



POLICY AND REGULATORY STEWARDSHIP

Tax policy report: High-Wealth Individuals Research Project: July 2022 update

Date:	15 July 2022	Priority:	Medium
Security level:	In Confidence	Report number:	IR2022/355

Action sought

	Action sought	Deadline
Minister of Revenue	Note the contents of this report Refer to the Minister of Finance for their information	NA

Contact for telephone discussion (if required)

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15 July 2022

Minister of Revenue

High-Wealth Individuals Research Project: July 2022 update

Executive Summary

1. This report provides you with an update on various aspects of the High-Wealth Individuals (HWI) Research Project. Our last progress update report was dated 6 April 2022 [IR 2022-25].

Collection of information

2. Following completion of the family details questionnaire in November 2021, and the entity collection in February 2022, the third collection request, concerning financial information, was issued on 9 June 2022 as planned.
3. This seeks focussed information to complement data already held by the Commissioner or otherwise available. HWI households have until 24 August to respond to the questionnaire.
4. Response rates for the first two collections have been high; over 90% for the entity collection. Nevertheless, we continue to monitor compliance closely.
5. A subsidiary set of questions will be sent to a subset of approximately 80 - 100 HWIs in mid-July, targeted at obtaining certain financial data for individuals and entities (trusts, companies, and partnerships) for which we have insufficient financial data from returns and other sources.

Methodology – listed company work stream, trusts methodology, and foreign income

6. Significant progress continues to be made on development of the analytical methodology including that relevant to particular categories of entities, and preparation for writing of the final report.
7. Two areas of conceptual difficulty relate to the measurement of foreign income and taxation, and to the treatment of income derived by trustees, including how this can reasonably be attributed to those HWIs connected to the trust. Papers on these issues have been prepared for the next meeting of the Methodology Advisory Group.
8. We have also made progress on the listed company workstream. This workstream uses publicly available data on shareholdings and prices of listed companies to calculate the capital gains and corporate tax from holdings of listed companies over the period 2004-2021. We will report to you on this workstream in August.

Purpose

9. The purpose of this report is to provide you with an update on the HWI Research Project, specifically on the progress of the information collections and development of the methodology. We previously updated you on 6 April 2022 [IR2022-125 refers].

Collection of information

Entity and Financial collections

10. As previously reported, two collection exercises have been undertaken. The first, in November 2021, collected information about the HWI's immediate family – domestic partners and dependent children – so that our analysis can be undertaken based on the family unit, comparable to Stats New Zealand's Household Economic Survey. The second, in February 2022, asked for additional information concerning some entities such as trusts and companies. The criteria were carefully described in guidance issued to each HWI and domestic partner.
11. The response rate to these requests has been high. Although some responses are still being received, the overall rate is about 90% for both of these collections.
12. On 9 June 2022, the third information collection process was initiated using section 17GB of the Tax Administration Act 1994. This collection uses the same mix of secure email and physical channels. The questions asked focus on filling gaps in our knowledge of the affairs of each HWI family, and do not generally cover information which we already hold or can reasonably access (e.g., most real property data which we can access through public records).
13. The main areas of inquiry, relating to the years 2016 to 2021 (except as noted), are summarised below. These were contained in a spreadsheet-based disclosure statement which each addressee is required to complete and return:
 - (a) An estimate of household spending in the 2019 year (to assist with calculating the effect of GST) and a question about gifts and inheritances received in the last 50 years;
 - (b) Real property information – the address of the family's principal residence, and information on properties held by bare trustees or nominees to complement data we obtained from public records;
 - (c) Details relating to trusts – for each in-scope trust, information about the relationship (settlor, appointor, trustee etc), real properties held, settlements made, distributions;
 - (d) The portfolio investments of the family, including opening bank balances, fund balances, contributions and distributions;
 - (e) Distributions, ownership changes, and capital investments into identified non-portfolio entities.
14. Initial feedback indicates that a number of individuals are already engaging constructively. Enquiries have been received through the helpline and some responses have already been submitted. We have sought to ensure in our guidance that the rationale for the questions is clearly communicated.
15. The HWIs have until 24 August to respond.

Supplementary targeted requests during July

16. A supplementary set of requests will be sent in mid-July. It is expected that 80-100 individuals will receive this targeted request.
17. The object of this targeted collection is to fill knowledge gaps on entities which Inland Revenue does not have sufficient existing data (from IR 10 and other resources) to calculate the various income measures.

18. The work on design of this supplementary request is well advanced.

Monitoring compliance

19. Although there has been a high response rate for the first two collections, we continue to review our compliance options.
20. We have used a number of approaches to support compliance, including having a dedicated email-based support unit, web resources, ongoing liaison with tax agents and advisors, and an ascending sequence of communications reminding HWIs of their obligations. We have also developed policies allowing for extension of time if needed. The key strategy, which has largely worked well to date, is about communication and persuasion. We have continued to receive responses to the entity collection over recent weeks.
21. At this point we have made no operational decisions about stronger compliance options, namely the use of civil court orders, or prosecution for failure to provide information, under the Tax Administration Act 1994. We will continue to consider our compliance strategy and options over the coming months.

Legal questions raised by commentators

22. As mentioned at a meeting with you on 21 June, one of the interesting sessions at the International Fiscal Association (IFA) conference concerned the scope of section 17GB of the Tax Administration Act, which is the power we have used to collect information for the Project. This session was presented by barrister Andrew Butler.
23. In the presentation and subsequent discussion, the presenter and members focussed on the following points:
 - (a) The power is new, enacted in 2020, and differs from existing information gathering powers through its focus on the purpose of tax policy improvement.
 - (b) The protections built into the provision, to prevent wider use being made of the information gathered, are different from similar legislation (the specific example used was the Statistics Act) in a number of respects. Commentators raised the question of whether this was appropriate, or whether the protections in section 17GB should be strengthened.
 - (c) That the BORA prohibition on unreasonable search is a relevant consideration in the use of the power.
 - (d) A concern that other state agencies could adopt similar policy provisions over time, giving agencies broad powers to collect information from individuals.
 - (e) The difference between collecting information for the administration of the tax system, which occurs largely outside public and political debate, and collecting information for policy development, which is often the subject of public and political debate, and whether this puts the Commissioner in an unusual or difficult position.
24. Many of these points have been raised by other stakeholders and have each been considered as we developed our approach to the collection of information for the Project. However, we took away three main points from the session.

- a. First, there is ongoing interest in the Project and the limitations on the use of the power at law, of which we need to remain cognisant.
- b. Second, as previously reported to you, stakeholders have some concerns with the design of the power that we will continue to monitor in our policy work.
- c. Third, the importance of ensuring adequate BORA input in the design of legislation.

Methodology

Update on issues for discussion at next Methodological Advisory Group (MAG) in August

25. Our methodology will be subject to peer review by an academic reviewer. In addition, the MAG, made up of 10 subject matter experts from outside Inland Revenue, has been formed to provide input into the methodology. This group last met on 13 April 2022 and is expected to meet again in early August. It continues to be a valuable source of insights into the approach we should take in our final report.
26. At the 13 April meeting, the group discussed a paper prepared by Inland Revenue staff on Valuation and Capital Gains in the context of establishing our income measures, including possible options for calculation of realised and unrealised capital gains. This included discussion on how unlisted companies would be valued (using Comparable Companies Multiples Analysis method), the classifications of real property assets and the use of 2016 values as the relevant cost base for realised gains (our measurement period is 2016-21).
27. Two topics which will be discussed in the MAG in August are areas of significant conceptual difficulty. These are our proposed approach to allocating income and trustee tax arising within trusts, and the way that we deal with foreign income and taxes.

Trust income allocation

28. Income within trusts is likely to be a material component of the total income of HWIs and their families. To recognise this when calculating ETRs, we plan to calculate trust income consistently and then attribute that income to individuals who have a significant interest in those trusts.
29. When calculating economic income ETRs we intend to apply a similar approach to that used with companies. That is, deeming income to an individual to include any distributions received from the trust plus any increase in value of the trust (both realised and unrealised capital gains) and any income retained within the trust (undistributed). We will apply this across each asset class, for example, real property, portfolio investments and non-portfolio investments. To balance this, tax paid in ETR calculations should include any tax individuals personally paid on taxable distributions they received, together with a portion of tax paid by the trust over the examined period.
30. We propose to attribute the calculated accumulated income amounts to HWIs and their families on the basis of the trust's relationship to them, using three methodologies. First, we will look at whether all of the trust's beneficiaries are members of the HWI's family. Then we will consider the degree of control the family held, for example through powers of appointment. Finally, if neither of

those approaches applies, allocation will depend on the level of distributions made in the past (or to which an identifiable entitlement exists).

Foreign income and foreign taxes

31. Our methodology proposes to include foreign income if practically possible. This would also include foreign income taxes if they are similar in nature to New Zealand income taxes which have been imposed on the foreign income as part of the ETR analysis.
32. It is often impractical and costly to access the information concerning both foreign income and taxes. We therefore propose the following approach to different types of foreign income for the economic income and gross cash income measures:
 - a. **Foreign portfolio income earned directly by individuals and trusts** – this is income from investments such as foreign portfolio shares (FIF interests) and foreign debt. We will have the necessary income information from disclosures in the Financial Collection to include this income in the ETR calculation. We also have the necessary tax information from tax data bases and will include foreign taxes that are reported as “overseas tax paid” on the New Zealand tax returns (for the foreign tax credit).
 - b. **Foreign non-portfolio entities (usually CFCs) owned directly by individuals and trusts** –if an individual or trust has received a taxable dividend from a controlled foreign company (CFC), or has attributed passive income, that income and the corresponding tax will be included in the ETR. However, due to incomplete information on the income and foreign taxes of the CFC itself, we are intending to not include its income in the income measures. It appears from our analysis that this ownership structure is not common, hence this will not have a material effect on the results.
 - c. **Foreign subsidiaries of domestic non-portfolio entities** (for example, an HWI owns more than 10% of a New Zealand corporate group that has some foreign subsidiaries) – for listed non-portfolio entities (approximately 70), foreign income will be implicitly included. This is because capital gains from share price movements, included as income, means the value of foreign operations are included in the valuation. Both foreign and domestic tax are then included in the calculation. For unlisted companies, our internal data (such as IR 10 information) is limited to New Zealand group members, and as such we are not able to include foreign income and foreign taxes of the group for the measures (apart from information included with dividend income).

Analysis and reporting

33. Given the response rates to the first two information collections, and progress made in collating and organising the department’s other information sources, we have been able to commence some analytical work. Work has also begun on designing and writing the final report itself.

Consultation

34. We have consulted with the Treasury in preparation of this report.

Next steps

35. We plan to report to you in August on the listed company workstream.

Recommended action

We recommend that you:


agree to proactively release this report.

Agreed/Not agreed

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

Referred/Not referred

s 9(2)(a)



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/ /2022