Regulatory Impact Statement: Personal income tax relief

Coversheet

Purpose of Document	
Decision sought:	Agree to progress the personal income tax changes in the Budget 2024 Cabinet Paper.
Advising agencies:	The Treasury, Inland Revenue
Proposing Ministers:	Minister of Finance (Hon Nicola Willis)
Date finalised:	24 April 2024

Problem Definition

When prices and incomes rise from generalised inflation and wage growth, but nominal income tax thresholds remain unchanged, individuals end up paying a larger proportion of their income in tax. Over time, this may result in the amount of tax being paid at different income levels not aligning with the Government's intentions.

Executive Summary

The desired amount of tax paid at different income levels is a judgement for ministers to make and will depend on their goals for progressivity in the personal income tax (PIT) system, revenue needs, and economic goals.

Both the National Party and the ACT Party announced plans for PIT relief during the 2023 general election, with relatively similar objectives of compensating for fiscal drag, increasing the financial return to work, and increasing after-tax incomes. The ACT party also had the goal of flattening and simplifying the personal income tax system by reducing the number of tax rates and thresholds. In the National-ACT coalition agreement, a commitment was made 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."

Given the commitments made by parties in the coalition Government during the 2023 election and the compressed timeframe for decisions, officials focused on the plans put forward by the National and ACT parties during the election and variations on these plans. The income tax changes proposed by National and ACT are set out in the table below.

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

The ACT plan would be phased in over several years, with the final settings in the table being implemented from 1 April 2026. This would be combined with a Low- and Middle-

Income Tax Credit (“the tax offset”), which would be paid out at time of taxation to compensate for a higher bottom tax rate. The National plan would be effective from 1 July 2024 and also includes lifting the abatement threshold of the Independent Earner Tax Credit (IETC) from $48,000 to $70,000.

Officials also considered two variations on the ACT plan that make less significant changes to the thresholds and rates, as well as an alternative to the ACT plan that can be achieved at a lower fiscal cost while still achieving the objective of simplifying the personal income tax system by reducing the number of tax rates and thresholds. Three cost-saving variations on the National plan were also considered.

Officials judge that the National plan effectively addresses the policy problem of fiscal drag while having minimal negative consequences on other policy objectives. The plan does involve a significant fiscal cost. The ACT plan delivers larger efficiency gains but at a much larger fiscal cost, while also producing significant administrative effort by introducing a new tax offset. Officials therefore support the broad approach of the National plan, with the following further recommendations:

i. consider cost-saving alternatives to the plan to support a return to surplus,

ii. delay implementation to 1 October 2024 to reduce the fiscal cost, minimise administrative demands for Inland Revenue and ensure all taxpayers receive the benefit of the tax changes on time,

iii. do not proceed with the proposed IETC expansion. The longstanding view of officials has been that the objective of improving work incentives could be achieved more effectively by removing the IETC and making other changes to tax and transfer settings for the same fiscal cost. See T2017/164: Removing the Independent Earner Tax Credit[1] for further discussion of the IETC, and

iv. prevent the tax changes flowing through to student allowances. Alignment with the benefit system is a principle of the student support system, and since main benefits will not increase from the tax changes, the same approach should be taken for student allowance.

The Cabinet Paper recommends progressing the National plan, with an implementation date of 31 July 2024. This involves a large reduction in Crown revenue over the forecast period, estimated at $10.3 billion. This cost could be reduced by around $1 - 2 billion through the cost-saving variations suggested by officials.

The reduction in Crown revenue corresponds to an equivalent increase in the disposable income of taxpayers, owing to the reduction in tax levied on personal income. This may result in small efficiency benefits to the wider economy.

The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that CIPA requirements do not apply to this proposal as it not expected to result in any significant, direct emissions impacts.

[1] https://www.treasury.govt.nz/sites/default/files/2017-11/b17-3659148.pdf

Limitations and Constraints on Analysis

Given the commitments made by parties in the coalition Government during the 2023 election and the compressed timeframe for decisions, officials focused on the policies proposed by the National and ACT parties and modifications to these.

Officials consulted with private sector software providers and payroll service providers to understand the timeframes needed to make PIT changes. Broader consultation, including with Māori stakeholders, was limited owing to the Budget sensitive nature of the policy advice. However, the 2023 general election provided sufficient public engagement on the broad approach to tax relief proposed by the National and ACT parties. Previous public engagement by the Tax Working Group in 2018 revealed support for adjusting PIT thresholds in line with inflation, on the grounds that this would increase progressivity and compensate for the impacts of fiscal drag, which was viewed by some as an unprincipled and untransparent tax increase.

Distributional impacts of the policy options were assessed using the Treasury's Tax and Welfare Analysis (TAWA) model. Modelling results are based on survey data and cannot capture the actual situation of every household in New Zealand, meaning there are likely to be impacts from the package that are not reflected in the modelling outputs provided to ministers. The estimated fiscal costs also involve some uncertainty but can be used as a guide for decision making.

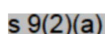
This regulatory impact statement focuses on changes to PIT thresholds and the IETC. Other policy changes for Budget 2024 that relate to household incomes, including Working for Families and the FamilyBoost policy, are covered in separate regulatory impact statements.

Responsible Manager

Tim Hampton

Director, Economic System

The Treasury



24 April 2024

Quality Assurance

Reviewing Agency:	The Treasury, Inland Revenue
Panel Assessment & Comment:	*The Quality Assurance reviewers at Treasury and Inland Revenue have reviewed 'Regulatory Impact Statement: Personal income tax relief' and consider that the information and analysis summarised in it partially meets the quality assurance criteria of the Regulatory Impact Statement framework.* *The RIS applies a comprehensive tax policy framework to assess the options considered for these personal income tax changes, against the Government's stated objectives for the package. This includes*

	presentation of a range of quantitative analysis of the key fiscal and distributional elements of the package. *The key reason the assurance panel considers this RIS does not fully meet the RIS criteria is the absence of public consultation on the specific proposals/options beyond discussions with private sector software providers and payroll service providers. Although the pre-election policies of all the parties forming the current Government included tax cuts, the specific proposals that are the subject of this RIS have not been formally consulted on. However, the Panel does acknowledge the limitations associated with the Budget-sensitive nature of these proposals.*

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. New Zealand’s progressive personal income tax (PIT) system means individuals pay higher marginal tax rates as their incomes rise above certain income thresholds. When prices and incomes rise from generalised inflation and wage growth, but nominal income tax thresholds remain unchanged, individuals end up paying a larger proportion of their income in tax.
2. The structure of the PIT system was most recently changed in 2021, with the introduction of a 39% rate for income over $180,000. All other rates and thresholds have been in place since 1 October 2010. Personal incomes have risen since that time, leading to higher average tax rates on personal income. The current rates and thresholds are shown in Table 1.

Table 1: Current personal income tax rates

For each dollar of income	Tax rate
Up to $14,000	10.5%
Over $14,000 and up to $48,000	17.5%
Over $48,000 and up to $70,000	30%
Over $70,000 and up to $180,000	33%
Over $180,000	39%

3. This phenomenon of rising incomes and fixed tax thresholds, known as “fiscal drag”, increases the amount of PIT revenue collected and has been a significant means by which governments have addressed growing fiscal pressures since 2010.
4. 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%.
5. The median full-time wage and salary worker earned $48,024 in the year ended June 2011 and paid $7,427 in personal income tax. In the year ended June 2023, the median full-time wage and salary worker earned $73,417 and paid $15,148 in personal income tax. 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. Their marginal tax rate also increased from 30% to 33%.
6. To completely offset the impact of fiscal drag for the median earner, personal income tax thresholds would have to be lifted by the same proportion that the median wage has increased, i.e., by 53%. This would substantially reduce the revenue collected by the personal income tax system and would likely not be a fiscally sustainable option.
7. If adjustments to PIT thresholds are not made, fiscal drag is projected to continue in the future as incomes continue to grow. In the 2024 Half Year Economic and Fiscal Update, average wages were forecast to increase by 16.6% between 2024 and 2028.
8. As more earners move into the higher tax brackets, there is a broad flattening in the taxation of incomes and the progressivity of the PIT system decreases. With the increase in the minimum wage to $23.15 per hour from 1 April 2024, a minimum-wage earner working 40 hours per week will earn $48,284 per year. This means that under

current settings, all full-time earners will have a marginal tax rate (the rate they pay on an additional dollar of income) of 30% or more and the most progressive stages of the personal tax system will be below the level of the full-time minimum wage.

9. Similar impacts can be seen for tax credits that have fixed income thresholds where credits start to abate. The Independent Earner Tax Credit (IETC) was introduced in 2009 to provide a targeted tax reduction of up to $520 per year to earners between $24,000 and $48,000 who do not receive other transfer payments. The IETC abates at a rate of 13 cents for every dollar earned over $44,000 and fully abates at $48,000. These abatement thresholds have not been adjusted in the 15 years since the IETC was introduced, meaning the target population has changed significantly.

10. For example, a full-time worker on the minimum wage in 2009 earned around $26,000 and would have received the full IETC payment assuming they met other eligibility requirements. In 2024, an individual working 40 hours per week on the minimum wage would earn just over the income limit of $48,000 and would not receive the IETC.

What is the policy problem or opportunity?

11. As described above, fiscal drag has the potential to erode the progressivity of the personal income tax system and has other 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 occurring as the $48,000 income threshold is crossed. Full-time minimum wage earners will therefore be heavily affected in coming years.
    - 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.

12. The desired level of progressivity in the PIT system is a judgement for ministers to make. Any decision to address fiscal drag by adjusting PIT thresholds will also depend on the revenue needs of the Government and their economic goals.

What objectives are sought in relation to the policy problem?

13. In the National-ACT coalition agreement, a commitment was made 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."

14. Both the National Party and the ACT Party announced plans for PIT relief during the 2023 general election, with the stated objectives as summarised in Table 2.

15. The New Zealand First Party also campaigned on tax relief in response to fiscal drag, and a commitment was made in the National-New Zealand First coalition agreement to, "by or before 2026, assess the impact inflation has had on the average tax rates faced by income earners."

Table 2: Objectives for PIT relief

National Party objectives	ACT Party objectives
compensate for the impact of fiscal drag on average tax rates	encourage work, saving and investment (including by reducing the top tax rate)
increase after-tax incomes, particularly for middle-income New Zealanders	flatten and simplify the personal income tax system by reducing the number of tax rates and thresholds
ensure there is a greater financial return from work	

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

16. Officials use the principles in Table 3 to assess the impact of tax policy changes. These principles broadly encapsulate the objectives described in Table 2 (e.g., the objective of encouraging work, saving and investment is included in the principle of efficiency and productivity). The weight given to each principle (priorities and trade-offs) is a value judgement for ministers to make.

17. In particular, trade-offs must be made between the first three principles. For example, using tax to redistribute income from higher earners to lower earners will likely have negative impacts on economic efficiency, while targeting efficiency gains by reducing tax rates would have a negative impact on fiscal sustainability. It is unlikely that all three objectives could be targeted with the same policy.

Table 3: Principles used to assess tax policy changes

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.
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.
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.
Integrity	Changes to tax rates and marginal tax rates can impact perceptions of fairness in the tax system and taxpayers' willingness to comply.
Macroeconomic impacts	Impacts of options could be considered in the context of the macroeconomic environment, e.g., capacity constraints and inflation.
Administrative / compliance costs	Officials favour options that minimise administration and compliance costs for software providers, employers, and earners.

What scope will options be considered within?

18. Both the National Party and the ACT Party announced plans for PIT relief during the 2023 general election. The income tax changes proposed by National and ACT are set out in Table 4 below. Given the commitment made in the National-ACT coalition agreement (see paragraph 13), officials focused on the proposals put forward by these two parties.

    a. The ACT manifesto plan would be phased in over several years, with the final settings in the table being implemented from 1 April 2026. This would be combined with a Low- and Middle-Income Tax Credit ("the tax offset"), which would be paid out at time of taxation to compensate for a higher bottom tax rate.

    b. The National manifesto plan would be effective from 1 July 2024 and also includes lifting the abatement threshold of the IETC from $48,000 to $70,000.

Table 4: National and ACT Party personal income tax policies

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

19. Given the commitments made by parties in the coalition Government during the 2023 election and the compressed timeframe for decisions, officials focused on the policies in Table 4 and modifications to these.

What options are being considered?

Option One – *Status Quo*

20. The status quo PIT thresholds are set out below.

Marginal rate	Upper threshold
10.5%	$14,000
17.5%	$48,000
30.0%	$70,000
33.0%	$180,000
39.0%	-

Option Two – *National manifesto plan*

21. The uplifted thresholds announced by the National Party during the 2023 general election are set out below. The National plan also includes lifting the abatement threshold of the IETC from $44,000 to $66,000.

Marginal rate	Upper threshold
10.5%	$15,600
17.5%	$53,500
30.0%	$78,100
33.0%	$180,000
39.0%	-

Option Three – *ACT manifesto plan*

22. The phased threshold changes announced by the ACT party during the 2023 general election are set out below. The plan also includes a tax offset to compensate for a higher bottom tax rate. The changes are phased in as follows:

    i. From 1 April 2024, the 10.5% marginal rate is removed and the threshold for the 17.5% rate is lifted to $60,000

    ii. From 1 April 2025, the 33% marginal rate is removed

    iii. From 1 April 2026, the 39% marginal rate is reduced to 33%.

<table>
<tr><th>Upper threshold</th><th>Status quo</th><th>2024/25</th><th>2025/26</th><th>2026/27</th><th>2027/28</th></tr>
<tr><td>$14,000</td><td>10.5%</td><td colspan="4" rowspan="3">17.5%</td></tr>
<tr><td>$48,000</td><td>17.5%</td></tr>
<tr><td>$60,000</td><td rowspan="2">30%</td></tr>
<tr><td>$70,000</td><td>30%</td><td colspan="3" rowspan="2">30%</td></tr>
<tr><td>$180,000</td><td>33%</td><td>33%</td></tr>
<tr><td>+</td><td>39%</td><td colspan="2">39%</td><td colspan="2">33%</td></tr>
</table>

23. After the ACT-National coalition agreement made a commitment to no earner being worse off than they would be under National’s plan, two variations on the ACT plan were considered at the request of ministers:

    a. Retain the 2024/25 settings in the ACT plan, without any further changes in subsequent years.

    b. Retain the 2024/25 settings in the ACT plan for the first two years, and then remove the 33% rate in 2026/27 (but retain the 39% rate).

24. These options included a tax offset with the following parameters:

    i. Phase in at 10 cents for every dollar earned between $1000 and $11,000 up to a maximum offset of $1,000.

    ii. Abate at 10 cents for every dollar earned between $48,000 and $58,000.

Option Four – *Alternative option to simplify the tax system (“Alternative plan”)*

25. Officials developed an alternative plan to achieve the objective of simplifying the tax system by reducing the number of tax rates and thresholds, but that could be achieved at a lower fiscal cost. This plan was developed by officials as an illustration of what could be achieved within these parameters.

26. The alternative plan combines the first two thresholds under a 14.5% rate and the next two thresholds under a 32.5% rate, leaving three tax thresholds overall. This option retains the 39% top tax rate and does not include a tax offset or extension to the IETC.

Marginal rate	Upper threshold
14.5%	$53,500
32.5%	$180,000
39.0%	+

Option Five – *Cost-saving alternatives to National plan*

27. Officials developed three alternative cost-saving options to the National plan, as set out below. These options all retain the basic approach of the National plan but make relatively small adjustments to different aspects of it.

	Option 2 *National plan PIT threshold changes*	**Option 5a** *National plan but retain bottom threshold*	**Option 5b** *National plan but 10% less for each threshold*	**Option 5c** *National plan but 50% less for $70,000 threshold*
10.5% rate	$15,600	**$14,000**	**$15,400**	$15,600
17.5% rate	$53,500	$53,500	**$53,000**	$53,500
30% rate	$78,100	$78,100	**$77,300**	**$74,000**
33% rate	$180,000	$180,000	$180,000	$180,000

28. Further to these alternatives, additional savings could be achieved by:
    a. delaying implementation of the plan to 1 October 2024 (from 1 July 2024)
    b. scaling the IETC expansion (i.e., a smaller increase to the threshold)
    c. retaining the current settings for the IETC (i.e., no increase to the threshold)

How do the options compare to the status quo/counterfactual?

	Option 2 ***National plan***	**Option 3** ***ACT plan***	**Option 4** ***Alt plan***	**Option 5a** ***Cost-saving***	**Option 5b** ***Cost-saving***	**Option 5c** ***Cost-saving***
Fiscal impact/ sustainability	- -	- - -	- -	-	-	-
Efficiency and productivity	+	+ +	+	+	+	+
Distributional impacts/equity	*na*	*na*	*na*	*na*	*na*	*na*
Integrity	+	+	0	+	+	+
Macroeconomic impacts	0	0	0	0	0	0
Administrative/ compliance costs	0	- -	-	0	0	0
Overall assessment	+	-	0	+	+	+

29. **Fiscal impact:** All options significantly reduce tax revenue over the forecast period (OFP). This policy analysis was prepared in the context of the Government's intention to fund this package from within Budget 2024 allowances, which was advised by the Treasury in its Briefing to the Incoming Minister of Finance in 2023 and is consistent with the objective of fiscal sustainability. Therefore, these packages would be considered fiscally sustainable when looked at in the wider context of the Budget decisions they are being taken in – as long as they are not so costly that it would no longer be possible to fund within allowances. However, the Treasury has advised the Government to reduce the cost of Budget 2024, and where possible to support a return to surplus. Whilst all the plans would therefore be viewed as fiscally sustainable in theory, there was a difference in cost, which may impact the feasibility of funding some of the plans within Budget 2024 allowances, and consistency with the goal of returning to surplus:

    - Option 3 has the largest impact of at least $15 billion OFP ($6.1 billion in 2027/28).
    - Option 2 and Option 4 have impacts of around $10-11 billion OFP ($2.8 billion in 2027/28).
    - Options 5a, 5b and 5c have the smallest impact of around $8-9 billion OFP ($2.2 - $2.3 billion in 2027/28).
    - The two variations on Option 3 cost around $6 billion (3a) and $12 billion (3b) OFP, and $1.8 billion (3a) and $5.0 billion (3b) in 2027/28.

30. **Efficiency:** Personal income tax has a negative impact on economic efficiency to the extent that it affects people's income earning decisions (in other words, distorting behaviour). All options would be expected to have positive impacts on efficiency by reducing the amount of tax levied on personal income, thereby decreasing distortions to work, investment and savings decisions. The removal of the 39% rate in Option 3 would have a relatively larger impact per dollar of fiscal cost, but the limited population affected would mitigate the aggregate benefits.

    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. This could have positive implications for overall labour supply and the productive capacity of the economy. Other factors will also contribute to a person's decision to work, however, so it is uncertain whether they will respond to increased incentives, and we have not formally modelled the impact of the options on overall labour supply. Annex 1 contains analysis of the impact of the options on EMTRs.

    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. 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.

31. **Distributional impacts:** Each option has different distributional impacts, with Options 3 and 4 being more targeted to reducing tax for higher-income earners, and Options 2 and 5 being more targeted to middle-income earners and those impacted by fiscal drag. As the desirability of a particular income distribution is a judgement for ministers, officials do not comment on whether an option is preferable regarding distributional impacts. Annex 2 contains analysis of the distributional impacts of the options.

Option 2 is most directly targeted towards addressing fiscal drag, as it makes proportional increases to all of the PIT thresholds that were in place in 2010, thus achieving the exact opposite effect as fiscal drag. The PIT threshold adjustments in Option 2 would reduce the annual tax liability of someone earning the 2023 median full-time wage ($73,417) by $902, reducing their average tax rate by 1.2 percentage points to 19.4%. This compensates 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.

Fully compensating for the accumulated fiscal drag since 2011 would therefore require an adjustment to PIT thresholds around four times larger than the adjustments in Option 2, which would likely increase the cost by a similar proportion. This would not be a fiscally sustainable option without substantial changes to government spending and/or revenue in other areas.

Adjustments to personal income tax thresholds will have flow-on impacts to other components of the tax and transfer system:

a. New Zealand Superannuation rates will increase due to both the direct impact of the PIT threshold adjustments and the indirect impact of being tied to the net average wage.

b. Student allowances will *increase* as the rates are set gross in legislation.

c. Main benefits will be *unaffected* by the tax changes as the rates are set net of tax in legislation.

32. **Integrity:** 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 from Options 2 and 5. Option 3 would also be expected to improve integrity by reducing the gap between the company tax rate and the top personal tax rate, thereby reducing incentives for tax avoidance.

33. **Macroeconomic impacts:** Treasury modelling shows that tax relief funded through an increase in government debt is expected to put some upward pressure on inflation and therefore interest rates. However, if tax relief is funded through an equivalent decrease in government spending, then the overall effect is a slight decrease in modelled interest rates. This is because the "fiscal multiplier" for tax relief is assumed to be lower than for government spending, meaning the decrease in government spending more than offsets the increase in spending by recipients of tax relief. To the extent that tax relief is funded within Budget 2024 operating allowances, a slight decrease in inflation pressures and therefore slightly lower interest rates would be expected.

34. **Administrative and compliance costs:** Options 2 and 5 are relatively simple changes to the PIT system and would have minimal impacts on administrative and compliance costs. However, implementation in the middle of the tax year would place one-off costs on Inland Revenue, employers and third-party payroll providers. Option 4 would be more complex owing to the changes in marginal tax rates.

Option 3 would be the most complex change owing to the introduction of the tax offset (a tax credit paid out at the time of taxation); effectively compensating for the higher bottom marginal tax rate. Introducing the offset would create substantial costs for private and public sector payroll providers and Inland Revenue. For taxpayers, the offset would likely lead to more end-of-year tax bills and place additional burden on those who have more than one source of income and the income from the secondary source occurs in the abatement zone for the tax offset. Those with a second job would

have to apply for tailored tax codes each year as the abatement zone is not reflected in the secondary tax codes.

35. **Other government commitments:** The ACT-National Coalition Agreement made a commitment to no earner being worse off than they would be under National's plan (Option 2). Option 3 – the ACT manifesto plan – did not meet this test, even with the use of a tax offset to compensate for the higher bottom tax rate. Variations on this plan – Options 3a and 3b – were developed in order to meet this test, but the use of the tax offset in these plans was considered to be a complex change that contradicted the aim of simplifying the tax system. Options 4, 5a, 5b and 5c also did not meet this test, although to a lesser degree than Option 3.

    In general, it would not be possible to deliver greater tax relief at some parts of the income spectrum compared to Option 2, while also ensuring no earner is worse off, without increasing the fiscal cost compared to Option 2.

36. **Overall assessment:** Options 2 and 5 are considered to be positive changes overall. They go some way to addressing the impacts of fiscal drag and have minimal negative consequences apart from the large fiscal cost. Insofar as ministers are willing to trade off the fiscal cost to meet their other objectives and can manage the cost within Budget allowances, officials support these options.

    Option 4 may also be supported if ministers were more focused on the goal of flattening the PIT system by reducing the number of thresholds and rates, noting that some low-income households would be made significantly worse off. However, officials do not support Option 3 as it would create significant additional compliance costs and it is unlikely that the fiscal cost could be managed within Budget allowances without making large sacrifices to other Government priorities.

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

37. Option 2 effectively addresses the policy problem of fiscal drag while having minimal negative consequences on other policy objectives, except for the large fiscal cost. The cost could be reduced through the alternatives in Option 5. Option 3 delivers larger efficiency gains but at a much larger fiscal cost, while also producing significant administrative effort and causing some earners to be worse off than under Option 2. **Officials therefore support the broad approach in Option 2 (the National manifesto plan)**, with the following further recommendations:

    a. consider cost-saving alternatives (Option 5) to support a return to surplus,

    b. delay implementation to 1 October 2024 to reduce the fiscal cost, minimise administrative demands for Inland Revenue and ensure all taxpayers receive the benefit of the tax changes on time,

    c. do not proceed with the proposed IETC expansion. The longstanding view of officials has been that the objective of improving work incentives could be achieved more effectively by removing the IETC and making other changes to tax and transfer settings for the same fiscal cost. See T2017/164: Removing the Independent Earner Tax Credit[2] for further discussion of the IETC, and

    d. prevent the tax changes flowing through to student allowances. Alignment with the benefit system is a principle of the student support system, and since main benefits will not increase from the tax changes, the same approach should be taken for student allowance.

[2] https://www.treasury.govt.nz/sites/default/files/2017-11/b17-3659148.pdf

What are the marginal costs and benefits of the option?

Groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Crown	Large reduction in Crown revenue over the forecast period.	$10.3 billion OFP	*Large reduction in revenue:* High *Broadly similar to forecast:* Medium
Inland Revenue and third-party payroll providers	Changes to PIT thresholds creates a small, one-off administrative cost for Inland Revenue and third-party payroll providers. Changes made within 3 months of announcement may create additional costs if some employers fail to make the changes on time.	Administrative costs to Inland Revenue and the Ministry of Social Development estimated at 15.4 million OFP. Costs to third parties is uncertain.	Medium
Part-year benefit recipients	Modelling shows 9,000 households will have a small reduction in income due to an unintended interaction with the personal income tax threshold adjustments and the way part-year benefit payments are calculated.	9,000 households have their income reduced by $1 per week on average compared to the status quo.	Medium
Total monetised costs	Main cost is reduction in Crown revenue over the forecast period. Forecast by Treasury using *Budget Economic and Fiscal Update 2024* forecasts. Forecasts of revenue are uncertain, but the evidence base for PIT revenue forecasts is relatively strong.	$10.3 billion reduction in Crown Revenue + $15.4 million administrative costs to Inland Revenue and the Ministry of Social Development	Medium
Non-monetised costs	Small costs to third-party payroll providers.	Low	Medium
Additional benefits of the preferred option compared to taking no action			
Taxpayers	Greater disposable income owing to reduction in tax levied on personal income.	$10.3 billion OFP	Medium
Wider economy	Small efficiency benefits from reductions in personal income tax.	Uncertain	Low
Total monetised benefits	Individual taxpayers receive the benefit of greater disposable income, equal to revenue lost by the Crown.	$10.3 billion OFP	Medium
Non-monetised benefits	Small efficiency benefits to wider economy.	Low	Low

Te Tiriti o Waitangi: Budget sensitivity did not allow for engagement with Māori stakeholders, meaning the extent to which Māori had a role in the design of the policy was limited. Analysis of distributional impacts for Māori has also been limited owing to short timeframes for advice. Available analysis of the option suggests average gains for Māori are relatively similar to other population groups, though a smaller proportion of Māori gain compared to the overall population (see Annex 2). By providing tax relief, the option is expected to have positive impacts on Māori wellbeing and building Māori capability.

Section 3: Delivering an option

How will the new arrangements be implemented?

38. Inland Revenue will continue to be responsible for the ongoing operation and enforcement of the tax system. The proposed changes will require amendments to Inland Revenue's tax administration system START and changes to Inland Revenue's customer facing content. While the changes to the START system can be made later, the changes to customer facing content will need to be made by 30 May so that the content can be made available as soon as the changes have been legislated. This will allow third parties to work on the system changes that they need to make to implement the proposed changes.

39. Inland Revenue will also need to contact significant groups such as payroll software providers and payroll service providers as soon as possible after the changes are announced to help ensure that there are no delays in beginning to implement the changes. Inland Revenue will have a communications plan in place that will go live after the changes have been legislated. This will include messaging to payroll software providers, payroll service providers, employers and individuals.

40. If the changes come into effect on 31 July 2024 and are only announced on 30 May 2024 it is likely that some employers will not be able to make the changes in time and will incorrectly calculate the income tax to be deducted from their employees pay. This can be corrected in later pay runs by the employer or can be corrected as part of the end of year tax assessment process that Inland Revenue runs.

Consequential tax impacts

41. 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:

- Resident Withholding Tax (RWT).
- Portfolio Investment Entity (PIE) tax.
- Fringe Benefit Tax (FBT).
- Employer Superannuation Contribution Tax (ESCT).
- Retirement Scheme Contribution Tax (RSCT).

42. The applicable rates and thresholds of these tax types would also need to shift to align with the proposed PIT changes. For example, under the National plan, the ESCT thresholds will also change as in Table 5 below:

Table 5: Change to ESCT thresholds resulting from personal income tax changes

Tax Rate	Status quo	New thresholds
10.5%	$0 - $16,800	0 - $18,720
17.5%	$16,801 - $57,600	$18,721 - $64,200
30.0%	$57,601 - $84,000	$64,201 - $93,720
33.0%	$84,001 - $216,000	$93,721 - $216,000
39.0%	$216,001 +	$216,001 +

43. The changes to RWT will also be made on 31 July 2024. The changes are increasing the income thresholds for the various personal tax rates, but they are not changing the rates themselves. While payers of resident withholding income will need to update their information on RWT and some recipients may need to adjust their selected RWT rates, there should be no changes to the actual withholding system that RWT payers use. In addition, if people are using the incorrect RWT rate, any under or overpayment can be corrected as part of the end of year tax assessment process that Inland Revenue runs.

44. The other consequential tax types including), PIE tax, FBT, ESCT and RSCT will be adjusted from the beginning of the next tax year (1 April 2025). This will allow more time to make the changes and reduce the complexity of the changes. This will in turn reduce compliance costs for employers. The trade-off for this is that investors and employees will receive the benefit of the changes from a later date, and this will be a permanent difference.

Third parties

45. 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. Officials 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.

46. Ideally, payroll software providers would be given 3 months' notice of upcoming changes. This is based on a timeframe of 6 weeks to complete and test the changes before providing the software to their clients 6 weeks before the implementation date. 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.

47. Shortening this timeframe to 2 months would likely mean clients would receive the software 2 weeks before implementation, instead of 6 weeks. This would likely mean some employees would have their tax calculated under status quo thresholds for a payment after the implementation date. However, this could be corrected in subsequent pay periods, or the difference picked up in the end of year tax assessment process.

48. Similarly, payroll service providers would ideally be given 3 months' notice of upcoming changes to the Pay as You Earn (PAYE) rules. Shortening this timeframe to 2 will increase the likelihood of errors. However, these could be corrected in subsequent pay periods, or the difference picked up in the end of year tax assessment process.

49. Some public sector organisations with specific payment challenges will need longer to implement the changes due to the special characteristics of the payments they make (i.e., this is not relevant to their standard departmental payroll functions). These include the payments made by the Ministry of Social Development (benefits, allowances and pension systems); Accident Compensation Corporation (compensation system) and the Ministry of Health (doctors and nurses payroll systems).

50. The identified organisations make payments that are subject to PAYE to a significant number of beneficiaries, superannuitants, compensation claimants and the health workforce. If they are unable to update their payment systems in time, incorrect

amounts of tax will be deducted, and the recipients (other than beneficiaries) will be likely to receive less of their payments than they are entitled to.

51. These organisations could be given advance notice, prior to Budget Day, on a Budget Secret basis, or errors could be addressed by Inland Revenue during the end of year tax assessment process. The Ministry of Social Development have provided initial indications that approximately three months lead in time (from the Cabinet decision) will be required for it to progress the necessary IT, legislative and operational changes in time; the Accident Compensation Corporation would need 8-13 weeks; and Health New Zealand would need approximately 4 months.

Implementation date

52. In 2010 (the last time thresholds were increased), 1 October was the date chosen in order to allow sufficient time for implementation as detailed. Officials have recommended the same date is chosen for these changes. A shorter delivery window is possible, but brings a higher likelihood of increased errors, which in turn will create an increased workload for Inland Revenue during the end of year tax assessment process.

53. The Cabinet Paper recommends progressing the PIT changes from 31 July 2024. With the changes being announced on Budget Day (30 May), this will allow approximately two months for third parties such as payroll software providers and payroll service providers to implement the changes. As noted above, these third parties would ideally be given 3 months' notice of upcoming changes.

54. Despite this shortened timeframe, we would generally expect most employers to be able to pay their employees under the updated tax scales from 31 July. There are likely to be some exceptions and some incorrect calculations, but these are able to be corrected in subsequent pay runs or as part of the end of year tax assessment process completed by Inland Revenue.

Legislative change

55. The tax changes will be included in Budget night legislation.

How will the new arrangements be monitored, evaluated, and reviewed?

56. Inland Revenue will continue to monitor the tax system in a range of ways to maintain the integrity of the tax system. Inland Revenue also regularly reports to the Government on the amount of tax being collected. It is not anticipated that any additional monitoring, evaluation or review above that which already occurs will be required as a result of the proposed changes.

Annex 1: Impact of Option 2 on effective marginal tax rates

Treasury modelling can estimate the distribution of EMTRs for the New Zealand population. Table 6 shows the number and characteristics of people who we estimate will experience a change in EMTRs from Option 2 in the year ending 31 March 2027. This analysis was only completed for Option 2 as this was the main option being considered at this stage in the advice process. It is important to note that not all people with income within the income tax ranges in Table 6 would experience the impacts shown – it will be dependent on their receipt of any benefits or tax credits, as well as the design of the final tax package.

The personal income tax threshold changes and extending the income range of the Independent Earner Tax Credit reduce EMTRs for 335,000 people (positive impact on work incentives) and increase EMTRs for 85,000 people (negative impact on work incentives).

Adding the proposed family-based tax credit changes (the In-Work Tax Credit and FamilyBoost) increases the EMTRs for a further 45,000 people (negative impact on work incentives). These people are in coupled families with children, and are spread across the first 4 income tax bands ($0 to $180,000). Modelling did not indicate an increase in EMTRs for sole parents.

These tax credits increase people's EMTRs because of the way the credits abate as incomes grow. Although people's income is increased by the credits, their EMTR also increases as they cross the abatement threshold and their payment reduces with each extra dollar of income. This negatively impacts their incentive to work. The proposed changes impact abatement in different ways:

a. The increase to the In-Work Tax Credit by $25 per week means the payment will take longer to abate to zero, as the abatement rate is constant. This means some people whose payment would otherwise have fully abated will now receive an abating payment.

b. As FamilyBoost is a new credit, people who receive it and whose family income is within the abatement range ($140,000 to $180,000) will have an increased EMTR because of the abatement of the credit.

Table 6: Impact of Option 2 on effective marginal tax rates

Reason for change	Taxable incomes between:	Work incentive	Threshold changes + IETC threshold to $70,000	Threshold changes + IETC threshold to $70,000 + family-based tax credits
PIT rate change from 17.5% to 10.5%	$14,000 - $15,600	Reduced EMTR, **increased** work incentive	35,000 people	35,000 people
Those who are eligible for IETC and no longer in abatement zone. Abatement rate of 13%	$44,000 - $48,000	Reduced EMTR, **increased** work incentive	45,000 people	45,000 people
PIT rate change from 30% to 17.5%	$48,000 - $53,500	Reduced EMTR, **increased** work incentive	125,000 people	125,000 people
Those who are eligible for IETC and are now in abatement range	$66,000 - $70,500	Increased EMTR, **decreased** work incentive	85,000 people	85,000 people
PIT rate change from 33% to 30%	$70,000 - $78,101	Reduced EMTR, **increased** work incentive	130,000 people	130,000 people
Those receiving changes to IWTC or FamilyBoost	$0 - $180,000	Increased EMTR, **decreased** work incentive		45,000 people, made up of: • 15,000 from IWTC • 30,000 from FamilyBoost
Total number of people whose work incentives are affected			**335,000** positively affected (reduced EMTR) **85,000** negatively affected (increased EMTR)	**335,000** positively affected (reduced EMTR) **130,000** negatively affected (increased EMTR)

EMTR analysis has been recently developed to support Treasury modelling and advice. Due to its experimental nature, Treasury considers these results have low reliability and medium risk.

Annex 2: Distributional analysis of options

Option 2

Officials provided distributional analysis of the PIT threshold and IETC changes in Option 2 in combination with other tax and transfer policies included in Budget 2024. These included the $25 per week increase to the In-Work Tax Credit (IWTC) and the introduction of the FamilyBoost policy, which gives parents a rebate of up to $75 per week for money spent on early childhood education fees. These four policies together are referred to as "the package".

Distributional analysis provided in advice was based on economic forecasts from the 2023 *Half Year Economic and Fiscal Update*, and household data from the 2021 *Household Economic Survey* (HES). The Cabinet Paper includes distributional analysis based on the latest available economic forecasts and household data (i.e., 2024 *Budget Economic and Fiscal Update* forecasts and 2023 HES data). The distributional analysis in this Regulatory Impact Statement therefore differs slightly from what is in the Cabinet Paper.

Overall, the package increases the income of 93% of households[3] by $30 per week[4] on average. Households with children gain by $39 per week on average. A small number of households (0.5% of all households) have their income reduced from the package by $1 per week on average, due to an unintended interaction with the tax threshold adjustments and the calculation of part-year benefit payments. 135,000 households (7%) are unaffected. Many of these will be receiving main benefits and have no change because benefit rates are set in after-tax terms.

Household impacts are in comparison to household incomes at the same point in time (the year ending 31 March 2027) if the policy change was not made. Gains and losses do not indicate whether a household is better or worse off compared to the previous year, but only how their projected income in 2027 *with* the policy change compares to their projected income in 2027 *without* the policy change.

Figure 1 shows the weekly impact of the package on household incomes, grouped by equivalised income quintiles.[5] The number of households in each quintile who have their income increased or reduced is also shown (e.g., 394,000 households in the third quintile have their income increased by $32 per week on average). Only households in the first quintile have their income reduced, by $1 per week on average. These are households who receive main benefit income for only part of the year, and receive a slight reduction in benefit income due to an unintended interaction with the tax threshold adjustments and the calculation of part-year benefit payments. It is unlikely this could be avoided by designing the package differently.

The first quintile contains the smallest number of gaining households (290,000). Most of the households unaffected by the package are in the first quintile (100,000 out of 135,000). Households in the first quintile also gain by the least on average ($13 per week). This reflects the fact that people receiving main benefits, who have relatively low incomes, do not gain from the package as benefit rates are set in after-tax terms. The largest weekly gain goes to

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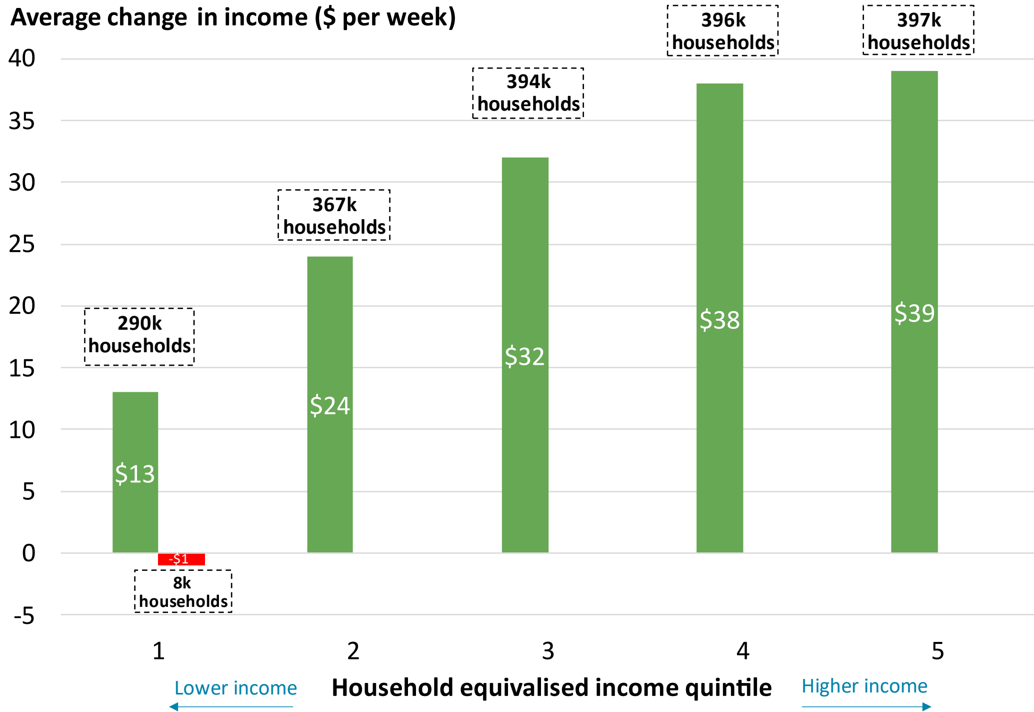
3 Households are defined as one or more people living together in a private dwelling and sharing facilities. A household could contain more than one family, which is defined as a single person or couple and any dependent children.

4 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.

5 Income equivalisation accounts for different household compositions (e.g., the number of adults and children) to allow for like-for-like comparisons across households. 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.

the fifth quintile, reflecting the fact that the maximum gain from the PIT threshold adjustments occurs at a relatively high individual income level ($78,100).

Figure 1: Impact on household incomes by equivalised income quintile



Officials also provided analysis of how each individual component of the package impacts household incomes. The individual package components impact households as follows:

i. The **PIT threshold changes** increase net incomes for 1.831 million households (93% of all households) by an average of $25 per week. These changes will also reduce net incomes for a further 9,000 households (0.5% of all households) by an average of $1 per week due to an unintended interaction with the personal income tax threshold adjustments and the way part-year benefit payments are calculated.

ii. The **IWTC increase** increases 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.

iii. The **IETC expansion** increases net incomes for 381,000 households (19% of all households) by an average of $10 per week.

iv. **FamilyBoost** increases net incomes for 80,000 households (4% of all households and 12% of households with children) by an average of $34 per week. The majority of these households are in the bottom half of the equivalised income distribution, and the lowest earning households gain by the most on average.

Individual-level analysis shows the impacts of the package by demographic group. Note that this analysis was developed later in the process and is based on the latest available economic forecasts and household data (i.e., 2024 Budget Economic and Fiscal Update forecasts and 2023 HES data).

Compared to the overall population, relatively fewer Māori, Pacific Peoples and women benefit from the package. Overall, 83% of individuals gain by an average of $16 per week. This compares to 74% of Māori gaining, 73% for Pacific Peoples, and 81% for women. Average gains for Māori and Pacific Peoples are equal to the overall population, while women gain by slightly less ($15 per week on average) due to lower incomes. By contrast, almost all seniors benefit from the changes (97%) due to the near-universal receipt of NZ Super, but by a smaller amount ($13 per week).

Options 3 and 4

To help understand the scale of the tax offset required to ensure no individual was worse off under Options 3 and 4 compared to the status quo, officials presented distributional analysis of these plans without the use of an offset. This is shown in Table 7.

Table 7: Individual and household impacts of Options 3 and 4, without a tax offset

Year ending 31 March 2027	**Option 3 (no offset)**	**Option 4 (no offset)**
Income level where individuals pay more tax compared with the status quo	Under $55,840 (Equivalent to around 47 hours on minimum wage)	Under $32,667 (Equivalent to around 28 hours on minimum wage)
Number of individuals aged 15+ with reduced disposable income compared to the status quo	1.111 million	0.656 million
Proportion of losing individuals that lose by more than $10 per fortnight	~75% of losing individuals	~40% of losing individuals
Average reduction in individual disposable income per fortnight	~$24 per fortnight	~$8 per fortnight
Share of all households that lose by more than $10 per fortnight	13.2% of households	2.8% of households

Multiplying the number of individuals losing by the average loss can provide a preliminary estimate of the total cost of compensating these individuals. This can serve as an approximation of the cost of a tax offset that would ensure no individual is worse off, as shown in Table 8. Larger offsets would be needed to ensure no one was worse off compared with the National plan.

Table 8: Summary of fiscal impacts of Options 3 and 4

	Option 3	**Option 4**
Preliminary estimate of annual cost of ensuring no earner is worse off	$0.6 - $0.8 billion p.a.	$0.1 - $0.2 billion p.a.
Indicative cost of threshold changes over forecast period (2024/25 to 2027/28)	$15.1 billion	$10.6 billion
Preliminary estimate of the combined cost over forecast period (2024/25 to 2027/28)	$17.5 - $18.3 billion	$11.0 - $11.4 billion

Option 5

In addition to reducing the fiscal cost, the cost-saving alternatives to Option 2 would alter the distributional impacts. These differences are summarised in Table 9.

Table 9: Distributional impacts of Options 5a-c compared with Option 2

	Option 5a *National plan but retain bottom threshold*	**Option 5b** *National plan but 10% less for each threshold*	**Option 5c** *National plan but 50% less for $70,000 threshold*
Key differences compared to Option 2	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 Option 2	**$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)
Impact on individuals 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 Option 2	0.14 million households no longer gain **(7%)** 1.69 million households gain by less than Option 2 **(85%)**	1.83 million households gain by less than Option 2 **(92%)**	0.33 million households gain by the same amount **(17%)** 1.50 million households gain by less **(76%)**

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.