Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **High Wealth Individual Research Project: Rationale and intended work**

Date:	26 May 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/197

Action sought

	Action sought	**Deadline**
Minister of Revenue	**Note** the contents of this report	14 June 2021

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**
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26 May 2021

Minister of Revenue

High Wealth Individual Research Project: Rationale and intended work

Executive summary

1. Inland Revenue received funding for its budget bid *Ensuring the tax system is operating fairly* for the two years to 30 June 2023.

2. In order to provide evidence-based policy advice and support perceptions of fairness about the tax system, it is necessary for Inland Revenue to be able to describe the progressivity of the tax system and accurately calculate the costs and benefits of any tax policy change.

3. However, a lack of information about forms of economic income which are generally non-taxable (especially capital gains) limits Inland Revenue's ability to provide evidence-based policy advice on the above issues. Estimates from overseas indicate that a disproportionate share of the income of High Wealth Individuals (HWIs) is capital gains, implying that the information gap is most acute for HWI customers. As a result, being able to calculate the economic income of this group would improve Inland Revenue's ability to provide advice.

4. Although internal and proprietary information can be used to partially construct measures of economic income across the income distribution, there are specific data gaps that require additional information to be collected from HWIs in order to reasonably estimate their economic income.

5. Inland Revenue intends to collect information to fill this gap using the new powers under section 17GB of the Tax Administration Act 1994 (TAA). The information collected will be directly relevant to calculating the economic income of HWIs. Furthermore, the information will only be used to provide advice for the development of policy for the improvement or reform of the tax system.

6. The information will be used to produce a comparison of the effective tax rates on economic income for HWIs. The HWIs that will be within scope for this research are those who are already in the compliance managed population, with an estimated net worth above $50m in a given year or who meet other criteria indicating substantial net worth. This report will be used to improve future advice on tax policy and to publicly report on the progressivity of the tax system.

7. s 9(2)(f)(iv) [redacted]

8. Our intention is to collect the highest quality information from customers in a timely manner, while also minimising the costs of compliance and protecting the privacy of individuals.

9. In order improve the quality and timeliness of the information collection, Inland Revenue intends to:

   - Limit questions asked to those that are necessary and reasonable to ask (given compliance costs and existing information) and clearly match the policy purpose,

- Ring-fence the collected information,
- Consult in order to increase buy-in and improve the clarity of the questions.

10. We plan to begin consulting with the tax community from 14 June. The focus of this initial consultation is to raise awareness with those potentially impacted by the project, this will help increase public buy-in and compliance.

11. s 9(2)(f)(iv) [redacted]

Recommended action

We recommend that you:

12. **note** the contents of this report.

    Noted

13. **refer** a copy of this report to the Minister of Finance for their information;

    Referred/Not referred

s 9(2)(a) [redacted]

Phil Whittington
Chief Economist,
Policy and Regulatory Stewardship
26/05/2021

Hon David Parker
Minister of Revenue
/ /2021

Background

Why is Inland Revenue undertaking this research?

14. A key gap in Inland Revenue's evaluation of *equity* and *efficiency* implications of the current tax system in an evidence-based way is information on *full economic income* – which is equal to an individual's ordinary income plus accrued capital gains.

15. An individual's economic income provides a more comprehensive view of their *ability to pay* than *ordinary income*, and by considering varying measures of income it is possible to more fully evaluate tax settings in an empirical manner in terms of efficiency, equity, and individual's ability to pay.

16. For this evaluation, in theory, Inland Revenue would want information on the full economic income of all New Zealanders. Such a process would be extremely time consuming, and for most of the population it is unlikely it would produce significant additional insights to the work currently underway at Treasury with respect to effective tax rates (ETRs) and economic income across the New Zealand population (noted in Appendix One).

17. After discussing the work currently underway across the New Zealand Government and evaluating gaps in our knowledge, Inland Revenue intends to focus on building a picture of the economic income for HWIs based on their individual information, the information of related entities, and where appropriate information on associated persons.

18. s 9(2)(f)(iv) [redacted]

19. The below process outlines Inland Revenue's intended use of the approved funding over the 2022 and 2023 fiscal years cumulatively ($5m). s 9(2)(f)(iv) [redacted]

20. Inland Revenue wants to provide a high-quality report following best practice for data and analytics – in order to produce the strongest evidence base for future tax policy advice. Such a process requires:

    - Inland Revenue to use internal expertise to update complex entity mappings associated with HWIs, identify and incorporate proprietary datasets, undertake an information collection program, verify information, and follow up with non-respondents in order to ensure high quality information is available for analysis.

    - The use of experienced internal microdata researchers to undertake comprehensive and rigorous analysis of the information in a way consistent with overseas research.

21. s 9(2)(f)(iv) [redacted]

22. The design process used could allow Inland Revenue to repeat the collection and report at regular intervals in the future. If longer-term funding was secured we aim to repeat this collection *every three years* to coincide with the regular Stats NZ

Household Economic Survey Wealth Module – allowing the Department to utilise insights from these data sources to build an understanding of tax paid as a proportion of economic income over the population as a whole.

23. An outline of other work underway across government on wealth and economic income distributions is provided in Appendix One.

Priority information gaps – capital gains and wealth information for HWIs

24. The gaps in our current information and the impact this has was highlighted in the Tax Working Group (TWG) 2019 report. Two clear areas where Inland Revenue was unable to provide evidence-based policy advice were with regards to:

- The *progressivity* of the existing tax system based on definitions of ability to pay/income that are wider than taxable income (e.g. economic income).
- The *quantum* of accrued and realised capital gains in a given year, for both revenue estimates and measures of this specific income source.

25. Overseas it has been established that those with the greatest ability to pay (those with high economic incomes) tend to disproportionately earn their income from capital gains – and that high income earners receive a disproportionately large amount of total capital gains income. In Gravelle (2020) it was shown that the top 0.001% (approximately 1,500 taxpayers) of those who earn income in the United States sourced 56.4% of their income from realised capital gains.[1] This can be compared with all income earners in the United States where 9.1% of income is sourced from capital gains.

26. Knowledge of the capital gains earned by high income individuals in New Zealand would contribute to the ability to analyse both questions highlighted during the TWG process.

27. Given Inland Revenue's current inability to provide a comprehensive answer to these questions, the TWG made the following recommendation:

To better understand the profile of capital income, wealth and its owners in New Zealand, the Group recommends that the Government:

- fund an oversampling of HWIs in existing wealth surveys
- include a question on wealth in the Census
- request the Department to regularly repeat its analysis of the tax paid by HWIs (Inland Revenue, 2016)
- commission research, using a variety of sources of data on capital income (including administrative data) to estimate the wealth of individuals.

28. To improve Inland Revenue's ability to answer questions related to economic income in the future, a time series of net worth profiles for the existing compliance managed HWI population and associated entities will be produced. For a population of around 400 compliance managed HWIs this corresponds to potentially as many as 30,000 entities that require valuation and attribution to the appropriate HWI group.

29. In building these profiles there will be significant investment in improving internal data availability and utilising external sources. However, there are ***data gaps*** that cannot be filled through existing processes related to HWIs or proprietary data on the New Zealand population. As established in report SNZ-MM2004, Stats NZ has

[1] **Gravelle**, 2020. "Sharing the Wealth: How to Tax the Rich," National Tax Journal, National Tax Association; National Tax Journal, vol. 73(4), pages 951-968, December.

difficultly capturing representative information about the wealth of HWIs – and as the information collected is only for a point in time, they are able to say even less about capital gains income.

30. As noted in report T2020/2965 this gap in the wealth data reduces the ability to describe the wealth distribution in New Zealand, requiring government officials to impute data from unverifiable external sources (e.g. the NBR rich list) or based on the taxable income flow attributed to them. This creates significant uncertainty about how to measure capital gains income and thereby economic income. Furthermore, it generates uncertainty about the true wealth distribution in New Zealand.

31. As a result, additional wealth information for a period of time will need to be collected directly from HWIs for the policy purpose described above.

32. This information will be used to produce a public report on the *effective tax rate paid out of economic income* for HWIs, to be published in mid-2023 (the ETR report). This report will be used to answer questions related to the *progressivity* of the current tax system and the *quantum of capital gains income*, to provide an information base for future discussions about tax policy in New Zealand.

Collecting information

33. Information collected will be combined with other sources of data which are relevant for these purposes, including proprietary data and information already held by Inland Revenue or likely to be collected in the future in administration of the Revenue Acts. One example is the trust administration information which is planned to be collected at about the same time (during 2022) under new rules also enacted at the same time as section 17GB.The exact nature of the trust data (e.g. as to settlements, trustees, beneficiaries etc) is aimed at ensuring compliance with current trust income tax rules but will contain information of relevance to the wealth information exercise.

34. This internal information collation exercise should provide a strong initial basis for evaluating the economic income of HWI groups. However, there are still likely to be gaps in the Department's information about HWIs' economic income on the basis of non-taxed income. As a result, Inland Revenue intends to use section 17GB to collect this information from HWIs.

35. s 9(2)(f)(iv) [redacted]

The information Inland Revenue intends to collect

36. Inland Revenue intends to collect information that it is currently unable to build a reasonable measure of. We will not know the exact questions that will need to be asked until internal data cleaning is undertaken.

37. However, the nature of the likely information is clear. There will need to be collection for a number of personal items, loans, and bank deposit information in order to accurately calculate both wealth and capital gains income over the period. Furthermore, where there are *non-tax paying entities* (e.g. trusts that do not have

taxable income) that hold assets it will be necessary to directly ask for information on the assets held in these trusts.

38. s 9(2)(g)(i) [redacted]

39. Future collection could also occur on a three-yearly basis, matching the collection schedule of Stats NZ's Household Economic Survey Net Worth module. The information collected would refer to the prior three years, in order to generate a consistent annual time series that can be used for future policy reporting and estimates of tax progressivity.

s 9(2)(h) [redacted]

40. s 9(2)(h) [redacted]

41. [redacted]

42. [redacted]

43. [redacted]

s 9(2)(h)

[redacted]

44. [redacted]

45. [redacted]

46. [redacted]

Consultation

47. We plan on undertaking two levels of consultation for this work: *initial consultation* to communicate the rationale for the collection and *technical consultation* to socialise the design and questions asked.

48. The initial discussions will mainly be face to face with key groups and specialist practitioners. It is not proposed that we issue any major public discussion documents or undertake public awareness campaigns. These discussions are intended to be done quickly but are important from the point of view of maximising compliance with the requests for wealth information which will follow. The key goals are therefore:

- Increasing public buy-in and compliance.
- Understanding and minimising barriers to efficiently obtaining the information we require.
- Refining the nature of that information.

- s 9(2)(g)(i) [redacted]

49. The purpose of consultation is not to determine whether we should collect the information. It is to communicate that we are collecting this information and is focused on improving response rates and social buy-in for the collection.

50. First, a fairly short period of high-level and targeted consultation will take place as soon as practicable (termed "initial consultation"). This will mainly involve discussion with some key tax advocacy groups and the major tax advisers, with the goal of explaining how we propose to use the power. There will also be discussions with public sector agencies at this time, e.g. Treasury, Stats NZ, the Privacy Commissioner.

51. We intend to commence communicating and setting up the initial consultation no later than 14 June 2021 with a view to completing discussions and considering feedback by 30 August 2021.

52. The key areas to form the basis of discussion in initial consultation will be explaining:

    - that this collection will occur in early 2022;
    - the purpose of the proposed exercise;
    - how we intend to minimise compliance costs by focussing on our knowledge gaps;
    - how we intend to protect the private information of the HWIs and their families;
    - our proposals for ring-fencing, and the type of analytics to be used (and how that is severed from the Department's operational functions);
    - our intentions with respect to enforcement of the power;
    - how the information will be used – the end products - and whether any of it will be publicly reported.

53. The second period of consultation will be more focussed on the actual knowledge gaps we will seek to fill by using the new power. This will occur in two phases and is expected to stretch out until March 2022.

54. Inland Revenue also intends to publish operational guidance on how the Commissioner will use this power prior to any notices being issued.

Future reporting

55. We plan on reporting to you after key milestones. This would involve the following reporting timeline:

    - May 2021: This report outlining the purpose of the project and the intended collection method.

s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv)

[redacted]

Appendix One: Wealth work steams across government

Key for lead agency:

- IRD = orange
- Stats NZ = green
- Treasury = blue

Objectives	Workstreams	Planned deliverables
1. Improving wealth data collection	A. Improved trust data collection: this work aims to improve our understanding of the wealth held in trusts, and to identify potential integrity risks presented by trusts. Trusts will now need to provide details on settlements, distributions, persons connected to the trust and financial statement information as part of their annual returns.	May 2021: Targeted consultation on financial statement requirements. June 2021: Public consultation s 9(2)(f)(iv) [redacted]
	B. Project Rawa (**this project**): this project aims to collect information on the wealth and economic income of high wealth individuals (HWIs). This will fill known data gaps and improve evidence on the progressivity of the tax system. Later stages of Project Rawa will use this information to undertake analysis of the effective tax rates (ETRs) paid by HWIs out of economic income	
	C. Household Expenditure and Wealth Survey (HEW): this new survey will replace the net worth and expenditure surveys previously collected in the Household Economic Survey (HES). Modest improvements can be expected as slightly more wealthy households will be included in the survey sample.	s 9(2)(f)(iv) [redacted]
2. Estimating the wealth distribution	D. Statistical modelling: Stats NZ is working with Treasury to improve measurement of the top end of the wealth distribution by using statistical modelling techniques. Preliminary modelling methods are currently being explored. The next HES net worth dataset will become available in February 2022.	s 9(2)(f)(iv) [redacted]
	E. Wealth distribution research: this work seeks to correct for known limitations in the HES net worth survey. The Treasury is preparing a working paper and analytical note on the New Zealand wealth distribution, which will present the methods referred to in T2020/2965.	s 9(2)(f)(iv) [redacted]
3. Examining the progressivity of New Zealand's tax system	F. Effective average tax rates (EATRs) by economic income: this work will calculate EATRs across the economic income and net worth distributions. Economic income sources that are not typically collected in surveys (e.g. capital gains) will be added into distribution.	

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Briefing note

Reference: BN2021/269

Date: 17 June 2021

To: Revenue Advisor, Minister of Revenue – s 9(2)(a)
Private Secretary, Minister of Revenue – s 9(2)(a)

cc: Naomi Ferguson, Commissioner
David Carrigan, Deputy Commissioner
Emma Grigg, Policy Director
Kerryn McIntosh-Watt, Policy Director
Phil Whittington, Chief Economist
s 9(2)(a), Executive Support Advisor to the Commissioner
s 9(2)(a), PA to Deputy Commissioner
Government & Executive Services (Ministerial Services)

From: s 9(2)(a)

Subject: **High Wealth Individual Research Project – Effective Tax Rate calculation**

Background

1. At a meeting on 9 June, the Minister of Revenue asked how effective tax rates (ETRs) will be calculated for the High Wealth Individual Research Project (the Project), and specifically how GST would be treated.

2. This note responds to those questions.

Effective Tax Rate calculation

3. Broadly speaking, individual effective tax rates are the amount of tax paid divided by income; $\frac{Tax\ paid}{(pre-tax\ income)} = ETR$.

4. Estimating an individual's *tax paid* and *income* requires certain assumptions to be made. It is our intention, at a high level, to base both terms on the individual's ability to consume at a point in time. The definition of economic income will be used in calculating *income* (denominator). Economic income is equal to the amount an individual could consume in one year and maintain the same amount of wealth.[1] This is distinct from taxable and realised income.

5. The purpose of this ETR measure is to represent an individual's contribution to current government income from their ability to contribute (their ability to pay). At a point in time, the government requires income to pay for goods, services, and redistribution. The principles of *ability to pay* and *equal sacrifice* indicate that we

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[1] In practice, an individual's wealth is not held constant and therefore a person's actual consumption is added to their change in wealth (their potential consumption).

would expect this ETR to rise with economic income, as those with high economic income have a greater ability to contribute and sacrifice relatively less from contributing.

6. *Tax paid* (numerator) will be attributed to the individual at the same proportion as income,[2] i.e. the proportion of company income attributed to the individual will be used to calculate the amount of company tax attributed to the individual. Later in this note we explore the treatment of GST paid within the tax paid calculation.

7. Example:

   An individual owns 50% of Business A. Business A's value increases by $100,000 in period 1. The individual is apportioned 50% of the income ($50,000). Business A paid $10,000 of tax in period 1. The individual will also be apportioned 50% ($5,000) of the tax paid.

   In this simple example the individual's ETR would be $\frac{\$5000}{\$50000} = 10\%$.

8. It is our desire to estimate and report on a range of ETRs, relaxing certain assumptions. Although these are yet to be finalised, they are likely to include:

   - ***Trusts, Charities and Private Foundations***: Changing which relationship determines the inclusion of trust net-assets and tax paid (settlors, appointees, trustees etc.).
   - ***GST:*** The inclusion and exclusion of GST paid. (See below)

9. Appendix 1 provides a simple example of how an individual's economic income, tax paid and effective tax rate could be calculated.

Treatment of GST

Will GST be included within the ETR calculation?

10. GST will be included within the tax paid (numerator) but have no impact on income (denominator). Higher prices of goods and services leads to a reduction in the real consumption by the individual, thereby impacting the economic income of the individual. On these grounds, we plan on including GST paid within one of the ETR estimates. This will increase the effective tax rates for all individuals.

11. An ETR will also be provided where this assumption is relaxed, and no GST is included.

How will the amount of GST be calculated?

12. The amount of GST apportioned to individuals will be calculated by multiplying the GST rate to an estimate of the individual's gross expenditure. The amount of GST apportioned to individuals is not recorded and therefore needs to be estimated.

13. The rationale is that this is (approximately) the GST paid by the individual at the point in time. As a result, it measures the individual's contribution to fund current government expenditure.

14. Applying an estimate of GST paid based on consumption and not income more closely relates to what they contribute now.

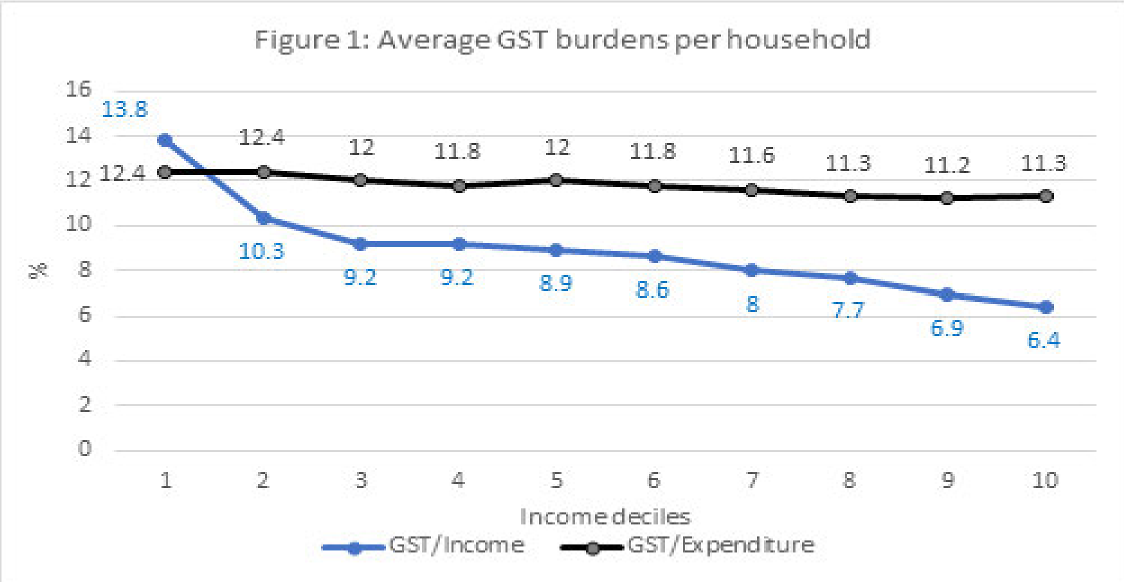
[2] The project will not seek to explore economic incidence of taxes or income further than attributing all of the company value and taxes to owners/shareholders at the proportion of their ownership share.

15. The amount of GST paid relative to income depends significantly on the savings or borrowings of an individual. An individual can, for a specific year, significantly reduce their GST liability relative to income by delaying consumption. Alternatively, an individual can significantly increase their GST liability relative to income by borrowing or by spending their savings/inheritance.

16. For individuals at different stages in their lifecycle this can have a significant impact on the timing of their tax paid – making the tax look more regressive than it is over the individual's lifecycle. (See Appendix 2 for further analysis)

17. Figure 1 shows the average effective GST burden on households, ranked using income.[3] The blue line shows, through the use of savings, that high-income earners in a particular year pay an effective GST rate that is less than half of the statutory rate. We would expect as a high-income individual changes from wealth accumulation (working age) to wealth de-cumulation (retirement) that their annual effective tax rate would shift from 6.4% closer to 13.8%.

18. The black line shows that GST on expenditure is reasonably consistent across income deciles.

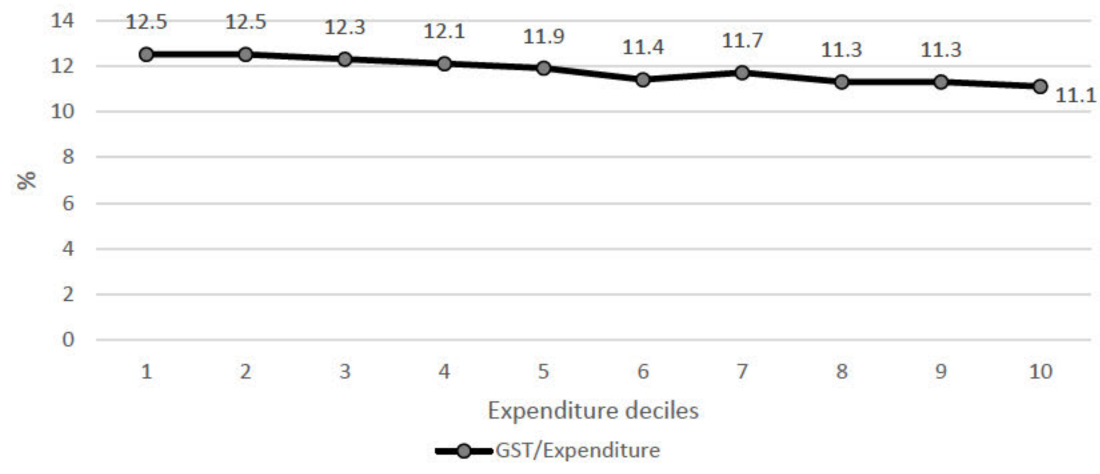


Source: Data from Thomas (2020, p.47)

19. Figure 2 below shows the average GST burden on households, ranked using expenditure. This is similar to the ranking used in this project, but does not include potential expenditure.

[3] Data from the 2016 Household Expenditure Survey, source Thomas, A. (2020), "Reassessing the regressivity of the VAT", *OECD Taxation Working Papers*, No. 49, OECD Publishing, Paris, https://doi.org/10.1787/b76ced82-en. .

Figure 2: Average GST burdens per household



20. The slightly regressive trend is linked to higher expenditure households spending more, in proportion, on GST exempt goods and services. Exempt goods and services include international travel, financial services, residential accommodation and transactions that are not reported.

21. It could be argued then that a rate of 11.1% (or 12.5%) should be used in calculating the GST incurred by high wealth individuals. However, many of the exemptions incur tax costs that are not captured in the data (because the costs are incurred overseas, or delayed):

- ***International travel*** – the individual's overseas expenditure is exempt from New Zealand GST but, as in New Zealand, it is customary for overseas travellers to incur GST (or VAT) in the overseas country.

- ***Financial services*** – many financial services are used as a store of wealth or are investment vehicles, they are very rarely final consumption. When the wealth is spent on final goods and services GST would apply. GST is simply delayed until the wealth is spent on final goods and services. This is similar to savings.

22. It would be expected that if the costs are included the average GST burden for households would be closer to the GST rate. However, due to the exemption of GST from residential property (rents) it is unlikely average GST rates will equal the GST rate, even if the data reflected all lifetime GST/VAT.

23. For calculating the ETRs, in addition to assuming high-wealth individuals incur GST at a rate of 15% on all expenditure (on a GST exclusive basis), we will calculate ETRs using alternative GST rates based on the data above.

Consultation with Treasury

24. Treasury was informed about this briefing note.

s 9(2)(a)
Policy Advisor
s 9(2)(a)

Appendix 1: Indicative ETR calculation

It should be noted that the example below is designed to be a very simple guide of the type of calculations that will be completed. Sensitivity analysis will be completed on several assumptions that underlie the basic headings and calculations below. A range of effective tax rates will be provided. For simplicity the example assumes no income is distributed (dividends) from the entities.

Steve is a high-wealth individual who owns and is an employee of Private Practice Ltd. He is also a majority shareholder of another 3 businesses, and appointee and settlor of 2 trusts. Steve holds a large art collection and share portfolio.

A simplistic personal comprehensive income statement and tax total is provided below, alongside an estimated effective tax rate.

Comprehensive income statement	Change in value	Ownership (%)	
Unlisted companies			
Steve'O Ltd	$ 500,000	50%	$ 250,000
Steve and Family Co	$ -	20%	$ -
Private Practice Ltd	$ 2,000,000	100%	$ 2,000,000
			$ 2,250,000
Non-corporate businesses	$ -	0%	$ -
Listed Companies (with interest of >10%)	$ -	0%	$ -
Trusts			
Steve and Family (Trust)	$ 250,000	100%	$ 250,000
123 Fake Street (Trust)	$ 1,000,000	100%	$ 1,000,000
			$ 1,250,000
Value of investments incl. personal items	$2,000,000	100%	**$ 2,000,000**
Total change in wealth			$ 5,500,000
Net saving			$ 250,000
Personal taxable income (salary)			$ 1,000,000
Steve's estimated economic income			**$ 6,250,000**
Consumption (Personal taxable income - saving)			**$ 750,000**
Tax	**Tax paid**	**Attribution**	**Attributed tax**
Unlisted companies			
Steve'O Ltd	$ 50,000	50%	$ 25,000
Steve and Family Co	$ -	20%	$ -
Private Practice Ltd	$ 250,000	100%	$ 250,000
			$ 275,000
Non-corporate businesses	$ -	0%	$ -
Listed Companies (with interest of >10%)	$ -	0%	$ -
Trusts			
Steve and Family (Trust)	$ 25,000	100%	$ 25,000
123 Fake Street (Trust)	$ -	100%	$ -
			$ 25,000
Value of investments	$ 200,000	100%	**$ 200,000**
Total attributed tax			$ 500,000
Tax paid on taxable income			$ 250,000
Estimated GST paid (based on consumption)			$ 97,826
Steve's estimated tax on economic income			**$ 847,826**
Effective tax rates (ETR)			847826 / 6250000
			13.6%

Appendix 2: Why income can be a poor way of measuring GST progressivity.

Academic literature

Mirrlees et al. (2011), 'Tax by Design': The Mirrlees Review, Oxford: Oxford University Press for Institute of Fiscal Studies (IFS), (https://ifs.org.uk/publications/5353)

"It can be misleading to look at current payments of all taxes as a percentage of current income: in general, a better guide to the lifetime distributional impact is to look at income taxes as a percentage of current income and expenditure taxes as a percentage of current expenditure. In the absence of data on whole lifetimes, snapshots of current income and expenditure must be used judiciously to give a rounded impression of the distributional impact of taxes."

Example

To see why it can be misleading to look at current payments of all taxes as a percentage of current income, consider an extremely simple example.

Suppose that a country consists of people who earn $100 of labour income (e.g., wages) in period 1 and spend half of this income while saving the rest. The amount saved earns interest at a rate of 10%. People spend what they have saved plus any after-tax interest in period 2. Consider four possibilities.

Situation A. – No tax. In the absence of any tax, people would spend $50 in period 1 and save $50. In period 2 they would spend $55.

Situation B. – Proportional. If we had tax at a rate of 20% on all income (labour plus interest income), they would earn $100 in period 1 and pay tax of $20 on this income. They would consume $40 and save $40. This would earn $4 of interest income on which $0.80 of tax would be paid. They would spend $43.2 in period 2. *The tax would be proportional*. Individuals in both period 1 and period 2 would be paying 20% of their incomes in tax. People in period 1 would be paying $20 on $100 of income and people in period 2 would be paying $0.80 on $4 of income.

Situation C. – Progressive. Now suppose instead we have tax at a rate of 20% on labour income but not interest income. In this case people in period 1 would once more earn $100 in period 1 and pay tax of $20 and consume $40 and save $40. In period 2 they would earn $4 of interest on which no tax is paid and have consumption of $44. *This would be a progressive tax.* People in period 1 who are on a high income of $100 would be paying 20% of their income in tax. People in period 2 who are on a low income of $4 would be paying no tax. Those on higher incomes are paying high average rates of tax.

Situation D. – Regressive? Finally suppose instead that we have a GST at a rate of 25% (and no tax on income). Once again people earn $100 of income in period 1 and spend half and save half. The $50 that is spent attracts $10 of GST so they end up consuming $40 of real goods and services. The GST is 25% of $40. They save the other $50 and this earns $5 of interest in period 2. They spend the $55 and pay $11 of GST which allows them to purchase $44 of real goods and services. **Note that this leaves them with exactly the same consumption as people in situation C.**

But tax collected in period 1 is $10 which is a tax of 10% of their income. Tax collected in period 2 is $11 which is 220% of their income of $5. A very simple analysis of this case might suggest that this *tax is regressive* because it results in a very high tax rate on low incomes in period 2 and a much lower tax on the higher incomes in period 1. But it makes little sense to describe situation C as having a progressive tax system and situation D as having a regressive tax system. In both cases the same consumption possibilities are open to people.

A problem with expressing taxes like GST as a proportion of income being earned in particular periods is that measures of progressivity or regressivity would end up being influenced by the timing of when people choose to spend their incomes and the incomes they have at this time. As mentioned in the body of this briefing note, we intend to report on both bases.

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Briefing note

Reference: BN2021/331

Date: 12/8/2021

To: Revenue Advisor, Minister of Revenue – Matthew Atherton
Private Secretary, Minister of Revenue – Nikki Chamberlain
Revenue Advisor, Parliamentary Under-Secretary to the Minister of Revenue – Ruairi Cahill-Fleury

cc: Naomi Ferguson, Commissioner
David Carrigan, Deputy Commissioner
Emma Grigg, Policy Director
Kerryn McIntosh-Watt, Policy Director
Phil Whittington, Chief Economist
s 9(2)(a) [redacted], Executive Support Advisor to the Commissioner
s 9(2)(a) [redacted], PA to Deputy Commissioner
Governance & Ministerial Services

From: s 9(2)(a) [redacted]

Subject: **Length of historical collection for HWI Research Project**

Purpose

1. The purpose of this note is to inform the Minister of the direction Inland Revenue is taking on the length of historic information collected from high wealth individuals (HWI).

Summary

2. Inland Revenue intends that this information is collected for a six-year period, specifically, income years 2016 to 2021 inclusive.

3. In terms of broad research interest, a long dataset would be desired for the wealth project. However, there are a number of issues that make data collection from a large number of years impractical and would significantly increase the risks associated with the project:

   a. s 9(2)(h) [redacted]

   b. Going back further periods also significantly increases the size and complexity of the project, particularly in regard to obtaining data on a defined population.

4. A listed company workstream is underway which attempts to consider specific taxpayers whose net worth is largely based on their controlling interest in listed companies. This will provide a longer time horizon for considering effective tax rates from economic income.

s 9(2)(h) [redacted]

5. The purpose of this wealth project is to understand the tax related contribution of HWI family groups from their economic income, measured by an effective tax rate (ETR). We are intending to provide the Minister with a report on the ETRs of the high wealth group in June 2023.

6. A longer time series of economic income and tax paid, would provide deeper information, however there are significant constraints that limit how practical it is for Inland Revenue to collect this information in the time available.

s 9(2)(h) [redacted]

Further practical constraints with longer information collection

11. The longer the period of information collection, the more complex the internal collation and analysis will be. This increases the risk that the project cannot be delivered in 2023.

12. Customers are also unlikely to hold information longer than the minimum required retention period of income year 2016. As a result, the information response rate is likely to be poor for years earlier than this period.

Conclusion

13. s 9(2)(h) [redacted] Inland Revenue is intending to collect information for a period of 6 years (TY16-21 inclusive). As this information is being collected in 2022, undertaking the historical collection for 7 years prior to 2022 leaves a maximum of 6 years of collection. For the 2021 year to be included, the collection would need to take place no earlier than April 2022.

Additional workstream for calculating ETRs

14. As the information collection exercise will be limited to 6 years, an additional approach is being taken which utilises internal and public data to generate ETRs from a smaller sample of high wealth individual's economic income for a longer horizon where this is practical.

15. This workstream will be similar in nature to past work completed by Inland Revenue in 2015-16 who investigated (largely qualitatively) what exposure there is to taxation as wealth accumulates. The 2019 Tax Working Group recommended within their final report that this type of analysis is regularly repeated.

16. This workstream aims to estimate the economic income and effective tax paid from a subset of the HWI population who hold a substantial amount of their wealth in publicly listed companies. Only administrative data and external data (i.e. publicly available data or data previously sourced from third parties) will be used for this longer horizon workstream. This will consider at least 20 years of historic data.

17. Furthermore, Treasury is intending to extend the work it is doing on wealth distribution through use of the capitalisation method back to 2001.

Consultation

18. Treasury and Statistics New Zealand were informed about this briefing note.

s 9(2)(a)
Policy Advisor
s 9(2)(a)

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **High Wealth Individual Research Project: Progress Update**

Date:	6 September 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/352

Action sought

	Action sought	Deadline
Minister of Revenue	**Note** the contents of this report and the attached draft Technical Consultation document, which is being provided to stakeholders this month.	10 September 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Felicity Barker	Policy Director, Wealth Research Project	s 9(2)(a)
s 9(2)(a)	Policy Advisor, Wealth Research Project	s 9(2)(a)

6 September 2021

Minister of Revenue

High Wealth Individual Research Project: Progress update

Executive summary

1. The High Wealth Individual Research Project (the Project) is progressing to schedule. A report on the effective tax rate (ETR) on economic income for High Wealth Individuals (HWIs) will be finished by June 2023. Collection of the substantive financial information is planned to begin in April or early May 2022.

2. Our focus over the last few months has been on bedding down the methodology we will use to calculate ETRs, putting in place internal systems and processes, and collating the data on the high wealth individual population that is already available to Inland Revenue.

3. s 18(c)(i) [redacted]

4. ETRs will be constructed for a range of income measures, including economic income and comprehensive income (which is economic income excluding imputed income). Material progress has been made on identifying what information is needed to construct these measures of income. The components of economic income (the most exhaustive measure) that will be used can be summarised as *taxable income, accrued capital gains*, *imputed income,* and *windfall gains*. Broadly, this information will be sourced as follows:

   - Taxable income: Taxable income of the entities and individuals. Information is being sourced internally from tax returns.
   - Accrued and realised capital gains: In short, this is the annual change in value of net assets held by a HWI family unit. Most of the information will need to be sourced from HWIs during the 2022 collection exercise. Values relating to listed companies and residential property will be sourced from external databases.
   - Imputed income: Imputed income is essentially the consumption benefit of owned assets. Only imputed income from residential accommodation will be calculated for the economic income measure. This information will be estimated using property value estimates from an external proprietary database.
   - Windfall gains: Primarily gifts received by an individual. This information will be requested from HWIs during the 2022 collection exercise.

5. A significant focus for the project is creating accurate and complete "entity maps". Entity maps link an HWI family unit with all the entities they have beneficial ownership in.

6. s 9(2)(h), s 18(c)(i) [redacted]

s 9(2)(h), s 18(c)(i) [redacted]

7. We intend to undertake an information collection exercise this year that will seek information solely on an HWI's entities. This is planned to begin in November this year and to be completed before the 2022 collection exercise.

8. s 9(2)(h) [redacted]

9. The next stage of stakeholder communications will begin in September. This round of discussion is aimed at tax agents and experts and is intended to build understanding and buy-in to the Project. This is important as the information collection will be completed by tax agents. We plan on sending out the attached communications document to stakeholders as part of this next stage.

10. Upcoming milestones for the Project include (a full list can be found in paragraph 66):

- the collection and confirmation of the entities HWIs have beneficial ownership in, to begin in November 2021, and
- estimating HWIs' economic income that is generated from listed companies (BN2021/331 refers), already begun.

11. s 9(2)(f)(iv) [redacted]

Recommended action

We recommend you:

13. **note** the contents of this report and the attached draft Technical Consultation document.

    Noted

14. **refer** a copy of this report to the Minister of Finance for their information.

    Referred / Not referred

s 9(2)(a)

Felicity Barker
Policy Director, Wealth Research Project
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2021

Purpose

15. This report provides details on the progress made on the High Wealth Individual Research Project (the Project). The Project will construct and collect information to produce a report by June 2023 on the effective tax rate (ETR) on economic income for High Wealth Individuals (HWIs).

16. To date, progress has been made on:

- identifying the population, the family unit, and their entities ("entity mapping")
- sourcing and preparing internal and publicly available data and identifying where gaps exist
- setting up internal processes to improve the response rate and quality of responses to the upcoming information request, and
- completing the initial consultation and starting the technical consultation.

17. Timelines and future milestones are also provided within this report.

Identifying the population, the family unit, and their entities

Population

18. s 18(c)(i) [redacted]

19. This population is not necessarily the wealthiest individuals, nor a representative sample of the top of the income or wealth distribution. A HWI includes family members and associated entities (see below).

20. For this Project, tax non-residents are being excluded from the population under analysis. Non-residents largely fall outside New Zealand's tax base and therefore including them would provide little insight in describing the progressivity of New Zealand's tax system.

21. Individuals on the HWI list that have been identified as deceased will not be included. However, if a successor can be linked to the wealth, that successor will be included.

22. s 18(c)(i) [redacted]

23. No further exclusions to the Project's population are currently being considered. Excluding non-residents and the deceased, we expect the Project's population to be approximately 350 lead individuals.

Family unit

24. Consistent with the academic literature, this research will look at Economic Family Units (an individual, their spouse, and dependent children[1]) to define the HWIs of interest. However, we do recognise the limitations of defining HWIs in this way, as families do not only share resources one way.

Entities

25. Determining the entities that HWIs are linked to, and derive economic income from, is one of the most important aspects to get accurate.

s 18(c)(i)

[redacted]

29. The new financial reporting requirements for domestic trusts (focused on monitoring compliance with the 39% rate) is expected to collect the type of information needed for entity mapping. However, these new requirements are only for the 2021–22 and later income years, whereas this Project is collecting information for the 2016 to 2021 tax years (BN2021/331 refers). Furthermore, the trust project will not collect all the information this Project requires. For this reason, the Project will collect trust information as well.

The beneficial ownership gaps will be filled through a separate information collection exercise to begin this year.

30. We will request information from HWIs on the entities and structures to which they are linked (see Appendix 1 – Entity Links). Under this request, we will provide HWIs with the entity maps we have created through collating and refining publicly available information and provide them an opportunity to verify and add to the entity maps.

31. This entity mapping information request is planned to begin in November this year and to be completed before the substantive financial information request (scheduled for late April/early May 2022). By understanding the HWIs' entities before the substantive request next year, we will be able to design a more targeted notice that should lower compliance costs for HWIs in 2022, while at the same time reducing the opportunity for interpretative differences.

32. The November request for entity information will not be made under a legal provision (that is, it will be a voluntary collection). However, to support response rates and quality, we propose that the information received will be ringfenced in the same way that information collected pursuant to section 17GB of the Tax Administration Act 1994 (TAA) will be (that is, only accessible to the Project). If

[1] The definition of dependent child used for the Project is that used by Stats NZ within their household survey: a child in a family who is aged under 18 years and not in full-time employment.

HWIs do not respond to the November request, we will assume their existing entity map is accurate. Nevertheless, we propose to include questions regarding entities as part of the compulsory notice in 2022.

33. HWIs will have until early February 2022 to provide the entity mapping information.

Sourcing and identifying internal and public information, and identifying where gaps need to be filled

Information required to estimate ETRs

34. An ETR is equal to the tax paid by an individual and the entities they have an interest in divided by a measure of the income earned by the individual and those entities.

35. While the tax paid by the HWIs can be accurately obtained, calculation of the ETR requires us to determine the appropriate measure of income. The final report will calculate ETRs for different measure of income – including economic income. Calculating and comparing various income bases helps provide context and allows for a number of views of a person's ability to pay tax (see Appendix 2 – Other income bases) for a description of the income bases we will use).

36. The primary components we will use to calculate these incomes measures are:

- taxable income
- accrued and realised capital gains
- windfall gains, and
- imputed income.

Sources of this information (gifts, taxable income, and accrued capital gains)

37. The only income source for which we have a complete picture is taxable income. Taxable income of the HWI population and entities (explained below) for the period of analysis is being sourced internally from tax returns.

38. Some information on capital gains can be sourced from external databases, and the Project will seek to use these registers and databases where available. The use of public registers and databases increases the accuracy of the data we use and reduces the compliance costs on individuals. The registers that have been identified as worthwhile investigating include:

- residential property titles
- Companies Office register data
- listed company ownership registers and share prices – Bloomberg, and
- other more bespoke registers, including aircraft and carbon credit registers.

39. In most cases, however, we will seek information from HWIs to estimate capital gains. To calculate an HWI's accrued capital gains, we will seek to collect information on, or to estimate, **all net assets** that the HWI has available to them (in effect, creating a personal income statement and balance sheet). We can then estimate the change in net assets year-on-year that cannot be explained by gifts or taxable income. This is equal to the HWI's accrued capital gains.

40. Imputed income is, broadly, the consumption value of assets a person owns. It cannot be measured accurately as it is purely an imputed value. For this Project,

we will provide income measures with and without imputed income. However, only the imputed income from residential accommodation will be included in the income measure. This will be estimated based on the annual value of property from external proprietary databases.

41. Information on the value of windfall gains (for example, gifts) received during the 2016 to 2021 tax years ("the period of analysis", BN2021/331 refers) will be requested from HWIs.

Calculating change in net assets

42. As discussed, we will estimate capital gains from the change in net assets. Net assets will need to be **estimated in many cases**. We have divided net assets into eight broad categories:

    1. Consumer durables/personal assets; for example, jewellery, art, and car collections.
    2. Real estate.
    3. Unlisted companies.
    4. Listed companies.
    5. Non-corporate businesses; for example, sole proprietors and partnerships.
    6. Personal financial investments; for example, share portfolios and bank accounts.
    7. Trusts (including entities held in a trust).
    8. Foreign-held entities.

43. Indicators to support valuing these assets vary within each category. We have currently identified over 200 unique indicators that would be useful in estimating an HWI's net assets. During the next three months, we will identify what data points are necessary and, therefore, what information we will request from HWIs.

44. We will not be asking HWIs to seek independent valuations of personal items or the businesses or property they hold.

45. Using internal valuation expertise, we have begun creating valuation models to use to estimate the value of unlisted/private companies and non-corporate businesses. Valuations of private businesses will always be an inexact art, but these models will help to ensure comparability and consistency to the extent possible.

46. For example, in the case of unlisted companies, information will be gathered on earnings for each year within the period of analysis. A range of valuation methods will be used to estimate the value of the company. This will then be compared to subsequent annual estimates to calculate a change in value of the company.

47. For trusts, we will collect information on all relationships an HWI has with a trust (trustee, settlor, power of appointment, and beneficiary) and impute a range of ownership values based on these relationships where the income cannot be accurately collected.

48. [redacted]

[redacted]

49. Various statistical methods and assumptions will need to be made to estimate an economic income range and, subsequently, an ETR range for the Project's population. Because an HWI' net assets (unlike taxable income) cannot be observed, using various methods and creating a range will reduce the level of scrutiny and should therefore increase the recognition of the final result.

Internal preparation of systems and processes

50. The substantive collection of financial account and personal item information to occur in late April or early May 2022 will be undertaken under Inland Revenue's formal information-gathering powers (specifically section 17GB of the TAA). As previously reported to you (BN2021/331 refers), this will collect information for the 2016 to 2021 tax years. We have put in place internal processes for undertaking this collection.

s 9(2)(h)

[redacted]

54. To help ensure the information is properly ringfenced, work has been completed on preparing internal processes for collection.

- Our collection and analysis platforms are secure, monitored, and ready for the quantity and type of non-tax data we expect to collect. Both platforms sit outside Inland Revenue's tax collection application (START).
- Only a small team of named data analysts, support staff and survey administrators will be able to view the individual responses.
- We are working alongside the Office of the Privacy Commissioner to draft and publish a Privacy Impact Assessment for the Project.

55. s 9(2)(g)(i) [redacted]

Compliance strategy

56. Ensuring good quality data and a high response rate will require a clear collection and compliance strategy. Our compliance strategy is designed to reflect best practice consistent with the Commissioner's general policy.

57. The strategy will seek to deliver the highest possible level of voluntary compliance from the Project's population. This will best ensure timeframes can be met.

58. A key part of our compliance strategy has been working with tax agents and other key stakeholders, such as the Law Society, in advance. During collection, support to HWIs (as well as advisors and agents) will need to be provided to answer queries. This will mainly be in the form of written/email communications. Phone support will be available where issues cannot be resolved by email, and this will be followed up with written confirmation.

59. s 18(c)(i) [redacted]

60. This messaging will outline that we may seek court orders and, in extreme cases, may prosecute for failure to provide the information. These options are a last resort, but the existence of these remedies may assist compliance with the notices.

Communications with stakeholders

61. We have completed initial consultation on the Project with key stakeholders, including CA ANZ, the Office of the Privacy Commissioner, and the Law Society. The purpose of this consultation was to raise awareness that a research project was forthcoming and to open relevant channels of communication with key players. As the collection will likely be completed by tax agents, we consider that improving their understanding and meeting their concerns will improve later response rates.

62. The consultation has been, and will continue to be, very targeted to a select group. Members of this group are either directly involved in assisting with the information collection exercise (tax advisors and umbrella groups) or stakeholders that will assist in ensuring the Project's timelines are maintained (legal practitioners and advisory groups).

63. The consultation so far has been constructive, with stakeholders willing to engage and provide insights as to the best way to collect the needed information. Stakeholders are concerned the quality and timeliness of responses may be impacted by factors such as:

- whether Inland Revenue are truly able to protect client information and privacy
- high compliance costs in collating the information sought, and
- the feasibility of collecting and analysing this amount of information.

They are also concerned that this is the first time Inland Revenue has used the new information collection powers and therefore special care should be made around privacy.

64. The next stage of communications will begin in September. This phase will reach a wider group of advisors and stakeholders. It will involve considerably greater detail, and so it should build on the work done so far with stakeholders. It will focus on how the collection exercise will be run and how the information gathered should be dealt with, but it will also still address the reasons for the exercise and the statutory issues, such as privacy.

65. We plan on sending out the attached communications document to stakeholders as part of this next stage.

Timelines and next steps

s 9(2)(f)(iv)

[redacted]

Appendix 1 – Entity Links

68. As part of our entity collection, we plan on requesting HWIs to provide information where they (or someone within their family unit) have any of the following types of entity links. These entity links have not been finalised, but they are based on similar exercises completed by the Australian Tax Office.

69. Requesting these entity links allows us to collect information on the wealth held in those entities and attributed to an HWI. However, this list does not include all assets held by an HWI (for example, residential property held in their own name and portfolio investments). These will also be requested from the HWI as part of the substantive net asset request.

Entity type	**Requested link of anyone within the economic family (or another person holding on behalf of someone within the economic family unit)**
Unlisted company	- Shareholder and shareholding % - Officer or director - Control or interest (describe)
Trust	- Appointer - Beneficiary - Trustee - Administrator or executor - Settlor - Power of appointment - Control the affairs of the Trust (describe)
Partnerships and non-corporate businesses	- A partner - In a joint venture - Other non-corporate business
Other entities	- Control or interest (describe)

Appendix 2 – Other income bases

In calculating ETRs the Project will use a range of income measures

The starting point – full economic income

70. Ultimately, economic income seeks to measure the amount of real goods a person can consume. This is because real consumption is the best indicator of material well-being.

71. A person's economic income can be measured as the amount they spend on consumption plus their change in wealth. A person's change in wealth is included because wealth can be viewed as deferred consumption. The person could have increased their consumption but chose to defer it by saving it, thereby increasing their wealth.

$$Economic\ income = consumption + increase\ in\ wealth$$

72. Direct savings[2] plus capital gains determine a person's increase in wealth. This can be reflected within the calculation of economic income.

$$Economic\ income = consumption + direct\ savings + accrued\ capital\ gains$$

73. Consumption and direct savings are the person's monetary outflows; that is, what the person allocates their money to, plus imputed income (which is part of consumption). The monetary outflows are equal to the monetary inflows to the person; that is, how much money they receive. Calculating a person's monetary inflows (taxable income and windfall gains) is simpler than their outflows. Overall, four components are needed to calculate an HWI's economic income:

$$Economic\ income = imputed\ income + windfall\ gains + taxable\ income + accrued\ capital\ gains$$

We can adjust full economic income in measuring an individual's ability to pay

74. The final report will calculate ETRs for different measures of income. Each of these measures gives a different perspective on an individual's ability to pay. For example, while economists generally think owned assets give rise to a stream of consumption benefits (imputed income), this does not give rise to monetary income from which an individual could pay tax.

75. A brief description is provided of the five other income base measures (alongside economic income) and how they differ from each other.[3]

    1. **Money income:** This is income that a person can readily retrieve. Liquid money that can be turned into consumption easily. Tax systems are generally based off this definition.

        - Income from labour (wages) and capital (dividends and rents). Realised capital gains, money gifts and public and private transfers received are also included. Excluded are imputed income and accrued capital gains.

    2. **Market income:** This is income obtained by the person transacting in the economy. The person has sacrificed something to receive this income (for example, selling your time or expertise).

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[2] Direct savings – for example, putting money in the bank or purchasing more assets.

[3] An example of imputed income is imputed rent (the amount a person would be willing to pay in rent to live in their owner-occupied property). "Gifts" encompasses inheritances and gifts in kind.

- Money income minus all gifts and transfers received.

3. **Disposable income:** Money available to the individual after transfers and taxes.

   - Market income after tax and all transfers received.

4. **Comprehensive income:** Similar concept to economic income.

   - Economic income excluding imputed income from the consumption of owned assets.

5. **Taxable income:** Defined within legislation and country specific.

   - As defined under section BD(1) of the Income Tax Act 2007.

76. Because imputed income is notoriously difficult to accurately measure and understand (even imputed income from residential accommodation), comprehensive income is likely to be the income base most widely recognised.