscal costs

Costs of the scenarios included in this report by fiscal year ($ million)

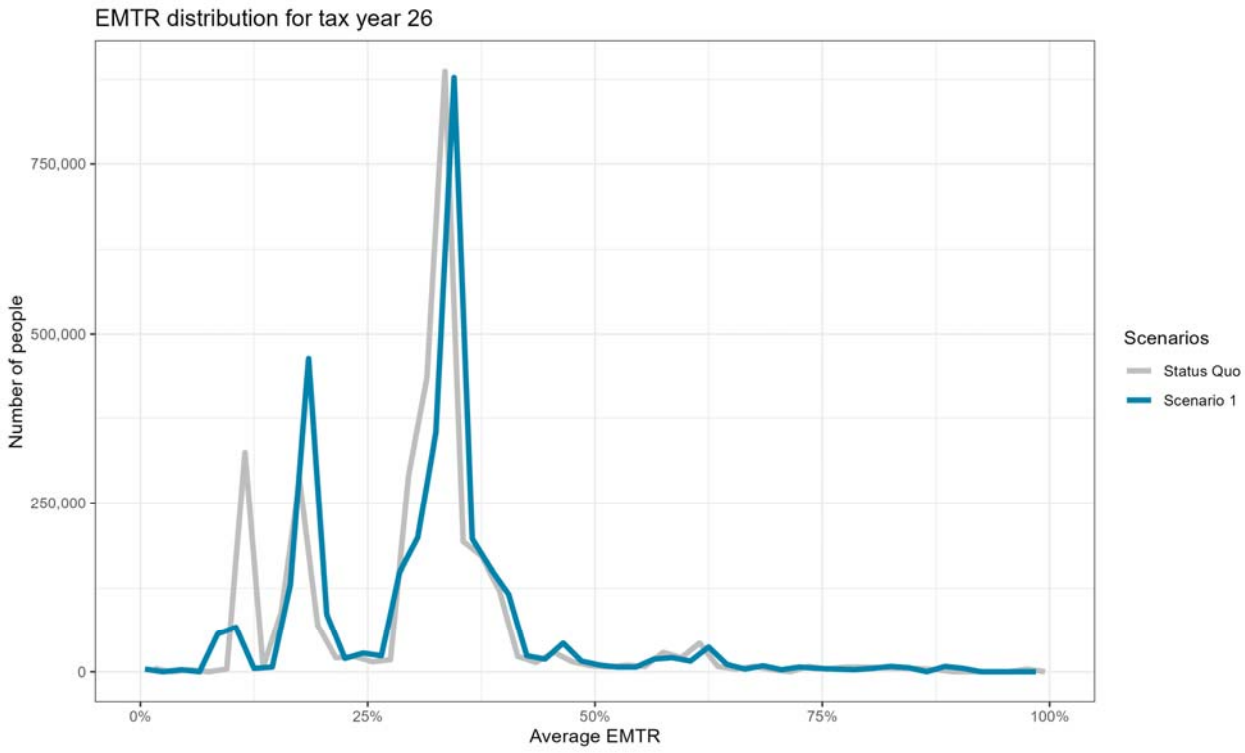
	Scenario	2024/25	2025/26	2026/27	2027/28	Total
A	Scenario 0	95	594	755	838	**$2,281**
A+B	Scenario 1	939	1,658	1,721	1,752	**$6,070**
A+B+C	Scenario 2	939	2,195	4,042	4,969	**$12,146**

Costs of National tax changes by fiscal year based on HYEFU preliminary forecasts ($ million)

	Scenario	2024/25	2025/26	2026/27	2027/28	Total
	National PIT changes	1,832	2,492	2,580	2,508	**$9,411**
	IETC expansion	161	205	193	182	**$741**
	Subtotal: PIT and IETC expansion	**1,993**	**2,697**	**2,773**	**2,689**	**$10,152**
	IWTC increase	161	158	151	143	**$613**
	Total	**2,154**	**2,854**	**2,925**	**2,832**	**$10,765**

Appendix Two – EMTR distribution

The following chart shows the distribution of EMTRs for tax year 2026 for scenario 1 compared with the status quo. It excludes superannuitants and beneficiaries that do not have any private income.



Disclaimer

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