



## POLICY AND REGULATORY STEWARDSHIP

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

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<b>Date:</b>	30 November 2022	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2022/445

### Action sought

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

### Contact for telephone discussion (if required)

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Name	Position	Telephone
Felicity Barker	Policy Lead, Economics	s 9(2)(a)

30 November 2022

Minister of Revenue

## **High-Wealth Individuals Research Project: November 2022 update**

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### **Purpose**

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1. This report provides you with an update on various aspects of the High-Wealth Individuals Research Project. Our last progress report was dated 15 July 2022, IR 2022-355.
2. The major advances in the Project since the last update have been the near completion of the Financial Collections, finalisation of the methodology and peer review for the first half of the draft report.
3. Significant progress continues to be made on the effective tax rate (ETR) calculations and analysis of economic income for the remaining chapters of the report and following up with the non-compliant individuals.

### **Collection of information**

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#### **Financial collection**

4. As mentioned in the last report, the Financial Collection (Collection 3A) was issued on 9 June 2022. The original due date was 24 August 2022, although a large number of extensions were granted. At the time of writing, we have had an 87% response rate with a further 2% who still have a valid extension.
5. The Supplemental Financial Collection (Collection 3B), referred to in the last update, was issued in early August 2022. This sought a limited amount of information on the financial statements of entities owned by members of the Project population, where Inland Revenue had insufficient internal information. Ultimately, only 45 individuals were required to provide information. At the time of writing the response rate for Collection 3B is 93%.
6. We are processing the information from the collections and have started to compile the data to enable the calculation of ETRs for economic and other types of income. For some individuals who have not responded to notices, internal and publicly available data about them will still be used in the calculations.

#### **Compliance approach**

7. As we have indicated in earlier updates, our compliance strategy has been designed to maximise the response rate, to enable the best data to feed into the calculations. This strategy has included early and ongoing consultation with professional bodies, provision of information explaining the Project, clear signposting of next steps and the information required from individuals, a dedicated contact team offering assistance to complete the responses and sending reminder letters when responses are overdue. We have also actively worked with a number of individuals to assist their compliance.
8. This end-to-end approach to compliance appears to have paid off as can be seen from the very high compliance rates across all four notices. As well as the good response rates to the two Financial Collections set out earlier, the Family Details and Entity Collection had response rates of 93% and 94% respectively.

9. A small number of individuals who are thought to hold significant wealth, but who had not fully complied with Entity and/or Financial Collections, are being contacted and individually managed to ensure their information is included in the ETR calculations. § 18(c)(i)
10. Whether enforcement action should be pursued against non-responders is an operational matter we are currently considering.

## Methodology

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11. The methodology we are using to calculate ETRs has largely been finalised. As discussed previously, a Methodology Advisory Group (MAG) has provided comment and input into the development of the methodology. Our approach has also been subject to peer review by two peer reviewers from academia.
12. Following discussions with the MAG in August, some changes have been made to the methodology for trusts to simplify the approach used to measure and allocate income from trusts. In short, where the family have a sufficiently strong relationship with the trust, the income from the trust included will be the trust's taxable income plus the capital gains on the trust's measured assets. There is a set of trust attribution rules to determine how much of the undistributed trust income, if any, is allocated to families. Overall, there are around 1100 trusts in our data set. Under the attribution rules around 7% of reported trusts will not have income allocated to the high-wealth families due to the family not having a sufficiently strong relationship with the trust and not having had received distributions from the trust over the Project period.
13. We have also adjusted the approach to calculating income from portfolio investments as there were some inconsistencies in the data reported. Our approach to calculating capital gains from portfolio income will now be based on the annual opening value of the portfolio multiplied by a market-rate of return for that year.
14. We are currently updating the modelling of the amount of GST paid by the high-wealth group based on their survey responses. This modelling will look at the GST to taxable income, GST to economic income and GST to expenditure ratio of the high-wealth cohort. We have also started to analyse the data on inheritances.
15. Following an examination of responses to the financial collection, we have made other methodology choices and refinements. We are planning to have a wrap-up meeting with the Methodology Advisory Group in mid-December.
16. There has been a recent study undertaken in the United States by the Council of Economic Advisers (CEA) that has a similar goal and methodology to our study.<sup>1</sup> The CEA study estimates the average Federal effective tax rate, based on a comprehensive measure of income, for America's wealthiest 400 families for the period 2010-2018. They find an average Federal effective tax rate of 8.2 percent. Sensitivity analyses yields estimates in the 6-12 percent range. The authors state that the low ETR is driven by preferential tax rates for capital gains and dividend income.
17. The number of families and the period of analysis in the CEA study is comparable to our study (320 families and 2016-2021, respectively). Their approach is more simplistic than the approach we are using, as the CEA have only used publicly available statistics. They estimated the tax paid by the

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<sup>1</sup> The CEA is an agency charged with providing the President of the United States objective economic advice. <https://www.whitehouse.gov/cea/written-materials/2021/09/23/what-is-the-average-federal-individual-income-tax-rate-on-the-wealthiest-americans/>

wealthiest families, based on tax paid by the 400 highest income earning families from IRS data, and multiplied it by an adjustment factor that converts it to a measure of the tax of the top 400 families by wealth. The economic income is then calculated as the change in the family's wealth (gross of tax) as reported by Forbes Magazine (comparable to previous Inland Revenue work using NBR reported wealth, BN2020/087 refers).

### **Analysis and reporting**

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18. Significant progress has been made on the drafting of the report. The first two parts of the report, setting out the overall approach and methodology, are significantly developed. The focus of the team is now on undertaking the data analysis and presenting the results of this analysis.
19. Chapters 1 through 10 were sent for external peer review on 17 October 2022. A copy of these chapters has been provided to you separately. Peer review comments have been received and the reviewers have expressed broad support for the approach. A second round of peer review will take place in January.

### **Next steps**

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20. We plan to publish the report in late April or early May next year. We will work with your office leading up to the completion of the report.

### **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

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**Felicity Barker**

Policy Lead, Economics

Policy and Regulatory Stewardship

**Hon David Parker**

Minister of Revenue

/ /2022