



**Inland Revenue**  
Te Tari Taake

**Policy and Regulatory Stewardship**  
**Kaupapa me te Tiaki i ngā Ture**  
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## Briefing note

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Reference: BN2023/153

Date: 4 May 2023

To: Revenue Advisor, Minister of Revenue – Jason Batchelor  
Private Secretary, Minister of Revenue – Helen Kuy  
Revenue Advisor, Associate Minister of Revenue – Harper Burtenshaw

cc: Peter Mersi, Commissioner  
David Carrigan, Deputy Commissioner  
Emma Grigg, Policy Director  
Kerryn McIntosh-Watt, Policy Director  
Phil Whittington, Policy Director  
Joanne Petrie, Executive Support Advisor to the Commissioner  
Jill Compton, PA to Deputy Commissioner  
Governance, Ministerial & Ministerial Services

From: Steve Mack

Subject: **Questions on the HWI report from 2 May**

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### Background

1. At your meeting with officials on 2 May, you asked for additional information on the following related to the High-Wealth Individuals (HWI) effective tax rate report:
  - Examples of ways we tax unrealised income;
  - Analysis of ownership patterns (we will provide this later);
  - Rate of return information for project population; and
  - A simple explanation for why unrealised gains are income.
2. We also update you on recent comments by Thomas Piketty on the report.

### Comments by Thomas Piketty

3. In a podcast broadcast by French radio on 28 April, Thomas Piketty referred to the HWI report during a debate about a French website that discloses where tax revenues are raised and how French taxes are spent.
4. His comments related to the HWI report were:
  - Transparency is good but the French website lacks details. He noted that in contrast, New Zealand just released a study showing tax distribution across the income and wealth distribution (referring to the Treasury study), and also the 300 wealthiest New Zealand families paid only 8% of their income in tax (note

the actual figure is about 9%), while the average for New Zealanders is about 20%.

- According to recent media releases, the wealthiest Americans pay about 4% (we presume he is referring to the Council of Economic Advisors study we cited in our report – that figure was about 8%).
  - He indicated he believed the equivalent figure for the wealthiest French is probably about the same as for the Americans. He encouraged the French government to do a similar study as our HWI study, using the 300 or 500 wealthiest French.
5. In earlier comments to Radio NZ, he described the New Zealand reports as “depressing but not surprising” and said the obvious solution was a progressive wealth tax at the top.

### **Unrealised income**

6. Measuring income on an accrual or unrealised basis is common for many purposes. For example, it is standard for business financial statements to be prepared on an accrual basis, because this is a fairer presentation of income over a period than on a realised or cash-flow basis.
7. The tax system uses a combination of cash-flow and accrual measures. Cash-flow is often used for simplicity and certainty and in many cases there is very little difference between a cash-flow and accrual measure (such as for wages and salaries).
8. Examples where the tax system measures income on an accrual instead of cash-flow basis include:
- **Financial arrangements (debt instruments)** – the financial arrangement rules (income and expense from debt) primarily require an accrual measure of income. For example, loan income or expense must be calculated on a yield-to-maturity basis and/or the change in value of the debt instrument over the year must be included. Some debt instruments may be measured on a cash-flow basis for simplicity when the value is small (such as bank deposits).
  - **Foreign investment funds (FIFs)** – FIFs are generally portfolio interests in foreign shares. Under the FIF rules, the primary calculation method is the fair dividend rate, a deemed 5% return regardless of the realised income (such as dividends) from the shares. An alternative measure is comparative-value, which is also an accrual measure (the unrealised gain or loss must be taken into account, although to reduce arbitrage there is a limit to recognising the loss).
  - **Depreciation loss** – when durable personal property is used to produce income, an annual deduction is allowed for an accrued depreciation loss. When the property is sold, gain or loss must be recognised so that the total deductions claimed equal the actual loss.

### **Rate of return information**

9. You asked for rate of return information. The following tables some high-level indicative returns for total economic income, and only non-taxable economic income:

**Rate of return tables (\$ millions)**

<b>Income years ending 31 March</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
<b>Total economic income (ex-imputed rents)</b>	4,798	1,049	6,801	1,276	2,218	14,585
<b>Total non-taxable economic income (ex-imputed rents)</b>	4,129	429	6,060	528	1,467	12,869
<b>Net Worth</b>	64,029	67,332	70,634	73,937	77,900	81,864
<b>Rate-of-return non-taxable economic income</b>	6.4%	0.6%	8.6%	0.7%	1.9%	15.7%
<b>Rate of return total economic income</b>	7.5%	1.6%	9.6%	1.7%	2.8%	17.8%

**Comparative portfolio return information (converted to NZ\$ returns)**

<b>Year</b>	<b>Stocks domestic price return</b>	<b>Stocks international total return</b>	<b>Stocks international price return</b>	<b>International Bonds</b>
2016	9.7%	6.1%	3.6%	15.9%
2017	3.1%	12.0%	9.3%	-5.9%
2018	11.6%	12.5%	10.3%	3.2%
2019	14.3%	9.0%	6.1%	5.5%
2020	-2.4%	-5.7%	-8.1%	17.7%
2021	23.2%	40.7%	38.0%	-11.1%

**Source:** S&P Global, see SPGlobal.com. Stocks domestic price return based on S&P/NZX 50 Index. Stocks international total and price return based on New Zealand Aggregate Bond Index. International bonds based on Global Developed Aggregate Ex-Collateralized Bond Index.

10. In the rate-of-return table, total economic income is total economic income not including imputed rents. Net worth is estimated from survey information, calculated data (such as real property values), and from public information (significant listed company shares). No personal debt is presumed to be associated with the wealth except with respect to real property. A debt level was assumed based on HES data for debt levels for the nearest year for the top ventile of the HES sample.
11. The non-taxable economic income is all the income (except imputed rents) other than base income and trustee income, which bears a full level of tax. We categorised capital gains on shares of business entities as non-taxable even though we did attribute some amount of company tax or trustee tax with respect to those amounts (because the income is primarily non-taxable at the individual level).
12. As with all calculated amounts, the results are dependent on the quality of the data (such as survey information), assumptions, and inaccuracies to the extent actual gains differ from the broad market return information we used to calculate many of the income amounts.
13. We provide historical data on market returns on portfolio investments for comparison to the calculated returns for the responder population.

### **Why unrealised gains are income**

14. The ETR calculations were based on “economic income”, which is based on Haig-Simons income, a concept widely used in tax economics as the most comprehensive measure of income. Effective tax rate calculations based on Haig-Simons income are standard for measuring the efficiency of a tax system (how much the tax system distorts investment inefficiently)<sup>1</sup> and also how much the tax adds to or reduces the taxpayer’s economic well-being broadly.
15. Unrealised gains increase a person’s ability to consume, which is why they are included in income. Even if the gain does not increase cash-flow so is not reflected in consumption immediately, it may increase consumption in the future if it is to be sold. The benefit of untaxed accruing gains can be substantial and if they are not taken into account, the calculated ETR would be incomplete and misleading when compared to ETRs on alternative investments.
16. For example, see the attached spreadsheet illustrating different outcomes depending on whether in investment is taxed currently (on accrual), taxed on realisation only, or not taxed at all. The lack of accrual taxation increases the after-tax return, and this should be reflected in the ETR calculation to accurately reflect how it differs from other tax treatments.
17. The purpose of including effective tax rates on accruing income is to test how successfully our tax system taxes income in the economic sense. The question of whether accruing gains are a sensible tax base is different from acknowledging that accruing gains directly impact someone’s wellbeing and ability to consume.

### **Consultation with the Treasury**

18. The Treasury was not informed about this briefing note due to time limitations.

Steve Mack  
**Principal Advisor**  
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<sup>1</sup> For example, the OECD’s *The Taxation of Household Savings*, calculates effective tax rates for different countries on different investments taking into account the benefit of the non-taxation or deferral of taxation of unrealized gains.

1. Compounding debt investment, 5% annual interest payment, tax rate 33%

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening value	\$1,000,000	\$1,033,501	\$1,068,125	\$1,103,910	\$1,140,895
Interest income	\$50,000	\$51,675	\$53,406	\$55,196	\$57,045
Less: tax	-\$16,500	-\$17,053	-\$17,624	-\$18,215	-\$18,825
Closing value	\$1,033,501	\$1,068,125	\$1,103,910	\$1,140,895	\$1,179,120

  

	Year 6	Year 7	Year 8	Year 9	Year 10
Opening value	\$1,179,120	\$1,218,627	\$1,259,458	\$1,301,658	\$1,345,272
Interest income	\$58,956	\$60,931	\$62,973	\$65,083	\$67,264
Less: tax	-\$19,455	-\$20,107	-\$20,781	-\$21,477	-\$22,197
Closing value	\$1,218,627	\$1,259,458	\$1,301,658	\$1,345,272	<b>\$1,390,349</b>

2. Property earns capital gain of 5% per year, sold in year 10, realised capital gains tax, tax rate 33%

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening value	\$1,000,000	\$1,050,001	\$1,102,503	\$1,157,631	\$1,215,517
Capital appreciation	\$50,000	\$52,500	\$55,125	\$57,882	\$60,776
Less: tax	\$0	\$0	\$0	\$0	\$0
Closing value	\$1,050,001	\$1,102,503	\$1,157,631	\$1,215,517	\$1,276,298

  

	Year 6	Year 7	Year 8	Year 9	Year 10
Opening value	\$1,276,298	\$1,340,112	\$1,407,118	\$1,477,474	\$1,551,348
Capital appreciation	\$63,815	\$67,006	\$70,356	\$73,874	\$77,567
Less: tax	\$0	\$0	\$0	\$0	-\$207,542
Closing value	\$1,340,112	\$1,407,118	\$1,477,474	\$1,551,348	<b>\$1,421,373</b>

3. Property earns capital gain of 5% per year, sold in year 10, no tax on capital gains

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening value	\$1,000,000	\$1,050,001	\$1,102,503	\$1,157,631	\$1,215,517
Capital appreciation	\$50,000	\$52,500	\$55,125	\$57,882	\$60,776
Less: tax	\$0	\$0	\$0	\$0	\$0
Closing value	\$1,050,001	\$1,102,503	\$1,157,631	\$1,215,517	\$1,276,298

  

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Opening value	\$1,276,298	\$1,340,112	\$1,407,118	\$1,477,474	\$1,551,348
Capital appreciation	\$63,815	\$67,006	\$70,356	\$73,874	\$77,567
Less: tax	\$0	\$0	\$0	\$0	\$0
Closing value	\$1,340,112	\$1,407,118	\$1,477,474	\$1,551,348	<b>\$1,628,915</b>