The Treasury

Budget 2024 Information Release

September 2024

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[1] 6(a) - to avoid prejudice to the security or defence of New Zealand or the international relations of the government

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[27] 9(2)(ba)(ii) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely otherwise to damage the public interest

[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

[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

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[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

[40] 18(c)(i) - that the making available of the information requested would be contrary to the provisions of a specified enactment

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Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

TE TAI ŌHANGA
THE TREASURY

Tax Policy Report: Personal Income Tax – Design and Delivery

Date:	23 February 2024	**Report No:**	T2024/419	IR2024/072
		File Number:	SH-13-5-2-5-1-M102388	

Action sought

	Action sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Note** the content of this report **Decide** which proposals you would like to table at the second Budget Ministers meeting on 11 March **Agree** to allow the Treasury to consult with the Reserve Bank of New Zealand on the likely impact of personal income tax changes on inflation	28 February 2024
Hon Simon Watts **Minister of Revenue**	**Note** the contents of this report.	None

Contact for telephone discussion (if required)

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

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Executive Summary

Purpose

This paper provides the results of the modelling of the personal income tax relief options commissioned by the Minister of Finance's office, for your reference ahead of the first Budget Ministers meeting on 26 February. It also seeks your direction on the options you would like to present at the second Budget Ministers meeting, where personal income tax will be a focus of the discussion.

This report follows on from T2023/2125 – IR2023/294, which provided high-level approaches and considerations for personal income tax relief including using the concepts of the ACT party's policy to deliver tax relief. Further modelling of alternative options for personal income tax can be provided ahead of Budget Ministers 2 at your direction.

Cost-saving options for personal income tax changes

This report includes three alternative cost-saving options for the threshold changes, saving **$0.75 - $1.16 billion** over the forecast period (OFP) compared to the National tax plan.[1] The National threshold changes and requested cost-saving options are set out in the table below. Further to these alternatives, savings could be achieved by:

- delaying implementation of the plan to 1 October 2024 (saving approximately **$0.5 billion** over the forecast period for the National plan and scaled options); and
- scaling the Independent Earner Tax Credit (IETC) expansion (saving **$0.52 billion** over the forecast period); or
- retaining the current settings for the IETC (saving **$0.75 billion** over the forecast period).

Cost-saving options for personal income tax changes

	Current upper threshold of each tax rate	**National personal tax plan threshold changes**	**Scaled option 1** *National threshold changes but retain bottom threshold*	**Scaled option 2** *National threshold changes but 10% less for each threshold*	**Scaled option 3** *National threshold changes but 50% less for $70,000 threshold*
10.5% rate	$14,000	$15,600	**$14,000**	**$15,400**	$15,600
17.5% rate	$48,000	$53,500	$53,500	**$53,000**	$53,500
30% rate	$70,000	$78,100	$78,100	**$77,300**	**$74,000**
33% rate	$180,000	$180,000	$180,000	$180,000	$180,000
Cost OFP start 1 July		**$9.39 billion** -	**$8.23 billion** *($1.16b less)*	**$8.58 billion** *($0.81b less)*	**$8.64 billion** *($0.75b less)*
Cost OFP start 1 Oct		**$8.95 billion** *($0.44 less)*	**$7.77 billion** *($1.62b less)*	**$8.09 billion** *($1.3b less)*	**$8.14 billion** *($1.25b less)*
Cost in 2027/28		**$2.49 billion** -	**$2.21 billion** *($0.28b less)*	**$2.28 billion** *($0.21b less)*	**$2.29 billion** *($0.20b less)*

[1] The fiscal costs for the cost-saving options are indicative only, to inform decision making. Further work would be needed to produce final costings, and these could differ. Part of the variance in cost between the scaling/ delaying scenarios and the National personal tax plan may therefore be due to methodological differences.

The cost of the National personal tax plan, including changes to the In-Work Tax Credit (IWTC) and the IETC, is estimated at **$10.75 billion** over the forecast period (**$2.82b in 2027/28**). This comprises:

- **$9.39 billion** for threshold changes (**$2.49b in 2027/28**),
- **$0.75 billion** for IETC (**$0.18b in 2027/28**), and
- **$0.61 billion** for IWTC (**$0.14b in 2027/28**).

Officials' views

Officials consider the National personal tax plan (and scaled options) aligns with our understanding of your objectives for personal income tax relief. However, officials recommend:

- **you consider progressing scaled personal income tax options** in order to create headroom in Budget 2024 allowances to fund other Government priorities.
- **delaying implementation of personal income tax changes to 1 October 2024** to reduce the fiscal cost, minimise near-term inflationary pressures and ensure all taxpayers receive the benefit of the tax changes on time – without the need for pre-announcement engagement with payroll providers.
- **against the proposed IETC expansion** and recommend ministers leave IETC settings unchanged for Budget 2024.

Next steps

We seek your feedback on the options presented and any further analysis you would like undertaken before you take any options to the second Budget Ministers meeting. Any further modelling will need to be commissioned by 28 February to ensure you receive this prior to Budget Ministers 2. The timeline below informs you of key dates for upcoming Budget Ministers meetings and when actions are needed from you.

Mon 26 Feb	Budget Ministers meeting 1 – raise the need for trade-offs with Budget Ministers
Tues 27 / Weds 28 Feb	Decision on options for presentation at Budget Ministers meeting 2
Mon 11 March	Budget Ministers meeting 2 – raise options for scaling PIT package with Budget Ministers
Mon 25 March	Budget Ministers meeting 3 – decision on key parameters of PIT package

A full timetable of decisions required can be found at the end of this report.

Recommended Action

We recommend that you:

a **Note** that officials recommend:

i. you consider progressing scaled personal income tax options in order to create headroom in Budget 2024 allowances to fund other Government priorities.

Noted

ii. delaying the implementation of the tax package to 1 October 2024,

Noted

iii. not implementing the proposed IETC expansion.

Noted

b **Indicate** the proposals you would like to table at the second Budget Ministers meeting on 11 March:

i. Personal income tax threshold changes

	Minister of Finance
National threshold changes	
Scaled option 1 (retain bottom threshold)	
Scaled option 2 (10% less for each threshold)	
Scaled option 3 (50% less for $70,000 threshold)	

ii. IETC expansion

National IETC expansion ($70,000)	
Smaller IETC expansion ($53,500)	
No IETC expansion (status quo)	

iii. Other (please indicate):

c **Indicate** the preferred timing of any personal income tax changes:

1 July 2024 1 October 2024 Other:

d **Agree** to allow the Treasury to consult with the Reserve Bank of New Zealand on the likely impact of personal income tax changes on inflation:

Agreed / Not agreed

e **Note** the contents of this report *(Minister of Revenue)*:

Noted

Jean Le Roux
Manager, Tax Strategy,
The Treasury

Maraina Hak
Policy Lead
Policy and Regulatory Stewardship,
Inland Revenue

Hon Nicola Willis
Minister of Finance

______/______/________

Hon Simon Watts
Minister of Revenue

______/______/________

Treasury Report: Personal Income Tax – Design and Delivery

Purpose

1. This paper provides you with an update on options for personal income tax relief to support your engagement at the first Budget Ministers meeting on 26 February. It also seeks your direction on the options you wish to present at the second Budget Ministers meeting on 11 March, where personal income tax will be a focus of discussion.

2. This report follows on from T2023/2125 – IR2023/294, which provided high-level approaches and considerations for delivering personal income tax relief, including using the concepts of the ACT party's policy to deliver tax relief.

Policy context

3. Tax revenue growth driven by policy changes and fiscal drag (when a greater proportion of income is being taxed at higher personal tax rates) has been a significant means by which the government has addressed growing fiscal pressures to date. However, fiscal drag has eroded the progressivity of the personal income tax system and has had broader impacts that may not align with Government objectives:

   - The increase in annual tax liability from fiscal drag is uneven across income levels, with the greatest impact at the $48,000 income threshold (note: The full-time minimum wage from 1 April 2024 will be $48,284 per year).
   - The average rate of tax on total personal income increases over time, reducing economic efficiency as people's decisions are more heavily impacted by tax.
   - The increase in tax from fiscal drag is arguably less transparent than explicit changes to tax settings and may engender less public debate.
   - When inflation exceeds wage growth, people's tax burden increases even as their ability to pay for goods and services decreases.

Policy objectives and principles

4. There are many ways to design personal income tax changes, and the options are infinitely scalable. The desired approach will depend on your objectives. Based on the National Party's *Back Pocket Boost* policy document, we understand that your objectives include:

   - Compensating for the impact of fiscal drag on average tax rates;
   - Increasing after-tax incomes, particularly for middle-income New Zealanders;
   - Ensuring there is a greater financial return from work.

5. We consider that the National personal income tax plan (and variations) align with our understanding of your objectives for personal income tax relief. However, officials consider expanding the Independent Earner Tax Credit (IETC) to not be the most effective means of increasing the financial return from work.

6. Separately, officials have used the following **principles** to assess the impact of personal income tax changes. The weight given to each principle (priorities and trade-offs) is a value judgement for Ministers to make.

Principle	Key considerations for Ministers
Fiscal impact/ sustainability	Reductions in tax revenue have a price tag. Revenue changes may also compromise long-term fiscal sustainability.
Integrity	Changes to tax rates and marginal tax rates can impact perceptions of fairness in the tax system and taxpayers' willingness to comply.
Efficiency and productivity	Reducing tax rates can reduce distortions to personal income decisions and could enhance incentives to work, save, and invest in human capital.
Macroeconomic impacts	Impacts of options could be considered in the context of the macroeconomic environment, e.g., capacity constraints and inflation.
Distributional impacts/equity	While tax relief may target a specific group, changes will impact across the entire taxpayer distribution including earner types, ethnicities, households, etc.
Administrative/ compliance costs	Officials favour options that minimise administration and compliance costs for software providers, employers, and earners.

Policy proposals

7. The National personal tax plan included the tax threshold changes set out in Table 1.

Table 1: Personal income tax changes proposed in National tax plan

Marginal rate	Current thresholds	National threshold changes
10.5%	$0 - 14,000	$0 - $15,600
17.5%	$14,001 - $48,000	$15,601 - $53,500
30%	$48,001 - $70,000	$53,501 - $78,100
33%	$70,001 - $180,000	$78,101 - $180,000
39%	$180,001 +	$180,001 +

8. The IETC is currently available for those who earn between $24,000 and $48,000 and who are not in receipt of Working for Families, New Zealand Superannuation, veterans' pension, income tested benefits or an overseas version of these. The IETC was introduced in 2009 to provide a targeted tax reduction for low to middle income earners who did not receive other income support.

9. The IETC abates at a rate of 13 cents for every dollar earned over $44,000 and is no longer available once an earner's income exceeds $48,000. The National personal tax plan involves retaining the bottom threshold at $24,000 and increasing the top threshold to $70,000 from 1 July 2024, with abatement at 13 cents for every dollar earned over $66,000.

10. The In-Work Tax Credit (IWTC) is a payment to low- to middle-income working families who are not in receipt of a benefit. The National personal tax plan involves increasing this credit by $25 per week to a total of $97.50 per week.

Estimated costs

11. The total cost of the National tax package, including the IWTC and IETC changes, is estimated at **$10.75 billion** over the forecast period (**$2.82b in 2027/28**). This comprises:

- **$9.39 billion** for threshold changes (**$2.49b in 2027/28**),
- **$0.75 billion** for IETC (**$0.18b in 2027/28**), and
- **$0.61 billion** for IWTC (**$0.14b in 2027/28**).

Options to reduce fiscal cost

12. Small reductions to the threshold increases proposed in the National personal tax plan could result in relatively large cost savings in the long term while still delivering comparable tax relief to individuals. We have prepared three scaled options as requested, which generate savings of **$0.75 - $1.16 billion** over the forecast period (OFP). These options are presented in Table 2 below.

13. Delaying the implementation of the threshold changes to 1 October 2024 would further reduce the total cost of each option by around **$0.5 billion**, although this saving would occur in the first year of implementation only and would not improve the long-term fiscal sustainability of the tax plan. An October start date would also avoid the need for pre-announcement engagement with payroll providers.

Table 2: Cost saving options for personal income tax threshold changes

	Current upper threshold of each tax rate	**National personal tax plan threshold changes**	**Scaled option 1** *National threshold changes but retain bottom threshold*	**Scaled option 2** *National threshold changes but 10% less for each threshold*	**Scaled option 3** *National threshold changes but 50% less for $70,000 threshold*
10.5% rate	$14,000	$15,600	**$14,000**	**$15,400**	$15,600
17.5% rate	$48,000	$53,500	$53,500	**$53,000**	$53,500
30% rate	$70,000	$78,100	$78,100	**$77,300**	**$74,000**
33% rate	$180,000	$180,000	$180,000	$180,000	$180,000
Cost OFP start 1 July		**$9.39 billion** -	**$8.23 billion** *($1.16b less)*	**$8.58 billion** *($0.81b less)*	**$8.64 billion** *($0.75b less)*
Cost OFP start 1 Oct		**$8.95 billion** *($0.44 less)*	**$7.77 billion** *($1.62b less)*	**$8.09 billion** *($1.3b less)*	**$8.14 billion** *($1.25b less)*
Cost in 2027/28		**$2.49 billion** -	**$2.21 billion** *($0.28b less)*	**$2.28 billion** *($0.21b less)*	**$2.29 billion** *($0.20b less)*

14. Further savings could be made by making smaller changes to the IETC threshold. Lifting the threshold to $53,500 instead of $70,000 would reduce the cost by **$0.52 billion** over the forecast period (**$0.12 billion in 2027/28**). Not proceeding with the expansion of the IETC would reduce the cost by **$0.75 billion** over the forecast period (**$0.18 billion in 2027/28**). Note that IR2024/032 – Working for Families changes for Budget 2024 provides alternative, cost-saving options for the IWTC.

Summary of scaled options

15. The fiscal costs of the scaled options are comparable – the differences are in who gains by less compared to the full National tax plan threshold changes, and by how much less they gain.

16. Under scaled option 1 – *National threshold changes but retaining the bottom threshold* – a small cohort of individuals and households will no longer gain from the changes, and the remaining cohort will be worse off in comparison to the National personal tax plan threshold changes, (though only by a small amount).

17. Conversely, the same cohort will continue to gain from the tax changes under the other two scaled options. Under scaled option 2 – *National threshold changes but 10% less for each threshold* – this is spread quite evenly across the income spectrum, whilst

under scaled option 3 – *National threshold changes but 50% less for $70,000 threshold* – only individuals earning above $74,000 will be worse off than under the National tax plan threshold changes.

Table 3: Comparison of scaled options with National personal tax plan

	Scaled option 1 - National threshold changes but retain bottom threshold	**Scaled option 2 - National threshold changes but 10% less for each threshold**	**Scaled option 3 - National threshold changes but 50% less for $70,000 threshold**
Key differences compared to National personal tax plan	Individuals earning below $48,000 will not gain at all.	Individuals across the income spectrum will still gain, but by less.	Only individuals earning above $74,000 will gain by less.
Saving compared to National personal tax plan	**$1.16 billion OFP** ($0.28b in 2027/28)	**$0.81 billion OFP** ($0.21b in 2027/28)	**$0.75 billion OFP** ($0.20b in 2027/28)
Gains under scaled option by income range	• Individuals earning below $48,000 will not gain, • Individuals earning between $53,500 and $70,000 will gain by $13.22 per week, • Individuals earning above $78,100 will gain by $17.89 per week	• Individuals earning between $15,400 and $48,000 will gain by $1.88 per week, • Individuals earning between $53,000 and $70,000 will gain by $13.90 per week, • Individuals earning above $77,300 will gain by $18.12 per week	• Individuals earning between $15,600 and $48,000 will gain by $2.15 per week, • Individuals earning between $53,500 and $70,000 will gain by $15.38 per week, • Individuals earning above $74,000 will gain by $17.68 per week
Impact on households compared to National personal tax plan	0.14 million households no longer gain **(7%)** 1.69 million households gain by less than the full National tax plan **(85%)**	1.83 million households gain by less than full National tax plan **(92%)**	0.33 million households gain by the same amount **(17%)** 1.50 million households gain by less **(76%)**

Assessment of proposals against principles

Principle 1: Fiscal cost and sustainability

18. The cost of the National personal tax plan, including IWTC and IETC changes, is estimated at **$10.75 billion** over the forecast period (**$2.8b in 2027/28**). To support medium-term fiscal sustainability, we recommend ensuring the personal income tax package is funded within the Budget 2024 operating allowances (including any savings that are identified) alongside the other expenditure pressures. This may require considering the options to reduce the fiscal cost presented in this report.

19. Decisions on the personal income tax package will impact the available balance within Budget 2024 allowances to fund other Government priorities and commitments. In making your decisions, you will need to consider what portion of the current Budget 2024 allowance and savings identified (i.e., baseline and targeted) is used to offset your tax commitments, versus what is used to offset your other priorities (i.e., cost pressures, new spending and operating associated with capital investment).

20. Any savings on the tax package will mean extra headroom for other priorities. Given the extent to which the allowances are oversubscribed, we recommend serious consideration of scaled options.

21. We note that one of the sources of tax package funding is available Emissions Trading Scheme cash proceeds, as agreed through the Mini Budget. These proceeds are expected to vary in the short term and decline in the medium term [T2023/1981 and the Annex of manifesto and coalition costings provided on 27 November 2023 refer]. We have assumed that these variations are not intended to flow into the tax package and would instead impact fiscal indicators directly.

Principle 2: Integrity

22. The revenue-raising capability of the personal income tax system depends on taxpayer compliance, which may be influenced by people's perceptions of the fairness of the tax system. To the extent adjustments to tax thresholds in response to fiscal drag improve perceptions of fairness, we would expect some small positive impacts on compliance.

23. Since 1 October 2010 (the last time personal income tax thresholds were adjusted) the most significant impact from fiscal drag has been on individuals whose incomes had just crossed the $48,000 threshold at the time (assuming their incomes have continued to grow in line with average wage growth). This is because of the steep increase in their marginal tax rate from 17.5% to 30%.

24. The median full-time wage and salary worker earned $48,024 in the year ended June 2011. In the year ended June 2023, the median full-time wage and salary worker earned $73,417. Owing to the effect of fiscal drag, their average tax rate (the total tax paid per dollar of income) increased by 5.1 percentage points from 15.5% to 20.6% between 2011 - 2023.

25. The personal income tax threshold adjustments in the National personal tax plan would reduce the tax liability of this median earner by $902, bringing their average tax rate down to 19.4% and compensating for around one quarter of the average tax rate increase from fiscal drag since 2011. The expansion of the IETC would not benefit these earners as they will earn above the new threshold.

Principle 3: Efficiency and productivity

26. Personal income tax has a negative impact on economic efficiency to the extent that it affects people's income earning decisions. Particularly important are decisions to work, save and invest in education, which may be negatively impacted by higher tax rates. Reducing tax rates may therefore be expected to increase these incentives, with positive implications for overall labour supply and the productive capacity of the economy. The effect on overall labour supply of the National personal tax plan is likely to be small, however, given the size of tax relief being delivered.

27. The tax threshold adjustments will have a positive impact on returns from work by decreasing marginal tax rates for earners between the old and new thresholds (e.g., earners between $48,000 - $53,500 have their marginal tax rate reduced from 30% to 17.5%). The changes will also reduce the total tax paid by all earners above $14,000. However, it is uncertain whether greater returns from work will incentivise people to enter employment or work more hours.

28. The expansion of the IETC will have opposing impacts on financial returns from work. While it will increase overall returns for earners between $44,000 - $70,000, it will also have a negative impact on marginal returns for earners between $66,000 - $70,000, which may reduce their incentive to work additional hours (see Table 4). It is therefore

likely that this objective could be achieved more effectively by removing the IETC and making other changes to tax and transfer settings for the same fiscal cost.[2]

29. Officials therefore recommend against the proposed IETC expansion and recommend ministers leave the IETC settings unchanged for Budget 2024.

Impacts on incentives to enter employment

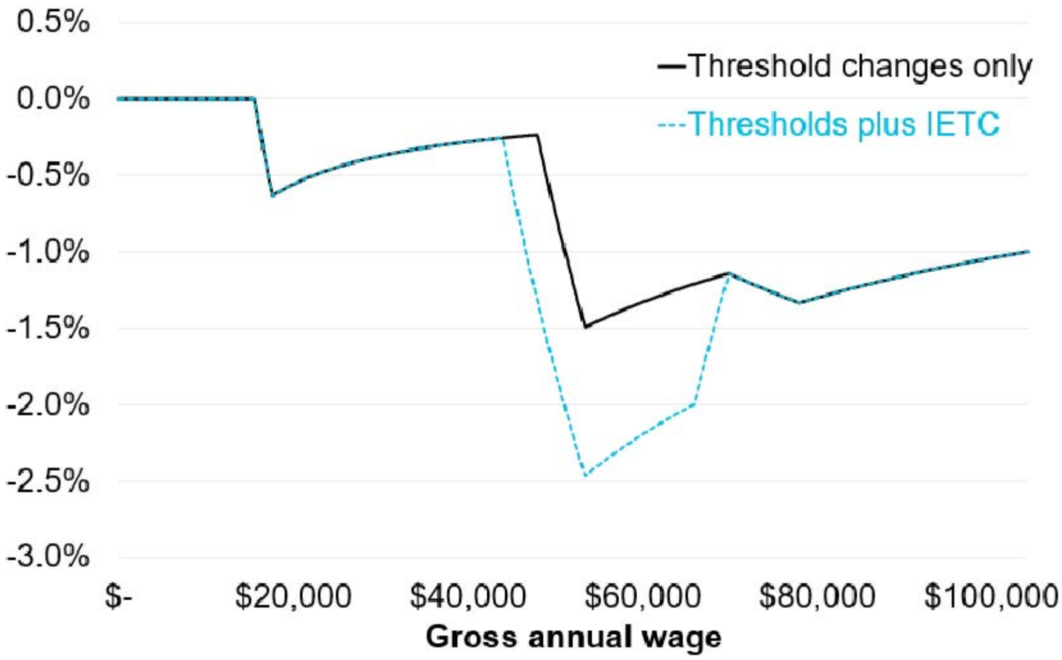
30. Most empirical evidence suggests that the largest effects on overall labour supply are likely to come from increasing the incentive to enter employment (compared to the incentive to work additional hours, which is expected to have a smaller effect). In particular, women and sole parents are most responsive to incentives to enter work.

31. This incentive can be demonstrated through the participation tax rate, which shows the fraction of additional gross earnings lost to either higher taxes or lower benefits when a jobless person takes up employment. Tax changes that significantly reduce participation tax rates would be expected to have the largest impact on incentives to enter work and therefore overall labour supply.

32. Figure 1 demonstrates the impact of the National personal tax plan on participation tax rates for a single earner without children. The changes reduce participation tax rates across the income spectrum, with the largest impact occurring at a gross annual wage of $53,500. For someone entering the workforce at this income level (e.g., working 40 hours per week at $25.65 per hour), the tax threshold changes reduce their participation tax rate by 1.5% and the IETC expansion (assuming they are eligible) reduces it by a further 1.0%.

33. Given that this person will now keep a greater proportion of the gross wage they earn, they would be expected to have a greater incentive to enter work. Other factors will also contribute to a person's decision to enter work, however, so it is uncertain whether or not they will respond to this increased incentive, and we have not formally modelled the impact of the tax plan on overall labour supply. The scaled threshold options would have similar but smaller impacts on participation tax rates.

Figure 1: Impact of National personal tax plan on participation tax rates for single earner



[2] See T2017/164: Removing the Independent Earner Tax Credit for further discussion of the IETC. The report notes that "removing the IETC would have a very small negative impact on labour supply."

Impacts on incentives to work additional hours

34. For those already in work, the decision to work more or fewer hours can be influenced by effective marginal tax rates (EMTR – the fraction of each additional dollar earned that is lost to tax and reduced transfers). Changes that significantly reduce effective marginal tax rates would be expected to enhance incentives to work additional hours and may also encourage workers to increase their wage prospects by upskilling.

35. Treasury modelling can estimate the distribution of EMTRs for the New Zealand population. Table 4 below shows how many people in a certain income bracket would experience a change in EMTR through proposed threshold and IETC changes. It is important to note that not all people with income within those tax ranges experience these impacts - it will be dependent on their full tax picture including their receipt of any benefits or tax credits.

Table 4: Modelled changes in EMTRs compared to the status quo

Taxable incomes between:	Work incentive	Reason for change	A) National personal tax plan threshold changes only	B) Threshold changes + IETC threshold to $70,000	C) Threshold changes + IETC threshold to $53,500
$14,000 - $15,600	Reduced EMTR, **increased** work incentive	PIT rate change from 17.5% to 10.5%	✓ 35,000 people	✓ 35,000 people	✓ 35,000 people
$44,000 - $48,000	Reduced EMTR, **increased** work incentive	Those who are eligible for IETC and no longer in abatement zone. Abatement rate of 13%		✓ 45,000 people	✓ 45,000 people
$48,000 - $53,500	Reduced EMTR, **increased** work incentive	PIT rate change from 30% to 17.5%	✓ 125,000 people	✓ 125,000 people	✓ 75,000 people (less affected due to overlap with IETC abatement range)
$66,000 - $70,500	Increased EMTR, **decreased** work incentive	Those who are eligible for IETC and are now in abatement range		✓ 85,000 people	
$70,000 - $78,101	Reduced EMTR, **increased** work incentive	PIT rate change from 33% to 30%	✓ 130,000 people	✓ 130,000 people	✓ 130,000 people
Total number of people affected			**290,000** positively affected	**335,000** positively affected **85,000** negatively affected	**285,000** positively affected

36. The option to implement the National plan threshold changes only and the option to move the IETC threshold to $53,500 are roughly equivalent in the number of people who receive a reduction in EMTR (and therefore increased work incentives). In both of these options, no one experiences decreased work incentives. Between these two, it would be a choice for ministers what taxable income band they want to focus on.

Principle 4: Macroeconomic impacts

37. Whether the proposed personal income tax changes will affect the current rate of inflation will largely depend on how the overall package of tax reforms is funded. At the margins, personal income tax relief without an accompanying reduction in government spending could reasonably be expected to increase the demand for goods and services and cause inflation to increase.

38. We are looking to provide analysis on the estimated impact of the personal income tax package on inflation and interest rates ahead of final decision making. We also recommend that the Treasury consult the Reserve Bank of New Zealand on how they think inflation will be impacted by the personal income tax changes before finalising the package.

39. To minimise the extent to which Budget 2024 contributes to near-term inflationary pressures, we recommend funding the tax package within the Budget 2024 operating allowances and delaying implementation to 1 October 2024. Focusing the tax relief in a way that supports labour force participation, including for women, will also reduce the inflationary impact.

Principle 5: Equity and distributional impacts

40. While tax relief may target a specific group, changes will impact across the entire taxpayer distribution including earner types, ethnicities, households, etc. It is for Ministers to determine whether the incidence of any change to the personal income tax system is equitable and whether it meets the desired distributional objectives. This is a value judgment that could be based on value frameworks such as ability to pay and the progressivity or otherwise of the tax system.

41. The distributional analysis set out below is intended to support your assessment of the equity of the different proposals outlined in this paper.

42. 92% of all households will gain by an average of $25 per week under the National threshold changes excluding the IETC changes (for tax year 2026/27). The gains are larger for higher income households. Households in the top three income deciles will gain by between $36-$38 per week, while just over three quarters of households in the bottom three income deciles will gain, by between $6 and $12 per week.

43. Table 5 below provides an overview of the number of individuals and households better off than currently (and the average amount they gain by) under the National personal tax plan.

Table 5: Impact of National personal tax plan (thresholds only)

Scenario	Number of **individuals** gaining	Average weekly gain per **individual**	Number of **households** gaining	Average weekly gain per **household**
National threshold changes only	**3.38 million (80%)** **16%** less than $5 **64%** more than $5	**$14 per week**	**1.83 million (92%)** **8%** less than $5 **85%** more than $5	**$25 per week**

44. The gains increase as incomes increase:

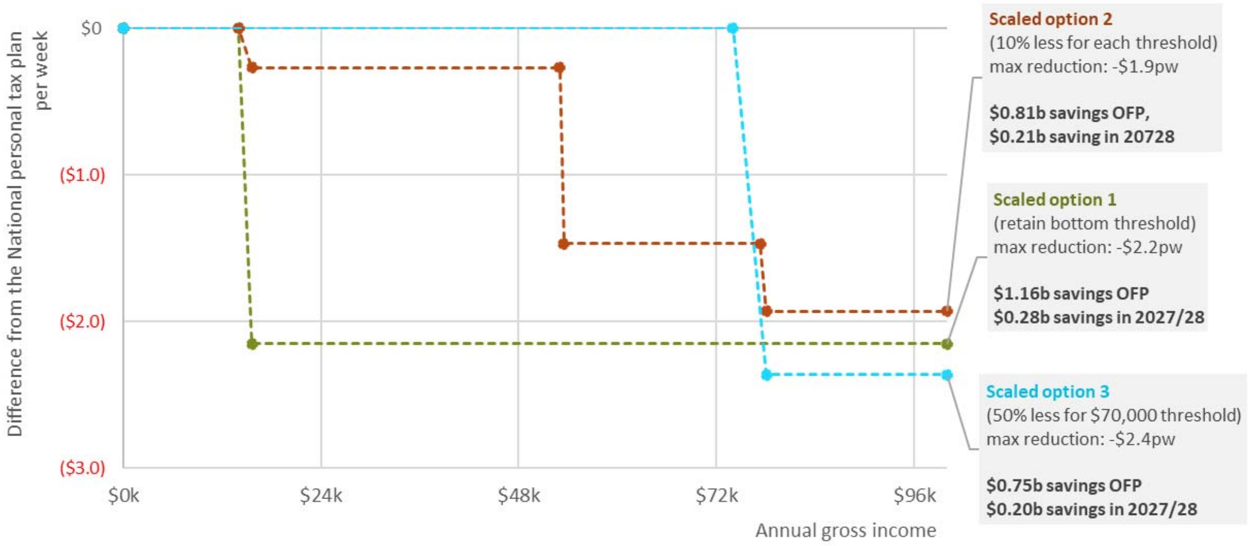
- Individuals earning between $15,600 and $48,000 will gain by $2.15 per week,
- Individuals earning between $53,500 and $70,000 will gain by $15.38 per week,
- Individuals earning above $78,100 will gain by $20.05 per week.

45. A very small number of individuals and households will be worse off than they would be under the current settings by an average of $1 per week as a result of the threshold changes (36,000 individuals and 9,000 households). This is a consequence of the way transfer payments are calculated for people that receive these payments for only part of the year.

Distributional impact of options to scale threshold adjustments

46. As discussed above, small reductions in the threshold adjustments under the National personal tax plan will deliver relatively large cost savings. The options have slightly different distributional impacts. Figure 2 shows the impact of the scaled options relative to gains under the full National threshold changes by income level.

Figure 2: Difference in gains from National tax plan for scaled options by income level



47. Individuals with income below $48,000 (around 15% of individuals and 7% of households) will no longer gain under scaled option 1. These individuals and households would have received less than $5 per week in tax relief under the threshold changes in the National personal tax plan. The remaining individuals and households will still gain, but by a reduced amount.

48. The 80% of individuals and 92% of households receiving tax relief under the full National personal tax plan will continue to gain under the scaled options 2 and 3. However, almost everyone will have the size of their gains reduced under scaled option 2.

49. Only individuals with income above $74,000 will be impacted as a result of changes under scaled option 3. Under this option, just under one in five households that are gaining under the National personal tax plan will continue to gain by the same amount (approximately 330,000 households). Part of the impact on households who gain by less is due to the indirect effect on NZ Super rates.

50. A small number of individuals and households will be better off under scaled options 1 and 2 than under the full National threshold changes. This is because these changes either fully or partially mitigate the issue for part-year transfer recipients (see paragraph 45). Table 6 summarises the impacts of the different scaled options.

Table 6: Impact of different scaled options

	Number of **individuals** gaining	Average weekly gain per **individual**	Number of **households** gaining	Average weekly gain per **household**
National threshold changes only	**3.38 million (80%)** **16%** less than $5 **64%** more than $5	**$14 per week**	**1.83 million (92%)** **8%** less than $5 **85%** more than $5	**$25 per week**
Scaled option 1 - National threshold changes but retain bottom threshold	**2.78 million (65%)** **2%** less than $5 **64%** more than $5 *15% no longer gain*	**$15 per week** (see footnote 3)	**1.69 million (85%)** **1%** less than $5 **84%** more than $5 *7% no longer gain*	**$24 per week**
Scaled option 2 - National threshold changes but 10% less for each threshold	**3.38 million (80%)** **16%** less than $5 **64%** more than $5	**$12 per week**	**1.83 million (92%)** **8%** less than $5 **85%** more than $5	**$23 per week**
Scaled option 3 - National threshold changes but 50% less for $70,000 threshold	**3.38 million (80%)** **16%** less than $5 **64%** more than $5	**$12 per week**	**1.83 million (92%)** **8%** less than $5 **85%** more than $5	**$23 per week**

Adjustments to IETC expansion

51. Choices around the IETC will impact the targeting of the overall package. A smaller increase to the IETC threshold will reduce the fiscal cost. Table 7 outlines the impact of the different IETC expansion options.

Table 7: Impact of different IETC scaling options

	Number of **individuals** gaining compared to threshold changes only	Average weekly gain per **individual**	Number of **households** gaining compared to threshold changes only	Average weekly gain per **household**
IETC threshold to $70,000	**445,000**	**$8 per week**	**371,000** ~19% of all households	**$10 per week**
IETC threshold to $53,500	**121,000**	**$6 per week**	**114,000** ~6% of all households	**$6 per week**

52. While the IETC is targeted at low to middle income individuals, many of these individuals are part of higher income households. Around 60% of households that gain under both IETC proposals are in the top half of households by income deciles.

53. Just under 20% of all households in the top three income deciles will gain directly from the IETC expansion if the threshold is lifted to $70,000, compared with only around 5% of households in the same income range under the scaled alternative.

[3] The average gains increase slightly under scaled option 1 because there are a smaller cohort of individuals and households that would benefit from the personal tax changes.

Principle 6: Administrative and compliance costs

Application date

54. Mid-year tax changes will require the application of composite rates for end-of-year calculations. With the added complexity of the mid-year change to the IETC, it is likely that the number of taxpayers who will be under or over-taxed at source will increase. It is also likely that those under-taxed with a tax bill more than Inland Revenue's automatic write-off threshold will increase. This will increase taxpayer contacts for Inland Revenue (therefore requiring additional administrative resource and effort over the coming year).

55. Mid-year tax changes will cause further compliance costs for employers, payroll software providers and payroll service providers due to the need to change the applicable tax thresholds mid-year. Beyond this, there are also consequential impacts on other tax types including Employer Superannuation Contribution Tax (ESCT) and Fringe Benefit Tax (FBT) which will require significant compliance efforts by employers. Portfolio Investment Entities (PIEs) will also bear additional compliance costs due to the impacts of the PIT changes on the Prescribed Investor Rate (PIR).

Employer Superannuation Contribution Tax (ESCT)

56. ESCT is the tax which employers pay on their contributions to their employee's superannuation scheme (e.g., KiwiSaver). The rate of ESCT applied over a given tax year is calculated by an employer based on either the employee's earnings over the previous tax year, or else the employee's projected earnings over the coming tax year.

57. A mid-year tax change – be that in July or October – will result in additional compliance costs for employers. Additionally, any inaccurately calculated deductions (either due to human error or in delays updating rates) will be full and final and will have flow-on effects to employee KiwiSaver balances.

Fringe Benefit Tax (FBT)

58. FBT is the tax payable by employers when additional benefits are supplied to an employee (e.g., a motor vehicle available for private use, low interest loans). Employers typically file FBT returns on an annual or quarterly basis and can choose to pay a flat rate or to attribute the benefits to each employee and calculate their FBT based on their marginal tax rates.

59. The mid-year change to PIT thresholds will therefore increase the number of rates which employers would need to apply to their employees. As well as increasing compliance costs for employers and leading to inaccuracies in FBT returns, this would also increase Inland Revenue's administration costs due to increased customer contacts.

Prescribed Investor Rate (PIR)

60. Investors are required to elect their PIR which is determined by their income in the previous two years and a set of thresholds. Therefore, the mid-year tax change will require PIEs to split the PIE tax calculation over two periods to reflect a mid-year change.

Options to reduce compliance costs

61. The increased compliance costs arising from the outlined consequential changes could be somewhat mitigated by allowing employers to apply FBT rates based on the increased thresholds for the entire tax year. Similarly, ESCT and PIR could remain under existing rules for the 2024/25 tax year, with new rules applying the following year.

Implementation

Consequential tax impacts

62. Several other taxes have rates that are based on the personal income tax rates. Changes to the personal income tax rates and thresholds will therefore require further legislative amendments to these other tax types. Affected tax types include the Resident Withholding Tax (RWT), PIE tax, FBT, ESCT and Retirement Scheme Contribution Tax (RSCT). The applicable rates and thresholds of these tax types would also need to shift to align with the proposed PIT changes.

63. For example, per National's proposed changes to the personal income tax thresholds, the ESCT thresholds will also change as in Table 8 below:

Table 8: Change to ESCT thresholds resulting from personal income tax changes

Tax Rate	Status quo	New thresholds
0.105	$0 - $16,800	0 - $18,720
0.175	$16,801 - $57,600	$18,721 - $64,200
0.300	$57,601 - $84,000	$64,201 - $93,720
0.330	$84,001 - $216,000	$93,721 - $216,000
0.390	$216,001 +	$216,001 +

Third parties

64. Third parties such as payroll software providers and payroll service providers will need to make changes to their systems and their software to implement the personal income tax changes. We have consulted with private sector software providers and payroll service providers to understand the timeframes needed to make changes. The time required is dependent on the level of complexity of the changes. Some providers also noted that there may be additional capacity issues for changes on 1 July for private sector providers with Australian customers (as Australia has a 30 June year end for payroll tax).

65. Payroll software providers give updates to their clients at least 6 weeks before any change comes into force. This is because clients need to load information for pay runs into their system before they make the payments. Some pay information can be input as much as a month before the pay run and as such the new software would need to be in place for this information to be processed correctly. The payroll software providers first need to make the changes and test them before they can provide the updated software to their customers so they would typically require information on the changes at least 3 months before the implementation date.

66. Payroll service providers would be able to work within a 3-month timeframe for minor changes such as those in the National personal tax plan. Therefore, announcement of the changes on Budget Day (30 May) would not leave sufficient time to implement the changes by 1 July 2024. To give sufficient time to implement the changes the Government could make an announcement following Cabinet approval, provided the announcement was made by 1 April 2024.

67. The Ministry of Social Development have provided initial indications that approximately four months lead in time (from the Cabinet decision) will be required for it to progress the necessary IT, legislative and operational changes.

Next steps

68. We seek your feedback on the options presented and any further analysis you would like undertaken before you take any options to the second Budget Ministers meeting. Any further modelling will need to be commissioned by 28 February to ensure you receive this prior to Budget Ministers 2.

69. You will receive advice this week on options for the IWTC (refer IR2024/032), which you should consider in conjunction with the advice in this report.

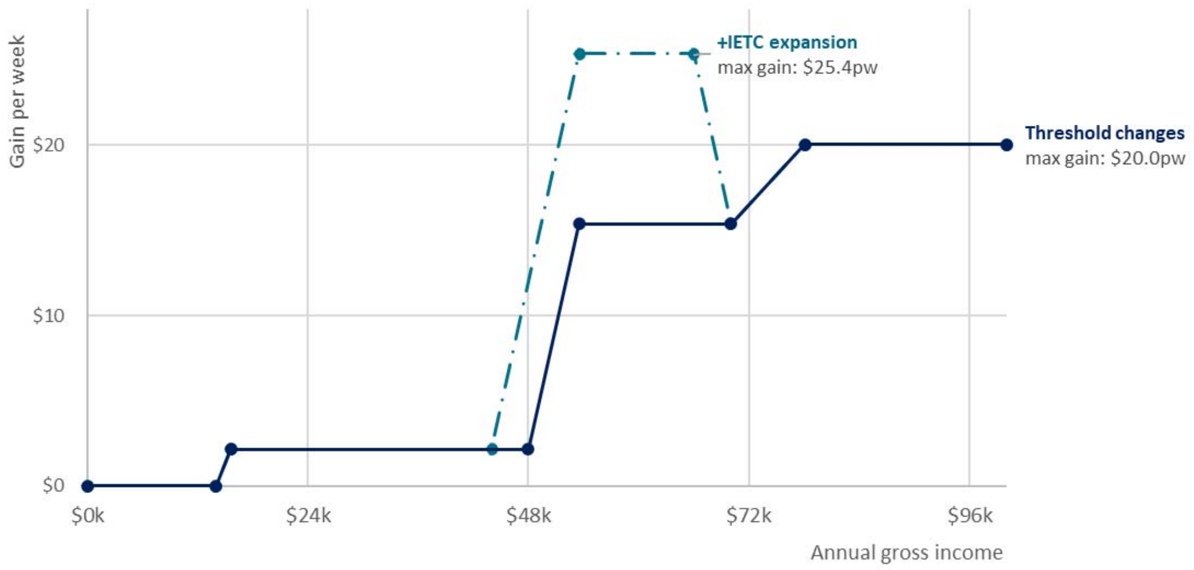
70. The timeline below informs you of key dates for upcoming Budget Ministers meetings and when actions are needed from you.

Timeline of key dates and actions for Budget Ministers meetings

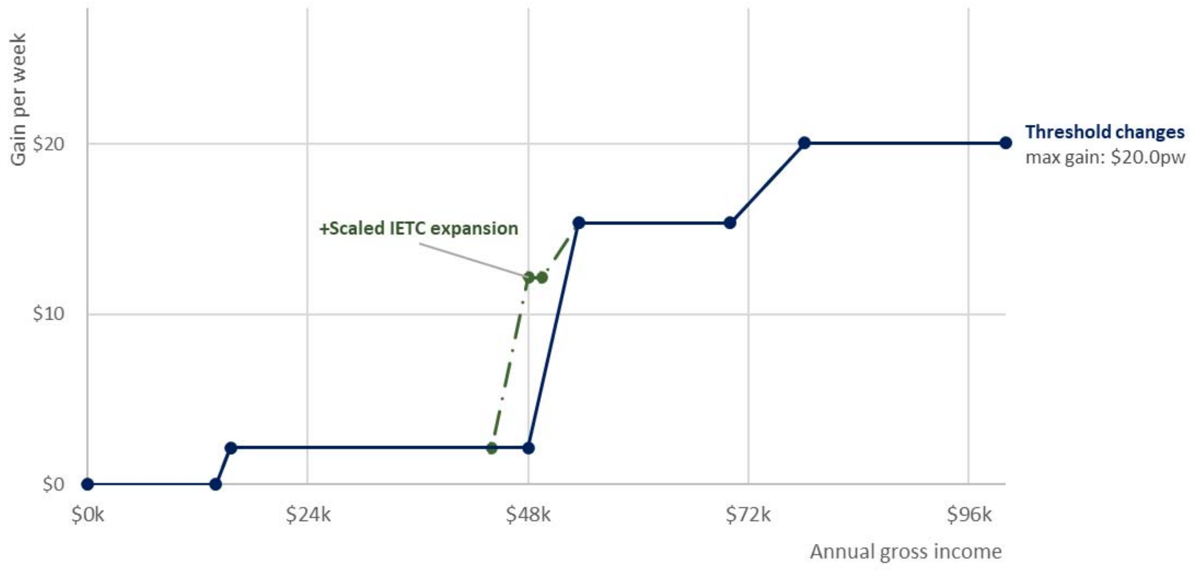
Date	Deadline	Action needed
Mon 26 Feb	Budget Ministers meeting 1	**Raise** fiscal picture and need for trade-offs with Budget Ministers.
Tues 27/ Weds 28 Feb	Decision on options for presentation at Budget Ministers meeting 2	**Decide** which of the scaling and timing options you would like to present at Budget Ministers 2, based on this paper and any feedback from Budget Ministers 1 . **Decide** if you want any additional scenarios modelled. If so, you should be able to see the results before Budget Ministers 2, though they won't be ready in time for you to present them at this meeting.
Thurs 29 Feb	Officials start work on any further modelling for Budget Ministers 2	**Commission** any further modelling you would like to see before Budget Ministers 2.
Mon 4 March	Officials submit papers for Budget Ministers 2 for your review. These include the scaling options you have chosen from this report.	None
Fri 8 March	Officials submit modelling results of any additional scenarios you have requested	None
Mon 11 March	Budget Ministers meeting 2	**Raise** options for scaling PIT package with Budget Ministers
Tues 12/ Weds 13 March	Decision on options for presentation at Budget Ministers meeting 3	**Decide** if there are any changes you would like to make to options or additional scenarios you would like to present at Budget Ministers 3, based on feedback from Budget Ministers 2 and results of any additional scenarios modelled.
Mon 18 March	Officials submit papers for Budget Ministers 3 for your review	None
Mon 25 March	Budget Ministers meeting 3	**Raise** options for scaling PIT package with Budget Ministers. **Decide** on key parameters of PIT package – PIT threshold changes, IETC and IWTC package, and implementation date - therefore confirming fiscal impact of tax changes. **Commission** final costings.
Fri 29 March	Officials submit report which details smaller decisions still to be made in relation to PIT – for example, decisions on consequential tax types.	**Decide** PIT package in totality. This will refine the costing of your final package by a small amount.
Mon 8 April and **Wed 10 April**	Budget Ministers meeting 4; and Budget Ministers meeting 5	No action on PIT. These meetings will be a clearing house for any final outstanding decisions on the Budget package – small and discrete items within a fixed funding envelope.

Appendix 1: Summary of gains

Gain per week: National tax plan thresholds and full IETC expansion



Gain per week: National tax plan thresholds and scaled IETC expansion



Appendix 2: Summary of costs

Note that the fiscal costs for the cost-saving options are indicative only, to inform decision making. Further work would be needed to produce final costings, and these could differ. Part of the variance in cost between the scaling/ delaying scenarios and the National PIT plan may therefore be due to methodological differences.

1 July 2024 implementation

Changes	$billions	2024/25	2025/26	2026/27	2027/28	Total OFP
Thresholds only	**National threshold changes only**	**-$1.82**	**-$2.51**	**-$2.56**	**-$2.49**	**-$9.39**
	- Scaled option 1 (retain bottom threshold)	-$1.57	-$2.19	-$2.26	-$2.21	**-$8.23**
	- Scaled option 2 (10% less for each threshold)	-$1.67	-$2.28	-$2.34	-$2.28	**-$8.58**
	- Scaled option 3 (50% less for $70,000 threshold)	-$1.69	-$2.30	-$2.36	-$2.29	**-$8.64**
Thresholds + IETC expansion	**National threshold changes + IETC expansion**	**-$1.99**	**-$2.72**	**-$2.75**	**-$2.68**	**-$10.14**
	- National threshold changes + scaled IETC	-$1.88	-$2.57	-$2.62	-$2.55	**-$9.62**
Full National personal tax plan	**National threshold changes + IETC expansion + IWTC**	**-$2.15**	**-$2.88**	**-$2.91**	**-$2.82**	**-$10.75**

1 October 2024 implementation

Changes	$billions	2024/25	2025/26	2026/27	2027/28	Total OFP
Thresholds only	**National threshold changes only**	**-$1.38**	**-$2.35**	**-$2.69**	**-$2.52**	**-$8.95**
	- Scaled option 1 (retain bottom threshold)	-$1.18	-$2.04	-$2.34	-$2.21	**-$7.77**
	- Scaled option 2 (10% less for each threshold)	-$1.25	-$2.12	-$2.44	-$2.28	**-$8.09**
	- Scaled option 3 (50% less for $70,000 threshold)	-$1.27	-$2.14	-$2.45	-$2.29	**-$8.14**
Thresholds + IETC expansion	**National threshold changes + IETC expansion**	**-$1.50**	**-$2.56**	**-$2.88**	**-$2.70**	**-$9.65**
	- National threshold changes + scaled IETC	-$1.41	-$2.39	-$2.73	-$2.55	**-$9.08**
Full National personal tax plan	**National threshold changes + IETC expansion + IWTC**	**-$1.62**	**-$2.72**	**-$3.04**	**-$2.85**	**-$10.22**

Disclaimer for distributional outputs from the Treasury's TAWA model

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.