

# The Treasury

## Budget 2023 Tax Initiatives Information Release

July 2023

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## Joint Report: Initial Advice on Personal Tax Relief

<b>Date:</b>	10 February 2023	<b>Priority:</b>	High
<b>Security level:</b>		<b>Report number:</b>	IR2023/037 T2023/157

## Action sought

	<b>Action sought</b>	<b>Deadline</b>
<b>Minister of Finance</b> (Hon Grant Robertson)  <b>Minister of Revenue</b> (Hon David Parker)	<b>Agree</b> to the recommendations <b>Indicate</b> the parameters of further advice and provide any feedback	Monday, 20 February 2023

## Contact for telephone discussion (if required)

<b>Name</b>	<b>Position</b>	<b>Telephone</b>
Paul Young	Principal Policy Advisor, Inland Revenue	[35]
Stephen Bond	Manager, The Treasury	

# Joint Report: Initial Advice on Personal Tax Relief

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## Executive Summary

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You requested advice to support your consideration of potential personal tax relief measures, in particular establishing a tax-free threshold. This report provides initial advice and seeks your direction on parameters, including objectives, target groups, fiscal cost and application date, to enable further detailed advice to be provided.

Personal tax reductions could address a range of policy outcomes. In the context of increased average tax rates (ATR) and elevated prices, potential objectives identified include supporting incomes to assist with cost-of-living pressures, countering fiscal drag, supporting labour supply, and improving progressivity. With any given approach to tax relief, there will be trade-offs between objectives.

While establishing a tax-free threshold would provide a benefit to the greatest possible number of taxpayers, it is not well targeted either to those in active employment (as opposed to secondary earners or people with small amounts of passive income) or to individuals facing lower returns to additional work. As a result, it is unlikely to have any significant impacts on economic efficiency or work incentives.

Adjusting tax thresholds or marginal rates that are more likely to be relevant to individuals transitioning into work, or making choices about their work, could have a greater economic impact as well as provide a more significant gain to those taxpayers. We have therefore provided three alternative illustrative options to demonstrate how these trade-offs target different points on the income scale:

- a **Raising the bottom threshold:** provides greater gains at a level more consistent with active employment, and has the potential to smooth the interface with main benefits
- b **Reducing the 30% rate and raising the bottom threshold:** reduces the marginal tax rate at the \$48,000 threshold that will soon be faced by all full-time workers while still providing gains at a lower income level
- c **Increasing all thresholds:** addresses some of the impacts of fiscal drag and provides highest proportional gains at an income range with the highest concentration of workers with salary/wages.

We have provided illustrative options costing around \$2 billion per annum, which is approximately the cost of a tax-free threshold of \$5,000. A design based on a tax-free threshold of \$10,000 is also included to illustrate the cost of providing greater relief.

### ***Broader economic considerations***

You are currently considering funding a personal tax cut through the introduction of a deemed minimum income tax on high wealth individuals. As officials have previously advised, that proposal is likely to have significant economic costs [T2022/2703 and IR2022/516 refer]. Officials therefore recommend that you prioritise further consideration of income tax measures that are most likely to have the largest positive economic impacts, which could help to reduce some of the overall economic impact of a progressive tax switch.

### ***Other considerations***

All designs can also be adapted so that they do not provide a gain to earners with income above a certain level: for example, above the existing threshold of \$180,000 for the 39% marginal rate. While this can be done in a way that doesn't change those earners' overall tax

burden, it would have implications for marginal tax rates, which in turn could influence behaviours.

As part of any changes, consideration could be given to amending or removing the Independent Earner Tax Credit (IETC), which is no longer aligned with its original target population due to fiscal drag. Withdrawing the IETC would reduce or offset the gains from the changes for current recipients.

At this stage, we are assuming an earliest implementation date of April 2024. The implementation date that we would recommend would depend on a range of factors, including consistency with your fiscal and macroeconomic objectives. Earlier implementation than April 2024 may be feasible, but some existing initiatives may need to be deferred.

Phasing options can be provided to support your fiscal objectives; however, they are likely to give rise to higher compliance and administration costs, and they may not be efficient if the nominal gains provided to individuals from the tax changes are relatively small.

Tax relief options have a significant fiscal cost and there will be trade-offs with other spending priorities. Gains from tax changes are also difficult to target to those most in need, and the transfer system would be more cost-effective in supporting the lowest income households if this is the goal. While tax relief can increase after tax incomes for many individuals, it will not immediately assist most recipients of main benefits unless you choose to provide an increase to main benefit rates at additional fiscal cost. However, there would be a lagged impact on net benefit rates from the indexation of main benefits to the average wage.

There are consequential interactions between the tax and transfer systems and an assessment of these will be provided based on specific options. [33]

Further consideration of the combined effects of personal tax relief and other tax changes, and updated analysis will be provided as part of further advice.

**Recommended Action**

We recommend that you:

- a **Discuss** the contents of this report with officials at the Joint Ministers meeting on 16 February 2023;

Yes/No

*Subject to the outcome of the further discussion at Budget Ministers 2 on 20 February 2020*

- b **Indicate** your preferred targeting for personal tax relief options (Given all options involve some degree of trade-offs, understanding the groups that you may be targeting helps with finalising the design of the chosen approach):

Priority	Consider further?	Comment
Provide a gain to all income earners		
Provide a gain at a point on the income scale that targets low-middle earners		

Provide a gain at a point on the income scale that targets average earners		
Provide a gain to earners below a specified level only (for example, the \$180k threshold)		

- c **Direct** officials to report back by 10 March 2022 with final policy options (noting that variations or combinations of approaches are possible).

Yes / No

- d **Indicate** if you have any feedback on the illustrative approaches in the table below:

Approach	Feedback
Approach 1 – Tax-free threshold	
Approach 2 – Increase bottom threshold	
Approach 3 - Reduce 30% rate and increase bottom threshold	
Approach 4 – Increase all thresholds by a set percentage (excluding \$180k)	

- e **Indicate** whether, on the basis of the indicative analysis in this report, you prioritise the following policy outcomes (or other alternative outcomes):

Relief for a broad range of earners to support cost of living pressures	
Unwinding the impacts of fiscal drag on those most affected	
Improving economic efficiency and work incentives	
Improving the progressivity of the income tax system	

- f **Indicate** which additional elements should be considered further:

- a. Options for an accompanying increase to main benefit rates (**recommended**);

Yes/No

b. Removing or amending the Independent Earner Tax Credit;

Yes/No

c. Providing a gain to earners below a specified level only (for example the \$180k threshold);

Yes/No

g **Identify** your parameters for preferred application date and phasing:

<b>Parameters</b>	<b>Note</b>	<b>Comment</b>
Application date	Earliest efficient application date is April 2024, but earlier implementation may be feasible	
Options for phasing can be included in further advice	Phasing can assist with managing fiscal costs but some options will be more suited than others	

h [33]

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Minister of Finance  
/ /2023

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# Report: Initial advice on personal tax relief

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## Purpose of Report

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1. We understand that you wish to consider personal tax-reduction options for announcement at Budget 2023, in particular the possibility of a tax-free threshold. This report provides initial advice on personal tax relief measures and seeks your direction on parameters for further advice, including objectives, target groups, fiscal costs and application date.

## Context

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2. The structure of the Personal Income Tax (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 2010. Personal incomes have risen since that time, leading to higher average rates of personal tax. This is known as fiscal drag, and results in more taxpayers and taxable income being taxed in higher brackets because of wage inflation. The current rates and thresholds are shown below:

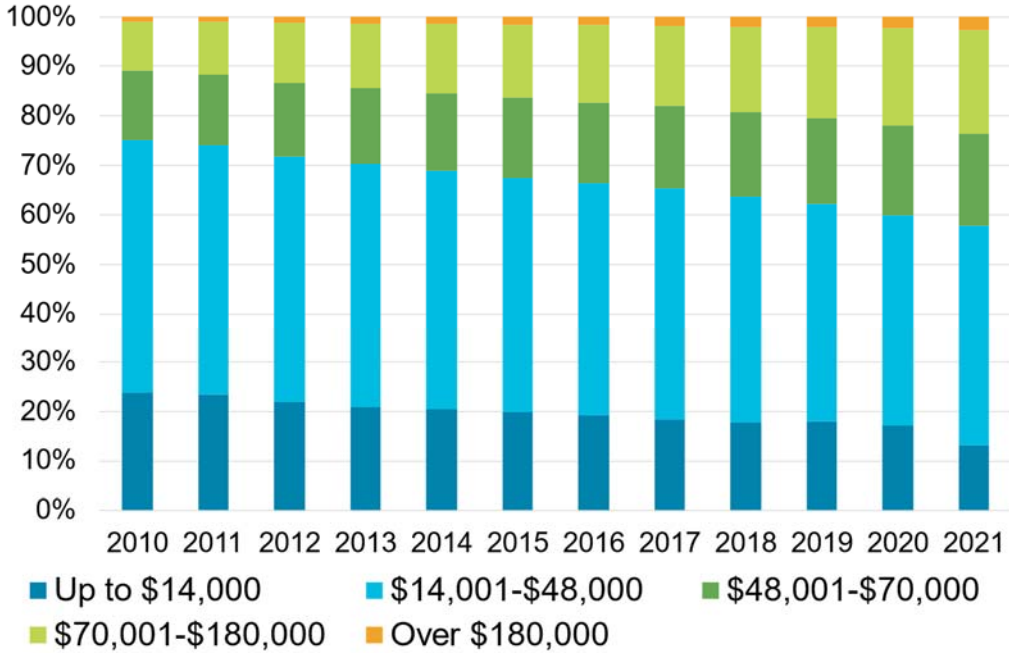
**Table 1: Current personal income tax rates**

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. Fiscal drag has implications for the tax system's alignment with the Government's objectives, as it changes the real value of tax thresholds. This may alter judgements about the system's fairness and efficiency, which will depend on expectations about the distribution of taxpayers across brackets, how much tax should be paid by earners at different income levels, and their potential behavioural responses.
4. Fiscal drag can also have unintended consequences as other Government policies change, particularly in the transfer system. For example, the gross single Jobseeker benefit rate in 2010 when the tax thresholds were set was below the \$14,000 tax threshold but is now significantly above it.
5. The effect of fiscal drag is an increase in tax revenue which improves the Government's fiscal position and strengthens resilience in the face of economic shocks. However, it also reduces the real value of wage increases that people receive, with some parts of the income scale impacted more than others. Since the tax changes in 2010, the highest increases in average tax rates (ATRs) are for individuals whose incomes cross the \$48,000 threshold, as the step-up in the marginal tax rate (from 17.5% to 30%) is steeper at this income level than at any other threshold.

- 6. If wages and salaries are assumed to have risen in line with increases in the Labour Cost Index (LCI), they would have increased by 28% since 2010.<sup>1</sup> A person earning \$48,000 in 2010 would now be earning \$61,427 and fiscal drag would mean an increase in their ATR of 3.2 ppt.
- 7. Over the forecast period, fiscal drag is likely to be most acute for those currently earning near the \$48,000 threshold, which includes full-time earners on the minimum wage.
- 8. Once the annualised minimum wage crosses the \$48,000 threshold (i.e, when the minimum wage reaches \$23.10 per hour), all full-time earners will have a marginal tax rate of 30% or more. As more earners move into the higher tax brackets, there is a broad flattening in the taxation of incomes. A taxpayer earning \$48,001 faces a marginal tax rate of 30%, while a taxpayer earning \$179,000 faces a marginal tax rate of 33%, only 3% higher over a large income range that will soon cover almost all full-time workers. This means that the most progressive stages of the personal tax system are soon likely to be below the level of the full-time minimum wage making the personal tax system less progressive.
- 9. Figure 1 shows how the distribution of taxpayers across tax brackets has changed over time. The greatest changes are the decreased proportion in the lowest bracket and the increase in earners with income between \$70,000 and \$180,000 from 9% to 19% since the 2009/10 tax year. The average wage (\$76,275 in the December 2022 quarter) is currently above the \$70,000 threshold, so is taxed at a marginal rate of 33%. In 2010, it was just above the \$48,000 threshold.

**Figure 1: Proportion of taxpayers in each bracket<sup>2</sup>**



<sup>1</sup> The LCI is an aggregate measure, so individual experiences will differ. Transfer impacts are not considered.

<sup>2</sup> Individuals with less than \$100 of taxable income are excluded.



10. In general, having a higher proportion of earners with higher marginal tax rates may be expected to lead to lower incentives to work and save over time, as the returns on these activities are reduced. Overall New Zealand has high labour-force participation rates relative to the OECD while also exhibiting average number of hours worked close to the OECD average. This has not changed significantly over the period since 2010. In the long run, accumulated fiscal drag would be expected to have a negative effect.
11. In the context of the global cost of living spike, higher average rates of tax may contribute to income adequacy concerns for some earners. Since 2020 nominal wage growth has accelerated, accompanied by a sharp rise in the Consumer Price Index (CPI). This means people may be paying higher rates of tax as their wages increase even as their real wages are falling because prices are increasing at a higher rate than their wages are. The application of higher tax rates can therefore have the effect of exacerbating the reduction in the buying power of their take home pay.
12. In the absence of unadjusted tax thresholds, fiscal drag is projected to continue. In the *Half Year Economic and Fiscal Update (HYEFU)*, wages were forecast to grow 24% between 2022 and 2027.

## Objectives of tax relief

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13. The main purpose of personal taxation is to raise revenue for the Government to fund services that improve living standards for New Zealanders. Personal taxation can also redistribute income to the extent desired by the Government.
14. Tax reduction measures can support a range of objectives, including distributional, equity and efficiency goals. There are likely to be trade-offs between some of these: for example, changes that achieve more redistribution may come with larger economic costs.

### ***Potential objectives***

15. In the context of higher average tax rates and elevated prices, potential objectives identified are:

- a *Supporting incomes to assist with cost-of-living pressures*

While all earners are impacted by elevated prices, low-to-middle income earners are the most vulnerable, as they spend a greater proportion of their income on core goods and services compared with higher income households. Changes that deliver greater gains at points on the income scale that target low or middle wage earners would be most aligned with this objective.

- b *Countering fiscal drag*

Fiscal drag leads to everyone with income above the bottom threshold facing higher average tax rates as their income increases. However, it has uneven impacts on ATRs, particularly at the \$48,000 threshold, owing to the steep increase in the marginal rate to 30%. Changes can be targeted to address the income levels most affected by historic fiscal drag (i.e. around the level of the 2022 median wage) or future fiscal drag (i.e. around the level of the 2023/24 full-time minimum wage).

c *Supporting labour supply*

Personal tax reduction measures can have positive impacts on incentives to work and save, by increasing the financial returns to these activities. Changes can be designed to increase work incentives for some earners: for example, at income levels where fiscal drag has led to higher marginal tax rates, or at the interface with the transfer system where effective marginal tax rates (EMTRs) are highest.

d *Improving progressivity*

With almost all full-time workers expected to have crossed the \$48,000 threshold within the next few years, the existing progressive structure is becoming less so. Earners face a steep increase in marginal tax rates at \$48,000, then only a 3% increase at \$70,000 for income up to \$180,000. Changes can be targeted to address this, for example, by adjusting the size of the rate increases or by lifting the thresholds.

16. Some approaches to tax relief will be better suited to meeting particular objectives. A key consideration is the progressive structure of the personal tax system, which means changes to rates or thresholds at the bottom of the system also flow through to higher incomes. The gains from a given tax change can therefore be difficult to target, which reduces the cost-effectiveness of tax relief as a lever for achieving certain objectives.

## Tax relief approaches

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17. To illustrate the trade-offs between different objectives, we have presented four possible approaches to income tax relief:
- a **A tax-free threshold** – this is common in other countries and provides a flat gain to all taxpayers earning more than the threshold (excluding recipients of main benefits)
  - b **Raising the bottom threshold** – this is a way of providing greater gains at a level more consistent with earnings from active employment, and it can smooth the interface with main benefits by reducing marginal tax rates for beneficiaries in part time work
  - c **Reducing the 30% rate and raising the bottom threshold** – this lowers the rate of marginal tax that will soon be faced by all full-time workers, and it can help to reduce high EMTRs for some WFF recipients
  - d **Increasing all thresholds** – this helps counter the impacts of fiscal drag, and provides the biggest proportional gain at a point in the income scale with the greatest concentration of earners with wages/salary income

**Table 2: Summary of approaches and impacts**

	<b>Approach 1</b> Tax-free threshold	<b>Approach 2</b> Raise the bottom threshold	<b>Approach 3</b> Reduce the 30% rate and raise the bottom threshold	<b>Approach 4</b> Adjust all thresholds except \$180k
Most earners receive a gain	✓	✓	✓	✓
Most earners receive the maximum gain	✓	✓	X	X
Greater gains at income level consistent with active employment	X	✓	✓	✓
Potential to improve work incentives	X	✓	✓	✓
Greatest gains to individuals most impacted by fiscal drag	X	X	X	✓
Supports progressivity as incomes grow	X	✓	✓	✓
Preserves integrity	X	✓	✓	✓

- 18. The tax-free threshold designs provide a gain to the greatest number of individuals, with the full gain achieved at the lowest levels on the income scale. However, for the same fiscal cost, the maximum gain per person is lower. The other design examples still provide a gain to a large number of individuals, however, designs 3 and 4 have a significantly smaller number of people receiving the maximum gain.
- 19. The gains arise at different income levels and for approaches 3 and 4 there are steps in the gains with more than one income bracket at which gains arise. The following table using the illustrative examples demonstrates this:

**Table 3: Summary of gains by approach**

	<b>Income band 1: \$0-\$14k</b>	<b>Income band 2: \$14k -\$48k</b>	<b>Income band 3: \$48k-\$70k</b>	<b>Income band 4: \$70k-\$180k</b>
<b>Approach 1 – \$5k Tax-free threshold</b>	Start gaining from \$0.  Max gain of \$525 at \$5k			
<b>Approach 2 – Raising the bottom threshold to \$22k</b>		Start gaining from \$14k.  Max gain of \$560 at \$22k		
<b>Approach 3 – Reducing 30% rate to 28.5% &amp; raising bottom threshold to \$20k</b>		Start gaining from \$14k.  Gain of \$420 at \$20k	Start gaining again at \$48k  Max cumulative gain of \$750 at \$70k	
<b>Approach 4 - Increasing thresholds by 10% (except \$180k)</b>		Start gaining from \$14k.  Gain of \$98 at \$15.4k	Start gaining again at \$48k  Cumulative gain of \$698 at \$52.8k	Start gaining again at \$70k  Max cumulative gain of \$908 at \$77k

20. Tax changes will have consequential impacts on key transfer payments:

- a The tax changes will flow directly through to the rate of New Zealand Superannuation (NZS), with couples seeing the same direct increase as two people earning around \$23,000 each. Raising the bottom threshold will therefore give the largest direct increase, while increasing all thresholds will lead to the smallest increase for NZS.
- b The tax changes will flow indirectly through to the rate of main benefits (and the rate of NZS in some circumstances<sup>3</sup>) due to annual indexation to the growth in the net average wage each April. However, this impact will be greatest where the average wage earner (estimated to be around \$78,500 in 2024) has the largest gains. This leads to slightly counterintuitive impacts under approach 4 for a person earning the same amount as the current Jobseeker-Single (gross) in wages, as shown in the following table.

<sup>3</sup> NZS has a complicated indexation regime. The new net couple rate, once adjusted for CPI, must remain between 66% and 72% of the net average wage. At present, higher than normal inflation has resulted in the couple rate sitting above 66% of the net average wage and therefore there is no further adjustment required.

**Table 4: Comparison of gains for beneficiaries and earners at the same income level**

	<b>Approach 1 Tax-free threshold</b>	<b>Approach 2 Raise the bottom threshold</b>	<b>Approach 3 Reduce the 30% rate and raise the bottom threshold</b>	<b>Approach 4 Adjust all thresholds except \$180k</b>
<b>Increase for Jobseeker-Single:</b> Automatic but lagged increase (net) due to tax changes increasing the net average wage which results in higher indexation on 1 April.	\$155.48 (~\$3pw)	\$165.88 (~\$3pw)	\$222.04 (~\$4pw)	\$268.32 (~\$5pw)
<b>Increase for low-income wage earner:</b> Immediate increase due to tax changes for someone earning \$20,982 (gross) in wages (i.e., the same level as JS under current settings)	\$525.00 (~\$10pw)	\$488.72 (~\$9pw)	\$420.00 (~\$8pw)	\$98.00 (~\$2pw)

21. If your intention is to target lower income workers, the changes can be focused on a point on the income scale where it is more likely to benefit these people. A change to the lowest threshold will provide the most benefit to part-time workers but will also benefit everyone earning over the current \$14,000 threshold. A reduction of the 30% tax rate or an increase in the \$48,000 threshold at which it applies will reduce the marginal tax rate of fulltime workers earning just over the minimum wage. These types of changes would also be likely to benefit minimum wage workers the next time the minimum wage is increased.
22. If your objective is to improve progressivity in the tax system, areas that could be focused on are the significant step up in tax rates at \$48,000 where the rates increase from 17.5% to 30% and the spreading of the tax thresholds at the higher tax rates.
23. The design of the tax system means that families with the same gross income level will have higher take home pay if that income is split between two earners as both earners will access the lower rates of tax. The potential changes would potentially increase this effect as multiple parties in the same family may be able to access the benefit of the changes.
24. Personal tax reduction measures can have positive impacts on rates of work, savings and investment by increasing the financial returns to these activities. Initial analysis suggests that the potential overall extent of labour supply effects is small given New Zealand's high labour force participation rate and the relative size of the proposed changes. This can be explored further once the type of changes and the fiscal parameters of those changes has been determined. High effective marginal tax rates (EMTRs) are likely to have a greater impact on these economic choices.
25. The highest EMTRs are at the interface with the transfer system. Tax changes can lower these EMTRs but the predominant cause is the policy settings that determine entitlement to transfer payments. Key interactions that will be explored further as the direction of change is better defined are the abatement rates for main benefits and tax credits, including Working for Families (WFF) and the Independent Earner Tax Credit (IETC). The relative impact of the tax change may therefore be small.
26. The integrity of the tax system will also be an important consideration in assessing any given approach. Alongside GST, personal income tax is the primary way in which most New Zealanders interact with the tax system. The fairness and integrity of the personal system can affect New Zealanders' views of the fairness and integrity of the tax system as a whole, and their levels of trust in Government and institutions.

- 27. Some high-level pros and cons of the approaches are set out below in the table and the sections on each approach. These use examples that have been designed to have a consistent fiscal cost of around \$2 billion per annum, but they are scalable. Further detail and statistical analysis of the designs for the illustrative approaches are included at Appendix A.
- 28. To illustrate the impact of scaling these designs, we have also considered a larger version of a tax-free threshold of \$10,000, with an indicative fiscal cost of around \$3.8 billion per annum.
- 29. There are a number of alternative approaches or combinations that can be considered depending on your objectives and preferred parameters. The examples provided serve to demonstrate these trade-offs rather than recommend a particular option.
- 30. Further analysis would be needed to understand the full distributional and economic effects of any given approach.

**Benefits and costs of illustrative approaches**

*Approach 1: Tax free threshold*

**Table 5: Summary of approach 1 - Tax free threshold**

	Max gain per person	Est. number who gain	Est. number who gain full amount	Income where full gain achieved	Indicative fiscal cost p.a.
<b>Design 1a: \$5k tax-free threshold</b>	\$525	4.1 million	3.4 million	\$5,000	\$1,918m
<b>Design 1b: \$10k tax-free threshold</b>	\$1050	4.1 million	3.3 million	\$10,000	\$3,787m

- 31. A tax-free threshold allows people to receive an amount of income up to the chosen threshold free of tax. All earners (except those receiving the main benefit) receive some benefit and anyone earning more than the threshold amount will receive the full nominal gain (dollar amount). This type of change provides the greatest proportional gain to those with the lowest individual incomes. It may also reduce compliance costs for a small group of people who earn non-withholding income (i.e. self-employment income) and have total income less than the threshold, if they no longer need to file a tax return.
- 32. A tax-free threshold is generally easier to understand than other types of tax change. However, owing to the interaction with the transfer system, it can create confusion, and those with persistently low household incomes may not benefit to the same extent from the change. Gains from tax changes are difficult to target to those most in need. The transfer system would be more cost-effective for an objective aimed at supporting persistently low-income individuals.
- 33. A tax-free threshold would benefit approximately 800,000 people more than the other illustrative options. These are all of the people that earn any amount of income greater than zero and less than \$14,000. Administrative data from Inland Revenue shows that of these people approximately 28% were dependent children and 13% received a welfare benefit as their primary income source. The core benefit recipients wouldn't directly gain but would receive a smaller lagged gain from a tax-free threshold owing to the way in which benefits are calculated. Only 37% received wage or self-employment income as their main source of income.

34. Using data from the 2020/21 Household Economic Survey to develop an estimate for the 2024/25 tax year, and removing those with income less than \$100 and those aged under 15 to focus the analysis, further characteristics of this smaller group can be identified. The table below summarises these findings. The characteristics are ordered mutually exclusively, i.e., individuals in each category have not been included in the other categories. The analysis shows that 78% of the people in this group are either temporarily on low incomes (i.e., students) or are supported by someone with a higher income (i.e., are a dependent child or have a partner with income greater than \$14,000). The remaining individuals may have received a part-year income or were financially supported by others in a household. Overall, the data suggests that the majority of individuals with income below \$14,000, while low income earners, may not be in extreme financial need and may not be a key target of concern.

**Table 6: Characteristics of individuals with income between \$100 and \$14,000**

Characteristic	Number	% of total	Received main benefit at any time during year
Student	130,000	42%	7,000
Is a dependent child	10,000	3%	
Partner with income >\$14,000	102,000	33%	22,000
Single with no children	51,000	16%	14,000
Other	20,000	6%	3,000
<b>Total</b>	<b>313,000</b>	<b>100%</b>	<b>46,000</b>

35. Other types of changes can deliver greater nominal or proportional gains at different points in the income scale (for example, at a level more consistent with active labour income) for the same fiscal cost. For example, a \$5,000 tax-free threshold delivers a \$525 gain to anyone earning over \$5,000, while for a similar fiscal cost raising the bottom threshold to \$22,000 delivers a \$560 gain to anyone earning over \$22,000.

36. On an individual income basis, a tax-free threshold increases progressivity at the bottom of the scale. However, adding an additional bracket at the bottom (where the proportion of taxpayers has decreased) does not improve progressivity higher up the scale (where the proportion of taxpayers is increasing, and progressivity is flattening) and may make progressivity issues higher up the scale more difficult to address in future (due to their cost and tendency to be increased over time as discussed below).

37. Tax-free thresholds tend to get progressively larger and are very difficult to remove (see UK and Australian examples in Appendix C), which reduces the flexibility to make future changes, including further tax relief at the lower end of the income scale. As they increase in size there is often a need for the second tax rate to be relatively high (e.g. 20% in the UK) and/or for offsetting measures to be introduced that create high effective marginal tax rates (e.g. 60% for incomes between 100,000GBP and 125,140 GBP). This can result in significant unevenness in the progressivity of the tax system and is likely to have implications for economic efficiency and the integrity of the tax system. A larger tax-free threshold also causes increasing integrity concerns as there can be significant gains from income splitting behaviour among non-wage and salary earners.

38. In general, this approach is expected to have lower efficiency benefits, as it only reduces marginal tax rates at a low level of income (around 4.2 hours p.w. on the 2023/24 minimum wage) and has a lower impact on ATRs for earners higher up the income scale. However, the gain is most neutral on the distribution of income between couples and it provides the best incentive for a secondary earner to enter work, though not necessarily to increase their hours. As with other tax changes, it will not have a

direct impact on main benefit rates. Also, it will not increase the financial return from work for people who have combined income from the main benefit and wages until the main benefit is almost fully abated (and therefore will not increase the returns from work for the majority of people receiving a main benefit and moving into work).

39. Relative to other types of changes, a tax-free threshold has flow-on impacts that may make it more expensive to implement and comply with. These include the need for a large number of businesses to adapt their systems and processes for the new rate. Additionally, it would be necessary to consider whether zero-rate options for other tax types such as Resident Withholding Tax (RWT), Portfolio Investment Entity (PIE), and Employer Superannuation Contribution Tax (ESCT) should be made available.

*Approach 2: Increase bottom threshold*

**Table 7: Summary of approach 2 - Increase bottom threshold**

	<b>Max gain per person</b>	<b>Est. number who gain</b>	<b>Est. number who gain full amount</b>	<b>Income where full gain achieved</b>	<b>Indicative fiscal cost p.a.</b>
<b>Design 2: Bottom threshold to \$22k</b>	\$560	3.3 million	2.6 million	\$22,000	\$1,912m

40. Increasing the bottom threshold also delivers the full gain at a relatively low income level. A person will get some relief if they have income over \$14,000, and will get the full gain if they have income over the raised threshold. For example, if the threshold was raised to \$22,000, anyone earning over \$22,000 would get the full gain of \$560 (approximately 2.6 million people).
41. An increase in the bottom threshold is more targeted to active income than a tax-free threshold. The bottom threshold corresponds to around 11.9 hours per week on the 2023/24 minimum wage; an increase in the threshold to \$22,000 would correspond to around 18.6 hours per week.
42. This approach is likely to have the greatest impact on work incentives for individuals receiving the main benefit. This is because it will reduce the marginal tax rate on wage income to 10.5% when the main benefit is below \$22,000 gross (or \$379 net per week). This means people receiving Jobseeker-single rate will face a lower marginal tax rate on the first hour of work.
43. As a result, we expect that this change would have some positive impacts on work incentives for part-time workers and for those working while receiving a main benefit. For dual earners, it provides some incentive for a secondary worker to move into work, but not necessarily to increase their earnings if they are already earning more than \$22,000. An exception to this would be some families receiving the minimum family tax credit (MFTC), because of the dollar-for-dollar abatement rate that applies to their MFTC entitlement.
44. Increasing the bottom threshold will benefit minimum wage workers who would see a decrease in their average tax rates.



*Approach 3: Raise bottom threshold and decrease 30% rate*

**Table 8: Summary of approach 3 - Raise bottom threshold and decrease 30% rate**

	Max gain per person	Est. number who gain	Est. number who gain full amount	Income where full gain achieved	Indicative fiscal cost p.a.
<b>Design 3: Bottom threshold to \$20k and 30% rate to 28.5%</b>	\$750	3.3 million	0.9 million	\$70,000	\$2,099m

45. Raising the bottom threshold by a smaller amount and reducing the 30% rate still gives some benefit to lower income earners but is more targeted to average earners. A person will get some relief if they earn more than \$14,000 but will only get the full gain if they earn \$70,000 or more. A person earning the equivalent of the 2022 average wage would get the full gain.
46. A large number of taxpayers would still benefit from this type of change although the full gain would be received by only approximately 0.9 million people.
47. Lowering the 30% tax rate would reduce the steep increase in marginal tax rates from 17.5% to 30%. There is a trade-off for a given fiscal cost between the extent to which the bottom threshold is increased (providing gains to all those with income over \$14,000) and the 30% rate reduced (targeted at incomes above \$48,000).
48. This approach helps to address progressivity in the mid/upper income range where it is flattening. It reduces the steep increase in rate at the \$48k threshold and increases the currently small step at the \$70k threshold.
49. The approach may have some positive impacts on work incentives and labour supply. This is because it would reduce the marginal tax rate paid by most low to middle hourly wage earners. The reduction in the 30% rate would impact interactions with current abatement thresholds for WfF and may reduce effective marginal tax rates for some recipients.
50. With a person working fulltime earning the minimum wage expected to earn just under \$48,000 by 2023/24, a reduction in the 30% tax rate applying from the \$48,000 threshold would help to reduce the average and marginal tax rate of lower income earners as future wage growth occurs.
51. Under this approach, there would be a small impact on work incentives for individuals receiving the main benefit from the increase in the lower threshold, but no direct impact from the change to the 30% rate.

*Approach 4: Increase all thresholds*

**Table 9: Summary of approach 4 - Increase all thresholds (inflation adjustment)**

	Max gain per person	Est. number who gain	Est. number who gain full amount	Income where full gain achieved	Indicative fiscal cost p.a.
<b>Design 4: Raise all thresholds by 10% (except \$180k)</b>	\$908	3.3 million	0.7 million	\$77,000	\$2,027m

52. A one-off adjustment for inflation would involve adjusting all of the tax thresholds, except the \$180,000 threshold, by a set percentage. The \$180,000 threshold would be excluded as it was introduced relatively recently whereas the other thresholds were all set in 2010. Everyone that earned over \$14,000 would still get some benefit.
53. Increasing all thresholds (except \$180,000) would reduce ATRs for all those with incomes above the current bottom threshold. Those with income currently at or close to the new thresholds will see the greatest reduction in their ATR. An inflation adjustment retains the existing structure of the personal tax system. This may not be desirable if different distributional or efficiency outcomes are preferred.
54. This approach will have the lowest nominal and proportional gains for individuals with income equivalent to the full-time annualised 2023/24 minimum wage. It provides higher nominal and proportional gains further up the income scale.
55. A person would need to earn more than the adjusted \$70,000 threshold to get the full gain from the change. If the thresholds were increased by 10% then a person would need to earn more than \$77,000 to get the full gain. Only approximately 0.7 million people would get the full gain (based on the 2021 tax year) although this would increase over time with fiscal drag.
56. The approach moves the thresholds for the 30% and 33% marginal rates higher up the income scale, which goes some way to addressing the flattening of progressivity in the mid-upper income distribution. It slightly reduces the large income range covered by the 33% rate (currently \$70,000 to \$180,000). However, it does not address the steep increase from 17.5% to 30%, the threshold around which future fiscal drag would most significantly bite. The approach would help to preserve progressivity in the tax system as incomes grow over the forecast period. The difference in ATRs between earners on 167%, 100% and 67% of the average wage would still decrease between 2022 and 2027, but to a lesser degree.
57. As this approach increases the threshold for the 30% rate, it is likely to see a greater reduction in ATRs at a point on the income scale with the greatest concentration of earners with wages/salary income (the largest relative benefit is at \$52,000 for a threshold adjustment of 10%), which may increase potential efficiency benefits. This will also impact interactions with current abatement thresholds for WfF.
58. There may be some positive impacts on work incentives for part-time primary and secondary workers. Full-time workers on the living wage would no longer face a marginal tax rate of 30%. The marginal tax rate for the average wage would decrease to 30%. There would be minimal impact on work incentives for most individuals receiving the main benefit.
59. Given the long period since thresholds were last adjusted (2010) a full adjustment to account for the effects of inflation would have a high fiscal cost. Adjusting for CPI would require an increase of 30% to each threshold, while adjusting for Quarterly Employment Survey wages would require a 48% increase.

60. This approach would be effective in compensating for historical fiscal drag but would do little to address income adequacy concerns for those on low to middle incomes.

### Sub-option to reduce/remove gains at top end of income scale

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61. When adjustments are made to lower rates and thresholds, everybody with income over the highest point of adjustment will receive the maximum gain. If the Government's objective is to support incomes in the face of rising prices, with a focus on low to middle income earners, adjustments could be made so that the gain does not apply at higher income levels.
62. Not providing the gain at higher income levels could help to maintain progressivity in the tax system at the upper end of the income scale and would also reduce the fiscal cost of the changes. However, it is likely to have some negative impacts for the integrity of the system and may have some small but negative impacts on work incentives.
63. Designing the change so that it does not provide a gain to those with incomes over \$180,000 would reflect the recent introduction of the top tax rate which has not been subject to as much fiscal drag as other rates. The number of individuals who would not receive the gain would be relatively low: approximately 104,000 taxpayers or 2.5% (this proportion is expected to increase as personal incomes rise).
64. We have considered a range of possible approaches, including adding an additional threshold and rate between \$70,000 and \$180,000, increasing the top marginal rate, providing the gain through an abating tax credit, and reducing the top tax threshold. If the Government did not want to provide the gain to high income earners, of the options considered we would recommend reducing the top tax threshold.
65. The reduction in fiscal cost would depend on the income level at which the gain is not provided and the specific option for tax relief. In the scenario of a tax-free threshold of \$5,000, removing the gain for incomes over \$180,000 by lowering the top tax threshold is estimated to reduce the fiscal cost by around \$153 million per annum. Approaches that provide a larger maximum gain would result in a greater reduction in fiscal cost.
66. Some people with income above the reduced threshold but below \$180,000 would receive a reduced gain from the changes. They may also perceive themselves as having a higher tax burden, as a result of becoming subject to the 39% rate, although they will in fact be paying less tax than under the status quo.
67. Subject to your direction, further assessment of costs and benefits can be provided in relation to the specific tax reduction approach.

### Interaction with transfer system

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#### ***Sub-option to provide increase to main benefits***

68. To ensure that beneficiaries receive at least the same gain as wage earners, you could choose to accompany tax changes with an increase to main benefit rates. Officials recommend that options for an accompanying increase to main benefits are provided in further tax advice.
69. Providing a direct increase to main benefit rates would require a separate policy decision with an additional fiscal cost. This would be in addition to the indirect impact. As noted above, the indirect increase via wage indexation to main benefit rates under approaches 1 - 3 will be smaller than the potential direct increase due to the tax change, while the indirect increase under approach 4 will be larger.

70. The estimated additional fiscal cost of accompanying a tax change with a \$10 per week increase to main benefits is around \$200 million per annum. If you are interested in further information on this option, officials will need to involve MSD officials. There are options to increase benefit rates by an equivalent amount to the tax change (i.e., 'flow through' the change), or alternatively provide a flat dollar increase. If a decision is taken to increase main benefits, a flat dollar amount may be administratively simpler and easier to communicate and gives more flexibility around the size of the increase.
71. This option is recommended if the intention is to support households, including the lowest income households, with cost-of-living pressures (income adequacy). Providing an increase would support horizontal equity and provide a greater reduction in AHC50 poverty. It would also ensure the changes do not increase BHC50 poverty. An increase of a similar size to the gains from the tax changes (e.g., up to \$10pw) would be unlikely to be distortionary to work incentives.

***Sub-option to remove Independent Earner Tax Credit***

72. As part of any changes, consideration could be given to removing or updating the Independent Earner Tax Credit (IETC), which is now providing a gain at a different level of the wage scale than originally intended.
73. The IETC was introduced in 2009 to improve the returns from work for individuals without state support, such as WfF and New Zealand Superannuation, earning \$24,000 - \$48,000. It provides a maximum entitlement of \$520 per year. The lower eligibility threshold was originally set at just under the full-time minimum wage at the time. There have been no changes to the tax credit since its implementation. Approximately 530,000 individuals are currently entitled to the IETC.
74. Full time minimum wage earners now earn above the abatement threshold of \$44,000 and from 1 April 2023 will earn close to \$48,000, the level at which the IETC fully abates.
75. The IETC is no longer well-targeted and may no longer be an effective mechanism to achieve its original objective.
76. As part of further advice, we could consider how the IETC might be amended to either better target its original population, or to support a different target group. We could also consider whether the IETC could be removed as part of a tax relief package.
77. Withdrawing the IETC would reduce or offset the benefits of the tax changes for current recipients.

[33]

**Economic impacts**

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79. You are considering personal tax changes as part of a package of tax changes. You should consider the combined effects of personal tax relief and other tax changes, and how they relate to your fiscal and economic objectives.

80. In particular, you are currently considering funding a personal tax cut through the introduction of a deemed minimum income tax on high wealth individuals. As officials have previously advised, that proposal is likely to have significant economic costs [T2022/2703 and IR2022/516 refer]. Treasury and Inland Revenue therefore recommend that you prioritise further consideration of income tax measures that are most likely to have the largest positive economic impacts, which could help to reduce some of the overall economic impact of a progressive tax switch.

## Implementation

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81. The timing of any changes should be consistent with your fiscal and macroeconomic objectives, such as the timing of the return to surplus, the need for fiscal policy to continue to support monetary policy in reducing inflation, and when additional revenue is raised from other tax measures. Treasury will provide further advice on these cross-cutting economic considerations next week, in advance of Budget Ministers 2.
82. Inland Revenue officials' preferred option is that these changes would apply at the earliest from 1 April 2024, i.e. from the start of the tax year following Budget 2023, as this would be the most efficient implementation date. Earlier implementation with a change mid-tax year may be feasible but would be more complicated and would require additional Inland Revenue effort as it would likely require the use of composite tax rates and/or thresholds for the part year before fully switching to the new settings at the beginning of the next tax year. A part-year change would also reduce the time available to the private sector to make the changes that they would need to make.
83. Changes to personal tax rates and/or thresholds will also have impacts on the private sector, with payroll service providers, employers, banks, portfolio investment entities (PIEs), share registries and other withholding taxpayers needing to make changes to their systems. This level of effort required will depend on the changes being made. We will provide further advice on this as part of the final policy advice.
84. The addition of a tax-free threshold would have flow-on impacts for the various withholding tax types with new non-exempt nil tax rates likely to be needed for resident withholding tax (RWT), PIE taxation, and fringe benefit tax (FBT).
85. Potential changes to welfare settings could also have implications for the implementation of personal tax changes and vice versa. These implications will be considered further as direction is received on the preferred approach.
86. Inland Revenue is reporting to Ministers separately on change capacity constraints IR2023/043 refers. The change effort required for the implementation of any personal tax reductions will need to be determined and considered in light of the existing capacity constraints.

## Next steps

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87. We propose that you discuss the contents of this report with officials at the Joint Ministers meeting on 16 February 2023 and provide initial direction on your preferred approach. Following this, officials will finalise slides to support your discussion of tax options at Budget Ministers 2 on 20 February 2023.
88. Decisions and feedback from the Joint Ministers meeting and Budget Ministers meeting will guide officials in their preparation of final policy advice on specific options. Detailed consideration of interactions with other tax and transfer initiatives will be needed to more accurately determine the impact of proposed changes.
89. Officials understand that there will not be any consultation on the proposals due to Budget secrecy requirements. Given this we have not undertaken the usual engagement processes, including with the Māori Advisory Panel.
90. Final policy reports on tax initiatives will be provided to Ministers on 10 March 2023 for further discussion at the Joint Ministers meeting on 16 March.
91. Draft Cabinet papers and Regulatory Impact Assessments will be provided to you on 17 March. After final decisions are taken at Budget Ministers 5 on 31 March, Cabinet papers will be finalised for lodging on 5 April.

## Appendix A: Design examples and high-level impacts

- Design examples for the four approaches are set out below. These are provided for illustrative purposes and have been based on a fiscal cost of approximately \$2 billion per annum (based on 2024/25 implementation), with the exception of the \$10,000 tax-free threshold design which has an approximate cost of \$3.8 billion per annum. Variations of and/or combinations of designs, are possible.

**Table 10: Approach 1 - Tax-free threshold**

Design 1a: \$5,000 tax-free threshold					
<b>New rates</b>	0%	10.50%	17.50%	30.00%	33.00%
<b>New thresholds</b>	1 - 5 000	5 001 - 14 000	14 001 - 48 000	48 001 - 70 000	70 001 - 180 000
<b>Indicative fiscal cost</b>					\$1,918 million

Design 1b: \$10,000 tax-free threshold					
<b>New rates</b>	0%	10.50%	17.50%	30.00%	33.00%
<b>New thresholds</b>	1 - 10,000	10 001 - 14 000	14 001 - 48 000	48 001 - 70 000	70 001 - 180 000
<b>Indicative fiscal cost</b>					\$3,787 million

**Table 11: Approach 2 - Raise the bottom threshold**

Design 2: Bottom threshold raised to \$22,000				
<b>New rates</b>	10.50%	17.50%	30.00%	33.00%
<b>New thresholds</b>	1 - 22,000	22,201 - 48 000	48 001 - 70 000	70 001 - 180 000
<b>Indicative fiscal cost</b>				\$1,912 million

**Table 12: Approach 3 - Raise the bottom threshold and decrease the 30% rate**

Design 3: Bottom threshold raised to \$20,000 and 30% rate reduced to 28.5%				
<b>New rates</b>	10.50%	17.50%	28.50%	33.00%
<b>New thresholds</b>	1 - 20 000	20 001 - 48 000	48 001 - 70 000	70 001 - 180 000
<b>Indicative fiscal cost</b>				\$2,099 million

**Table 13: Approach 4 - Raise all thresholds to account for inflation**

Design 4: All thresholds raised by 10% except the \$180,000 threshold				
<b>New rates</b>	10.50%	17.50%	30.00%	33.00%
<b>New thresholds</b>	1 - 15 400	15 401 - 52 800	52 801 - 77 000	77 001 - 180 000
<b>Indicative fiscal cost</b>				\$2,027 million

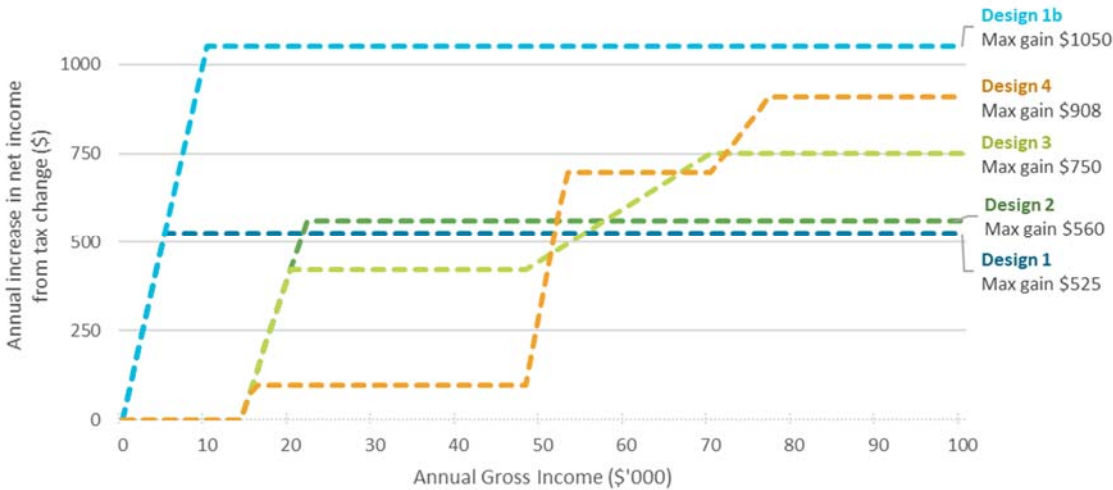
2. Table 14 summarises the gains for each design example. The tax-free threshold designs provide a gain to the greatest number of individuals, with the full gain achieved at the lowest levels on the income scale. However, for the same fiscal cost, the maximum gain per person is lower. The other design examples still provide a gain to a large number of individuals, however, designs 3 and 4 have a significantly smaller number of people receiving the maximum gain.

**Table 14: Summary of gains for individuals**

	Max gain per person	Est. number who gain	Est. number who gain full amount	Income where full gain achieved	Indicative fiscal cost p.a.
<b>Design 1a: \$5k tax-free threshold</b>	\$525	4.1 million	3.4 million	\$5,000	\$1,918m
<b>Design 1b: \$10k tax-free threshold</b>	\$1050	4.1 million	3.3 million	\$10,000	\$3,787m
<b>Design 2: Bottom threshold to \$22k</b>	\$560	3.3 million	2.6 million	\$22,000	\$1,912m
<b>Design 3: Bottom threshold to \$20k and 30% rate to 28.5%</b>	\$750	3.3 million	0.9 million	\$70,000	\$2,099m
<b>Design 4: Raise all thresholds by 10% (except \$180k)</b>	\$908	3.3 million	0.7 million	\$77,000	\$2,027m

3. Figure 2 illustrates how the different designs<sup>4</sup> would affect levels of income. This illustrates the points where an individual would see an increase in net income.

**Figure 2: Effect of example designs on after-tax incomes**



4. Table 15 summarises the impacts by individual 2023/24 income level (minimum wage for 2023/24 year, other wages based on HYEPU forecast). Designs 1 and 2 provide the full gain at the income of a full-time worker earning the minimum wage. Design 3 provides less of a gain at these levels, with the full gain provided at the level of the average wage. Design 4 does not provide a significant gain to people on the minimum wage, with the full gain provided at the average wage.

<sup>4</sup> This is based on hypothetical tax scale applied to arbitrary income levels, and no interaction with the benefit or tax system is included.

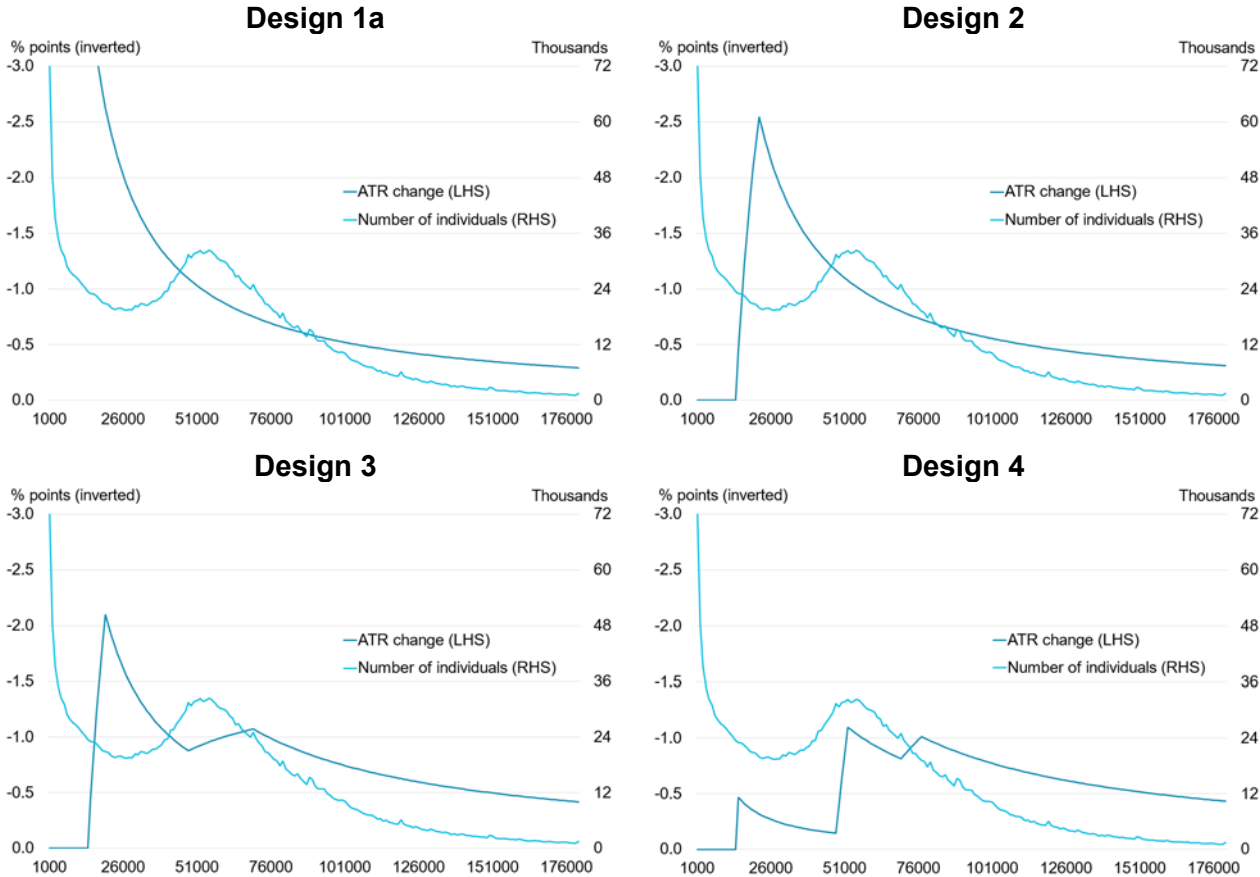


**Table 15: Impacts by 2023/24 individual income level**

Income level	\$47,346 (minimum wage from April 2023)	\$65,278 (median wage – estimate for 2023/24)	\$80,497 (average wage – estimate for 2023/24)	\$134,430 (167% of average wage – estimate for 2023/24)	\$180,000 (39% threshold)
<b>Design 1a</b>					
Change in tax paid	-525	-525	-525	-525	-525
Change in ATR	-1.1	-0.8	-0.7	-0.4	-0.3
<b>Design 1b</b>					
Change in tax paid	-1050	-1050	-1050	-1050	-1050
Change in ATR	-2.2	-1.6	-1.3	-0.8	-0.6
<b>Design 2</b>					
Change in tax paid	-560	-560	-560	-560	-560
Change in ATR	-1.2	-0.9	-0.7	-0.4	-0.3
<b>Design 3</b>					
Change in tax paid	-420	-679	-750	-750	-750
Change in ATR	-0.9	-1.0	-0.9	-0.6	-0.4
<b>Design 4</b>					
Change in tax paid	-98	-698	-908	-908	-908
Change in ATR	-0.2	-1.1	-1.1	-0.7	-0.5

5. The charts in Figure 3 below plot the income distribution of wage/salary earners against the ATR impact of the four main design options. This lets us compare the income levels where each approach is having the largest relative impact with how many individuals earn at that level of income. A design that provides larger benefits at the denser parts of the income distribution might be expected to have a larger impact on overall productivity/efficiency in the labour market.

**Figure 3: Distribution of wage/salary earnings vs. ATR impact by income level**



6. Further analysis of impacts would be needed, based on specific options. In addition to income levels and income types, distributional analysis will also need to consider how changes impact different demographic groups and understand equity implications. This will include impacts on Māori to the extent that data by ethnicity is available. Detailed analysis of the interactions with the transfer system will also be necessary, as this will have consequential impacts on the extent of gains provided to certain individuals.

## Appendix B: Transfer system interactions

**Table 16: Transfer system interactions**

	<b>Direct impact on net payment rate (i.e., will it increase automatically?)</b>	<b>Indirect impact on net payment rate (i.e. will it increase due to the impact on indexation?)</b>
<b>NZ Super</b>	<p><b>Direct impact</b> NZS rates are set at gross levels. Tax-reduction measures at or below the level of NZS will directly increase the net amount payable. This calculation is based on the couple rate and assumes income is split 50:50. For example, while the gross couple rate will be around \$46k from April 2023, the gain from the tax changes is calculated assuming two people earning around \$23k each. This is then increased in line with growth in CPI as part of the annual adjustment each 1 April.</p>	<p><b>Indirect impact</b> The net couple rate, once adjusted for CPI, must remain between 66% and 72% of the net average wage. The gross average wage in April 2024 is forecast to be around \$78.5k. Tax-reduction measures may have an indirect impact by increasing the level of the net average wage. The couple rate will be further lifted to 66% of the new net average wage on 1 April if the CPI adjustment does not lift the rate above the wage floor. This occurs after the tax changes are applied directly. Note the NZS rate is currently above the wage floor and is not forecast to return until 2027. Other rates of NZS are set with reference to the couple rate.</p>
<b>Main Benefits</b> (including Jobseeker Support, Sole Parent Support, Supported Living Payment, Youth Payment, and Young Parent Payment)	<p><b>No impact</b> While main benefits are taxable, they are set at net amounts in the legislation rather than gross levels. Tax-reduction measures do not increase the net amount payable, instead the gross payment rate will reduce.</p>	<p><b>Indirect impact</b> Main Benefits are indexed to growth in net average wages. Tax-reduction measures will increase the net average wage, which will lead to an increase in main benefit rates as a result of indexation. The size of the indirect impact will depend on the extent to which the tax changes increase the net average wage.</p>
<b>Student allowance</b>	<p><b>Direct impact</b> Student allowance rates are set at gross levels. Tax-reduction measures at or below the level of Student Allowance increase the net amount payable. Rates are dependent on circumstances, though most single rates between \$14k and \$21k.</p>	<p><b>No impact</b> Student allowance is indexed to inflation rather than average wages.</p>
<b>Paid Parental Leave (PPL)</b>	<p><b>Direct impact</b> Tax-reduction measures at or below the level of PPL would increase the net amount payable. Rate is around \$35k.</p>	<p><b>No impact</b></p>
<b>Accommodation Supplement (AS), Temporary Additional Support (TAS)</b>	<p><b>No impact</b></p>	<p><b>Indirect impact</b> A tax-reduction measure could affect how much AS or TAS someone is entitled to, as the formula includes the main benefit rate which will be indirectly impacted by personal tax changes via indexation.</p>
<b>Minimum Family Tax Credit (MFTC)</b>	<p><b>No impact</b> The level of the Minimum Family Tax Credit is a policy decision Cabinet takes on an annual basis. It will not automatically adjust in line with</p>	<p><b>Indirect impact</b> The level of the Minimum Family Tax Credit is determined by a formula which takes into account factors including the main benefit rate and minimum wage. All</p>

	personal tax changes. However, for some MFTC recipients, the 100% abatement rate will mean any gain from the tax changes will be offset dollar for dollar in their entitlement.	things being equal, a higher main benefit rate will flow through to a higher than otherwise level of the MFTC.
<b>Tax Credits excluding MFTC</b> (Family Tax Credit, In-work tax credit, Best Start Tax Credit, Independent Earner Tax Credit)	<b>No impact</b> Tax credits are non-taxable income. Tax-reduction measures will not increase the amount.	<b>No impact</b> Tax credits are not indexed to growth in average wages.
<b>Winter Energy Payment</b>	<b>No impact</b>	<b>No impact</b>

## Appendix C: UK and Australia tax-free thresholds

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1. The levels of the tax-free thresholds in Australia and the United Kingdom (UK) have both approximately trebled in nominal terms over the past two decades (Table 17). Controlling for CPI inflation, Australia's tax-free threshold has increased by 80% in real terms and the UK's has increased by 66%. These tax-free thresholds are accompanied by higher marginal tax rates compared to New Zealand at both the bottom and top of the income distribution.
2. Since 2010, the UK tax-free allowance has been withdrawn from those with incomes over £100,000 by taxing an additional £1 for every £2 earned over £100,000. As well as the £0.80 of tax payable on this £2 of marginal income, an additional £0.40 is owed on the £1 of withdrawn tax-free allowance. This results in a 60% marginal tax rate on income earned above £100,000 until £125,140 when the tax-free allowance is fully withdrawn and the marginal tax rate returns to 40%, before rising to 45% on income above £150,000. This anomalous rise and fall in marginal tax rates is likely to have implications for economic efficiency and tax system integrity.

**Table 17: History of tax-free thresholds and first marginal rates in Australia and the UK**

Year	Country	Tax-free threshold	First marginal rate	Top marginal rate
<b>2002/03</b>	Australia	\$6,000	17%	47%
	UK	£4,615	22%	40%
<b>2012/13</b>	Australia	\$18,200	19%	45%
	UK	£8,105	20%	50%
<b>2022/23</b>	Australia	\$18,200	19%	45%
	UK	£12,570	20%	45%

## Appendix D: Caveats and disclaimers (TAWA/IDI/costing assumptions)

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1. 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.