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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Personal Income Tax – initial distributional analysis of wider package

Date:	8 March 2024	**Report No:**	T2024/598
		File Number:	SH-13-5-2-5-1-M102932

Action Sought

	Action Sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Note** the contents of the report **Note** that a further report will be provided ahead of Budget Ministers 3 that includes analysis of FamilyBoost **Refer** to the Minister of Revenue	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Laura Browne	Senior Analyst	[39]	[35]	✓
Michael Eglinton	Senior Modelling Analyst			
Jean Le Roux	Manager, Tax Strategy			

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

Treasury Report: Personal Income Tax – initial distributional analysis of wider package

Executive Summary

This report responds to your request for distributional analysis across the wider personal income tax package. Modelling of FamilyBoost was not available for this report and will be included in advice provided ahead of the third Budget Ministers meeting on 25 March. The wider personal income tax package modelled in this report consists of:

- lifting Personal Income Tax (PIT) thresholds to $15,600; $53,500; $78,100; $180,000,
- increasing the In-Work Tax Credit (IWTC) rate by $25 per week,
- [33]
- extending the income range for the Independent Earner Tax Credit (IETC) to $70,000.

Indicative fiscal costs of the combined package (including FamilyBoost) are estimated at [33]

Key insights from the distributional analysis

- Over 90% of all households gain from the package.[1] Households with children on average gain by more than households without children ($35 per week vs $26 per week).[2]
- To see the impact of the reforms across the household income distribution we group households that have similar levels of income after considering their household size and composition (e.g., children vs adults).[3] We then report the average change in disposable income for each group. Using this approach, the 20% of households with the highest incomes (controlled for size and composition) gain the most. On average these households gain by around $40 per week. This is roughly the same for households with and without children.
- The average gains for low-income households (i.e., bottom 40% by equivalised household income) with children are higher on average than for low-income households without children. Low-income households with children gain between $24-$30 per week on average, while households without children with equivalent incomes are only gaining between $9-$15 per week. This is largely due to the increase to the IWTC, which increases net incomes to eligible

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1 Households are defined as one or more people living together in a private dwelling and sharing facilities. A household could contain more than one family, which is defined as a single person or couple and any dependent children.

2 This is a measure of change in household disposable income. Note that while we have used equivalised household income to compare groups, the average gains and losses are not adjusted for household size or composition.

3 We group households based on their equivalised disposable income. Equivalised income considers incomes after accounting for taxes and transfers and uses equivalisation to allow for like-for-like comparisons across different household compositions. Two households with different compositions (e.g., a single person compared to a couple with two children) need different levels of income to meet the same standard of living. Equivalisation attempts to account for the additional income needed to support more people and also economies of scale due to shared housing costs, utilities, etc.

households with children by around $20 per week. Around 80% of households gaining from the IWTC increase are in the bottom two deciles.

- None of the changes are designed to support beneficiary households, or households with very low incomes. This results in around 150,000 low-income households either having no impact from the package or losing by less than $1 per week.
- [33]
- The IETC expansion will impact around 20% of all households. The majority of the households benefiting are in income quintile 3 and 4. [33]
- Just under 80% of individuals gain from the package, by an average of $15 per week. For these individuals that gain, the average gain is $5-$6 per week for those with incomes below $35,700 per week (bottom 40%), and $21 per week on average for those with incomes above $67,300 per week (top 40%). This is consistent with the design of the policies.
- The average gains per income quintile for men and women are the same. However, women are overrepresented in the bottom two income quintiles (where the average gains are $5-$6 per week) and are underrepresented in the top two income quintiles (where the average gain is $21 per week).
- While not yet modelled, households that gain from FamilyBoost are largely around the middle of the income distribution. This is because lower income households are less likely to be paying for childcare and higher income households are abated out.

Recommended Action

We recommend that you:

a **note** the contents of the report

b **note** that a further report will be provided ahead of BM 3 that includes FamilyBoost

c **refer** to the Minister of Revenue

Refer/Not referred.

Jean Le Roux
Manager, Tax Strategy

Hon Nicola Willis
Minister of Finance

_____/_____/_______

Treasury Report: Personal Income Tax – initial distributional analysis of wider package

Purpose of Report

1. This report responds to your request for distributional analysis across the wider personal income tax package. Modelling of FamilyBoost was not available for this report and will be included in advice provided ahead of the third Budget Ministers meeting on 25 March.

2. Therefore, the wider personal income tax package modelled in this report comprises:

   a lifting Personal Income Tax (PIT) thresholds to $15,600; $53,500; $78,100; $180,000,

   b increasing the In-Work Tax Credit (IWTC) rate by $25 per week,

   c [33]

   d extending the income range for the Independent Earner Tax Credit (IETC) to $70,000.

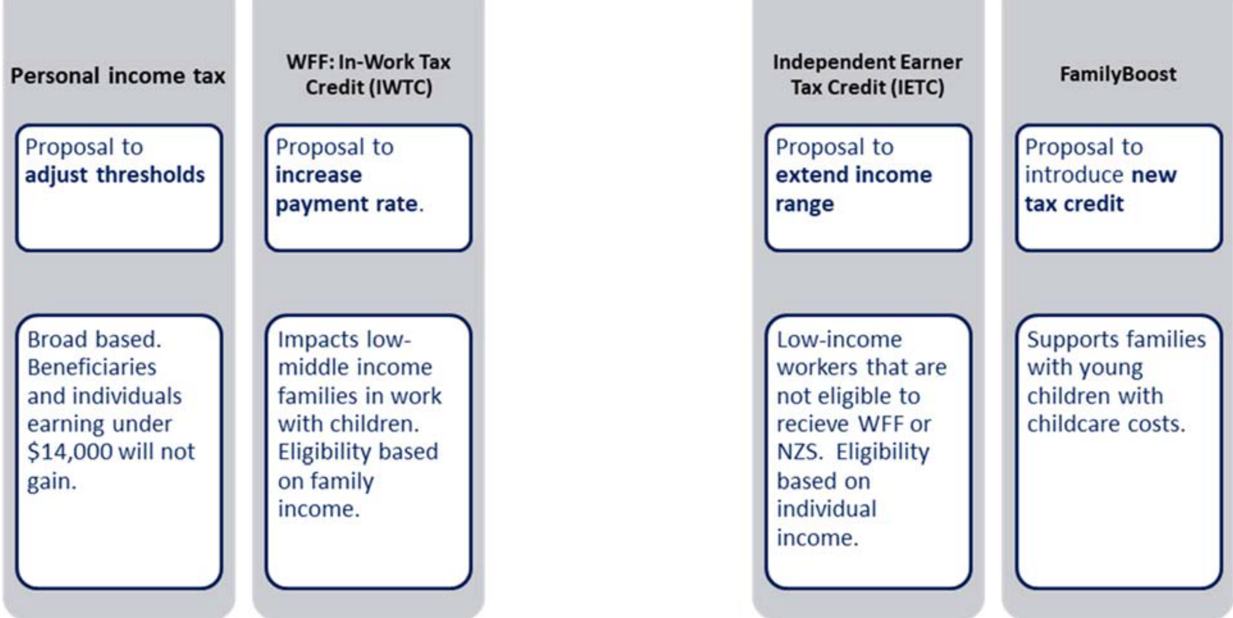
3. Modelling of impacts is shown for the year ended 31 March 2027. This ensures that all changes are fully reflected. Forecasts from the 2023 *Half Year Economic and Fiscal Update* are used as the baseline. The analysis has been produced quickly and includes assumptions that require further testing.

Overview

4. Several proposals under consideration for Budget 2024 will impact the net incomes of individuals and families. The analysis in this report helps understand the cumulative impact of these policies on individuals and households. Figure 1 below provides a high-level overview of the nature of the changes (row 1) and the cohort impacted by each proposal (row 2).

Figure 1 – Overview of proposals in the wider personal income tax package

[33]



Analysis of impact on households – combined package

5. This section looks at the impact of the wider personal income tax package on households. As noted, this analysis does not yet include the impact of introducing FamilyBoost.

6. Households are grouped into five even-sized quintiles[4] according to household equivalised income. Equivalisation controls for the size and composition (e.g., adults vs children) of different households to allow like-for-like comparisons of standard of living. For example, a household with two adults and two children (aged 15 and 12) would need to have disposable income of $100,000 to have the same standard of living as a single person earning $43,000. See Appendix 1 for further explanation.

7. The combined package (excluding Family Boost) will result in:

   a **1.798 million households** (90.5% of all households) <u>gaining</u> by an average of $29 per week. 1.689 million households (85% of households) gain by more than $5 per week. Households with children have higher average gains ($35 per week) than households without children ($26 per week). Table 1 below shows the average weekly gains and losses by income quintile and household type.

   b [33]

   c **143,000 households** (7.2% of all households) having <u>no change</u>. The majority of these households are in the bottom 20% of households by income and are likely in receipt of main benefits.

Table 1 – Average weekly gain from the combined package for households (HH) with and without children

Average weekly gain/loss ($)	**Share of HH**	**Quintile 1** (low)	**2**	**3**	**4**	**Quintile 5** (high)	**Total**
Households **gaining** <u>with</u> children	27%	$24	$30	$36	$42	$40	**$35**
Households **gaining** <u>without</u> children	64%	$9	$15	$26	$35	$39	**$26**
Households **losing** <u>with</u> children	[33]						
Households **losing** <u>without</u> children							

4 The first quintile contains the 20% of households with the lowest equivalised income and the fifth quintile contains the 20% of households with the highest equivalised income.

[33]

Analysis of impact on households – breakdown by package components

9. The previous section looked at the distributional impacts of the combined package. This section looks at the impact of individual components of the package, and then categorises the winners and losers across the combined package.

10. The PIT threshold changes, the increase to the IWTC, and the expansion of the IETC are all designed to increase net incomes. [33] Households can have their net incomes <u>increased or reduced</u> from a single component of the package, but the combination of changes is what determines whether they <u>gain or lose</u> from the overall package.

11. The individual package components impact households as follows:

    a. the **PIT threshold changes** will <u>increase</u> net incomes for 1.831 million households (93% of all households) by an average of $25 per week. These changes will also <u>reduce</u> net incomes for a further 9,000 households (0.5% of all households) by an average of $1 per week due to the part-year beneficiary issue explained in paragraph 7b above.

    b. The **IWTC increase** will <u>increase</u> net incomes for 160,000 households (8% of all households; 25% of households with children), including around 4,000 households that do not gain from the PIT threshold changes, by an average of $20 per week.

    c. [33]

    d. the **IETC expansion** will <u>increase</u> net incomes for 381,000 households (19% of all households) by an average of $10 per week.

12. The number of households impacted by the IETC expansion is dependent on the other changes in the package. [33]

    For individuals to receive the IETC, they must earn above $24,000 and below $70,000 (or $48,000 under the status quo), and not be eligible for Working for Families (e.g., the Family Tax Credit, IWTC or BSTC).[6] Eligibility for Working for Families is based on a family income test.

13. The IWTC increase will slightly extend the income range where families are eligible (by just under $5,000), [33]

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5 [33]

6 To be eligible for the IETC, individuals also cannot receive an income-tested benefit, New Zealand Superannuation, a Veteran's Pension, or an overseas equivalent of any of these.

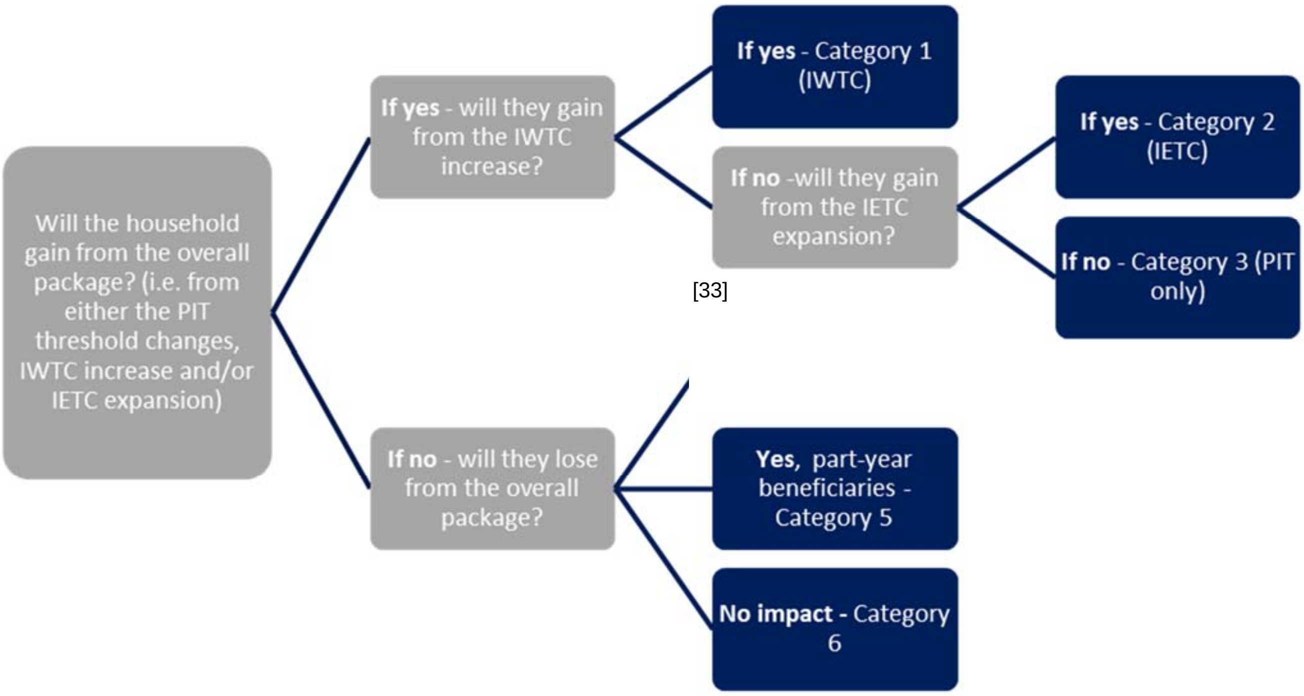
14. The modelling shows that around 11,000 households will only see an increase in their net income from the IETC expansion [33] . The modelling also shows that there are around 25,000 households impacted by both the IETC expansion and IWTC increase. There are a number of reasons this could be the case, including multiple families living in one household, or being eligible at different points in the year.

Categorising households by primary reason they are gaining or losing

15. As noted, households may see an increase or decrease in their net income as a result of more than one of the changes. The following section separates all households into **six mutually exclusive categories** based on the *primary* reason they are gaining or losing from the combined package. This allows us to show the distributional impact of the changes.

16. Figure 3 below presents a decision tree for how these categories have been defined. This prioritised approach means that households will only appear in one category. This means that all households in category 2 (IETC) are benefiting from the IETC changes, but only around 93% of households benefiting from the IETC changes are in category 2. The 25,000 households benefiting from both the IWTC increase and IETC extension appear in category 1.

Figure 3 – Decision tree for defining household impact categories



17. Figure 4 shows the breakdown by categories and income for all households, households with children, and households without children. [33]

Appendix 2 includes this information in table form.

[33]

18. The impacts on households from the personal income tax package by category are as follows:

a **Category 1 (gaining primarily from IWTC increase) – 160,000 households.** Around a quarter of households with children are gaining primarily from the IWTC increase. This change is well targeted to lower-income households, with around 80% of households in this category in the bottom two income quintiles.

b **Category 2 (gaining primarily from IETC expansion) – 356,000 households.** In contrast, only around 20% of households in category 2 are in the bottom two income quintiles. Around two thirds of households gaining primarily from the IETC expansion are in income quintiles 3 and 4. These households are less concentrated as it is based on an individual income test. For households with children to gain from the IETC expansion, they must have someone in the household with *individual* income below $70,000, but *family* income above the WFF cut-out point, which varies by number of children – see table 2 below.

Table 2 – Working for Families income thresholds

Number of children	**1 child over 3**	**1 child under 3**	**2 children**	**3 children**	**4 children**	**5 children**	**6 children**
WFF cut-out point with IWTC increase	$89k	$97k	$112k	$135k	$160k	$186k	$212k

c **Category 3 (gaining from PIT changes only)** – **1.282 million households**. A higher share of households without children (approximately three quarters) are gaining only from the PIT changes, compared with households with children (around two in five). Households in the top income quintile are more likely to be in this category.

d [33]

e **Categories 5 and 6 (losing from overall package or no impact) – 9,000 households losing, 143,000 no impact.** These two categories are mostly beneficiary households in the lowest income quintile.

19. While not yet modelled as part of the package, households that gain from FamilyBoost are largely around the middle of the income distribution. This is because lower income households are less likely to be paying for childcare and higher income households are abated out. We do not know at this stage whether this change will reduce the number of losing households in the package, or just increase the gains for a subset of households.

Analysis of individuals – combined package

20. While previous sections have focused on the impact on households, this section looks at the impact of the combined package on individual incomes. We have also included a gender breakdown. At this stage we have not modelled the components separately.

21. Individual income quintiles are grouped by taxable income, which includes main benefit income, NZ Super, and other taxable benefits. Gains and losses are expressed in changes to disposable income, which is total after-tax income including transfers. The modelling approach assumes that changes based on family income are split evenly between partners – e.g., an individual in a couple receiving the IWTC is assumed to receive half of the IWTC increase.

22. The combined package (excluding Family Boost) will result in:

    a **3.371 million individuals** (79.3% of individuals) gaining by an average of $15 per week. 67% of individuals gain by more than $5 per week. The number of people gaining is evenly split between men and women, though average gains are lower for women ($14 vs $16 per week).

    b [33]

    c **765,000 individuals** (18% of individuals) having no change. A slightly larger share of this group are female (55% vs 45%).

23. The average gains and losses by individual income quintile are shown below in Table 3. The table also includes the income range for each quintile. The average gains increase with income; however, the average losses are not as clearly correlated with income. [33]

24. The average gains per income quintile for men and women are the same. However, women are overrepresented in the bottom two income quintiles (where the average gains are $5-$6 per week) and are underrepresented in the top two income quintiles (where the average gain is $21 per week). This is what leads to the slight difference in averages noted above.

Table 3 – Average gains and losses by individual income quintile

Average weekly gain/loss ($)	**Quintile 1** (low)	**2**	**3**	**4**	**Quintile 5** (high)	**Total**
Current income range	*$0-22.4k*	*$22.4-35.7k*	*$35.7-67.3k*	*$67.3-106.4k*	*$106.4k +*	
% population female	**55%**	**58%**	**58%**	**45%**	**37%**	**51%**
Average weekly **gain**	$5	$6	$16	$21	$21	**$15**
Average weekly **loss**	[33]					

25. Figure 5 shows the distribution of individual impact by gender and income quintile. The large share of people with no impact in the bottom quintile is likely to be mostly individuals with incomes under $14,000 or beneficiaries.

[33]

Fiscal impact

26. The combined package (including FamilyBoost) will cost approximately [33] per year (though lower in 2024/25 at [33] with a total cost of [33] over the forecast period (OFP). Table 4 summarises the fiscal impact of the overall package including FamilyBoost.

27. Fiscal costings are indicative only to inform decision making, and final costings of the overall PIT package will be subject to change. Note that there may be interactions between the policies that may not be accounted for in these costings, although the fiscal impact of these is likely to be relatively small.

28. In 2027/28, the cost of the package is comprised of:

    a $2.49 billion for the threshold changes,

    b [33]

    c $0.17 billion for FamilyBoost.

Table 4 – Summary of fiscal cost of components ($billions)

Component	2024/25	2025/26	2026/27	2027/28	Total OFP
PIT changes: 1 July 2024	$1.82	$2.51	$2.56	$2.49	**$9.39**
IETC expansion: 1 July 2024	$0.17	$0.21	$0.19	$0.18	**$0.75**
IWTC increase: 1 July 2024	$0.16	$0.16	$0.15	$0.15	**$0.62**
[33]					
FamilyBoost: 1 July 2024	$0.17	$0.17	$0.17	$0.17	**$0.68**
[33]					

29. Officials have provided options to reduce the cost of the PIT, IETC, and IWTC changes [T2024/419 - IR2024/072 and IR2024/032 refer]. Options that will reduce the cost of the package and change distributional outcomes are summarised below in Table 5:

Table 5 – Options to reduce the fiscal cost of the personal income tax package

Policy	Description of scaling option	Saving in 2027/28	Saving OFP
PIT	Retain bottom threshold	-$0.28b	**-$1.16b**
PIT	10% less for each threshold	-$0.21b	**-$0.81b**
PIT	50% less for $70,000 threshold	-$0.20b	**-$0.75b**
IETC	Scaling the expansion of IETC to $53,500	-$0.12b	**-$0.52b**
IWTC	Reducing the IWTC increase to $15 per week	-$0.06b	**-$0.25b**
[33]			

Next steps

30. Officials will send a further report that includes distributional modelling of FamilyBoost in the week of 18 March. The table below provides a timeline of key decisions relating to the tax package.

Date	Milestone	Action sought
Tues 12/Wed 13 March	Decision on options for presentation at Budget Ministers meeting 3	**Decide** if there are any changes you would like to make to PIT options or additional PIT scenarios you would like to present at Budget Ministers 3. Note that officials require a minimum of 5 working days to provide modelling of new PIT scenarios.
Mon 18 March	Officials submit papers for Budget Ministers 3 for your review	None
Mon 25 March	Budget Ministers meeting 3	**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.

Appendix 1: Equivalised Household Income

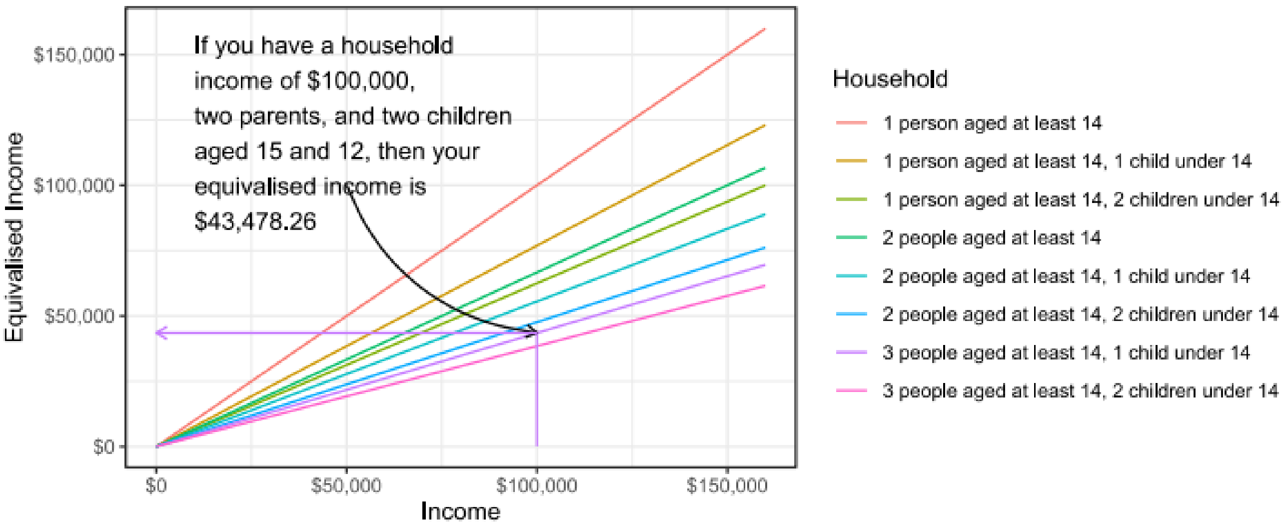
A household is defined as one or more people living together in a private dwelling and sharing facilities. A household could contain more than one family, which is defined as a single person or couple and any dependent children.

Households are grouped according to equivalised income, which allows like-for-like comparisons of standard of living across households of different sizes and compositions (e.g., adults vs children). The larger the household, the more income is needed to achieve the same standard of living since it is being shared between more people. Focusing on equivalised income controls for this effect and allows the distributional impacts of the tax package to be expressed in a consistent way.

Figure 6 demonstrates the concept graphically. For a household of one adult, equivalised income (vertical axis) is equal to actual income (horizontal axis). However, a household with the same actual income that is made up of two parents and two children would have a significantly lower equivalised income.

Note that while we have used equivalised household income to compare groups, the average gains and losses included in this report are not adjusted for household size or composition.

Figure 6 – Equivalised household income



Source: Treasury Analytical Note 23/01, Trends in the household income distribution 2007-2021

Appendix 2: Data tables for household impact categories

The following table shows the number of households by category.

		All households	Households with children	Households without children
Gaining	Category 1: IWTC	160,000	160,000	-
	Category 2: IETC	356,000	97,000	259,000
	Category 3: PIT only	1,282,000	271,000	1,012,000
Losing	[33]			
No impact				

The following table shows the share of households by category and income quintile for all households, households with children, and households without children. Shading indicates a higher share.

		Quintile 1 (low)	2	3	4	Quintile 5 (high)	Total
All Households		**20%**	**20%**	**20%**	**20%**	**20%**	**100%**
Gaining	Category 1: IWTC	2.3%	4.2%	1.0%	0.3%	0.1%	**8.1%**
	Category 2: IETC	0.5%	3.2%	5.7%	5.9%	2.7%	**17.9%**
	Category 3: PIT only	11.6%	10.7%	12.3%	13.1%	16.8%	**64.5%**
Losing	[33]						
No impact							

[33]

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.