Hon David Parker

Minister of Revenue

26 April 2023

SPEECH NOTES

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IRD High Wealth Individuals Research Project launch

Victoria University, Old Government Building, Lecture Theatre 1

Good afternoon.

This time last year, I gave a speech about shining a light on unfairness in our tax system.

There, I spoke about two key projects underway at Inland Revenue: the High Wealth Individuals research project and the tax principles work we are undertaking.

I am here today to announce the IRD research results.

For the first time, we have hard data confirming fundamental unfairness in our tax system.

The study looked at the income and tax of people who generally had net worth of more than $50 million, or $20 million if they controlled significant businesses, over the period 1 April 2015 to 31 March 2021.

Inland Revenue requested information on 350 high-wealth individuals and their immediate families and trusts. Of those, 311 responded.

The median wealth (i.e net assets) of the group in 2021 was $106m, with the mean (i.e. average) higher still at $276m.

In total, these 311 people have collective wealth of $85 billion.

The data shows beyond doubt that the wealthiest New Zealanders pay tax on their economic income at a rate well below what most New Zealanders pay on theirs.

It shows that the effective tax rate paid by middle income New Zealanders is at least double that paid by our wealthiest citizens.

This finding is truly ground-breaking. The work we have done to substantiate it puts us at the forefront of those countries that are trying to understand the fairness of their tax systems. Ours is an analysis of actual data, not a theoretical model or analysis of scenarios.

This work establishes an important basis for any future discussions about tax policy.

I want to be clear today that I am not announcing any new tax policy or tax switch. Labour's tax policy will be announced before the election.

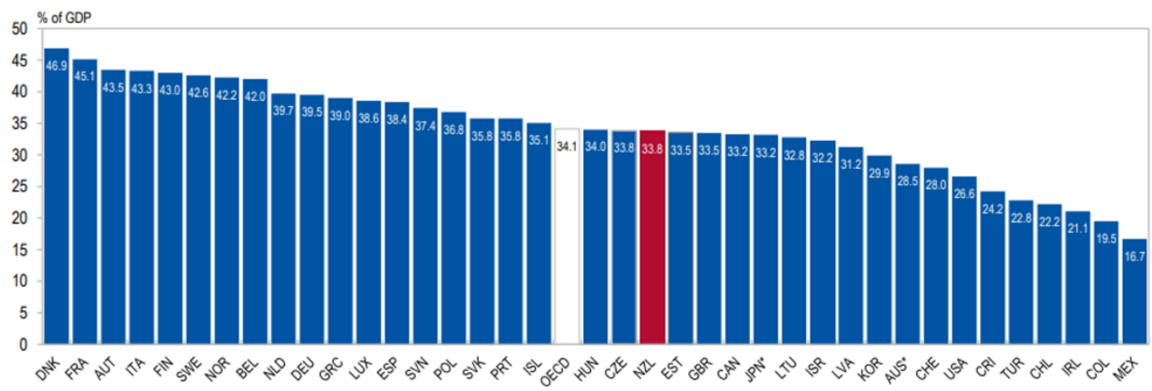
I repeat again today that I have never favoured taxing the family home, either by way of capital gains or imputed rents. High rates of home ownership are a cornerstone of a fair society.

Before I get to the substance of this work, I'm going to talk a bit about the background and how IRD conducted its study.

The current tax system

New Zealand is not a highly taxed nation. We sit in the middle of the OECD pack for total taxes.

Tax-to-GDP ratio compared to the OECD, 2021



Our total taxes don't change hugely as a percentage of GDP from year to year.

New Zealanders want their tax system to be fair. Voluntary compliance with tax obligations relies upon the system being seen to be fair.

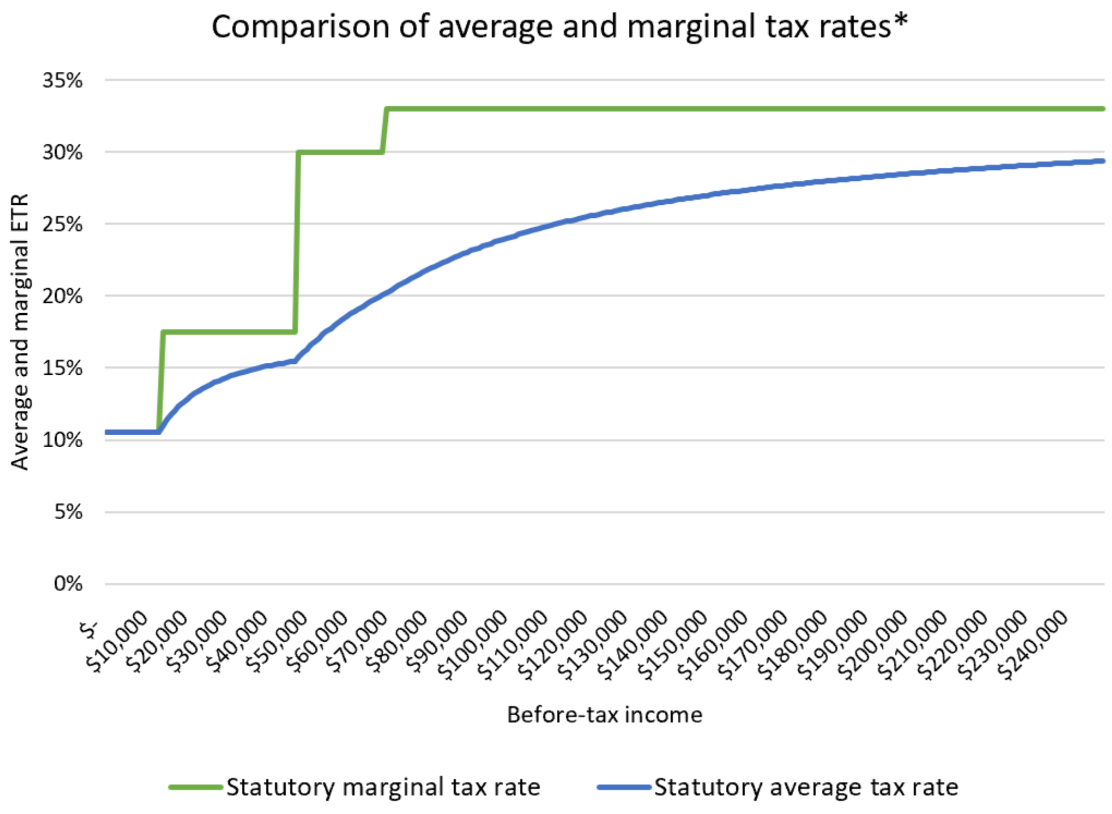
Salary and wage earners pay a fair rate of tax. When they earn an extra dollar, they expect to pay tax on it, and they expect other people who earn more to do the same.

But how can an individual understand what their fair share is, if they don’t know how much tax people with higher incomes pay?

We can only get this right if we know what the facts are. That requires real data - not scenarios or models.

Most New Zealanders earn the bulk of their income in salary and wages, which are taxed.

Currently, some people look at New Zealand’s headline personal income tax rates and see a system that charges higher rates on higher taxable income – and perhaps assume that the system is progressive overall – but it isn’t.



*Note: the project period is 2015-2021 which pre-dates the introduction of the 39% marginal rate, so is not included in this graph.

What is not apparent from this graph is that it doesn't include the types of income that are earned predominantly by very wealthy. The graph also excludes GST.

For these reasons – because it is an incomplete picture – the graph fails to show that in fact that the effective average tax rate for middle income kiwis is generally higher than it is for their wealthier co-citizens.

We have known that some of the wealthiest New Zealanders don't pay tax on some of their income, but we have not known how much, nor their effective tax rate overall.

Not all taxes need to be progressive, but the overall system ought to be. This is a settled principle of tax theory.

A major obstacle to understanding the current unfairness has been the lack of reliable information.

Household Economic Survey and its limitations

Until now, we have had to rely on the Household Economic Survey for information on the incomes of the wealthiest New Zealanders.

While that survey provides comprehensive information for most of the population, it is not accurate at the top end.

Last year I noted that the Household Economic Survey had surveyed just one household with wealth greater than $20 million. They've now found two.

That's right. The NBR rich list has been a better data set than the official statistics when it comes to high wealth. We have been similarly in the dark about their economic income.

Why, in a country with billionaires, has the data set we have used for policy purposes effectively ignored the wealthiest? It's not out by a factor of ten – that would be huge in itself. But that maximum is out by a factor of hundreds.

Despite the limitations of household surveys, they have told us that wealth is unevenly distributed in New Zealand.

According to the Household Economic Survey, the top decile – that is, the top 10 percent of households - holds 63 per cent of household net worth (excluding owner-occupied housing). That is more than the other nine deciles combined.

And there is a massive difference even between decile 10 and decile 9.

Further down the tree it's even more apparent. In fact, 50% of the population combined hold only 7 percent of net worth outside the family home.

In another contrast, the top 1 percent of households hold more than a quarter of all the financial assets in New Zealand.

This means that most income from investments is earned by a small segment of the community.

The data being released today shows that wealth is actually more concentrated than what the Household Economic Survey tells us.

As leading economist Thomas Piketty says, surveys tend to understate concentration of wealth, while data makes it clear.

Today's report also shows the tax paid. Until now, we haven't known the total income of that segment of the community, nor how much tax they pay on that income.
We do know the tax rate paid by wage and salary earners, and by small business owners, but not the rate paid by the top cohort.

This has made comparisons guesswork until now.
That's wrong, and that's why the Government moved to enable IRD to address this data gap.

The IRD research

Parliament conferred this much-needed information-gathering power on the Commissioner of Inland Revenue.

Before then, wealthy people and their intermediaries - accountants and lawyers - could refuse to provide this information.

IRD was allocated funds to conduct research relating to the tax paid by the wealthiest New Zealanders relative to their economic income – that is, their income from all sources.

The project was not targeted at tax administration for specific individuals, and is entirely separate to Inland Revenue's compliance activities.

It is not a criticism of those surveyed. It is not about chasing tax avoiders. Wealthy New Zealanders are usually hard working and creative people who comply with current rules.

Their cooperation has enabled this study to provide critical information about the rate of tax they pay compared with others, and I am grateful for that.

IRD's methodology has been critiqued and improved by outside experts. It is the IRD's report, not mine. It is their careful analysis, and you can trust it.

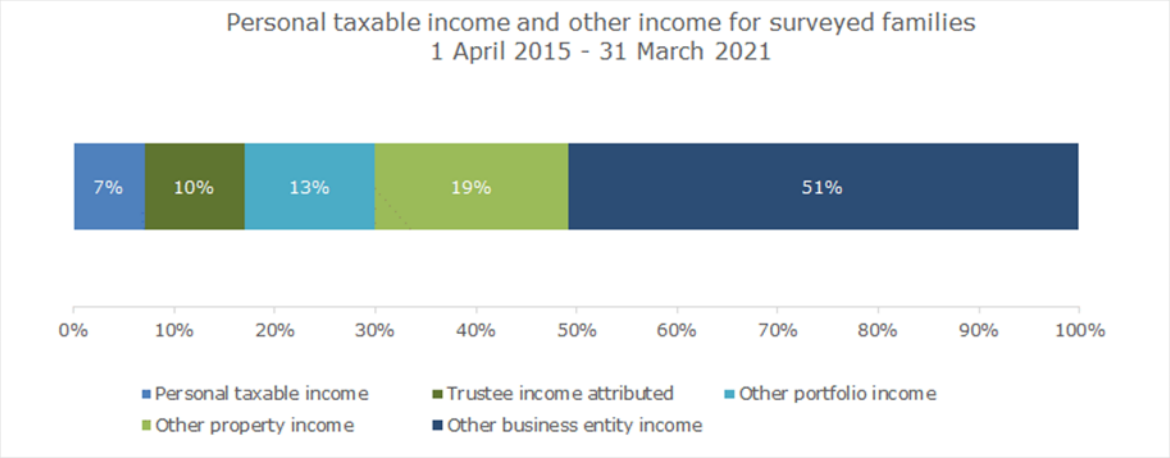
IRD findings

So today, Inland Revenue is publishing its findings on the effective tax rates for high-wealth individuals.

IRD has analysed their various sources of their income and the tax they pay.

Most people earn their income from salary and wages, which is all taxable. Their tax is paid largely via income tax and GST.

For the wealthiest Kiwis, on average, just 7% of their income is taxable as personal income.



As this slide shows, most of the high wealth group's economic income comes from investment returns. By most, I mean 93%.

Economic income is much broader than personal taxable income. It includes all income sources that increase a person's ability to buy goods, services, pay for everyday living costs and save.

The financial affairs of the very wealthy are often complex and can involve partnerships plus hundreds of companies and multiple trusts.

To understand the tax system, IRD needed to consider the income and taxes of all those entities– personal income tax, company tax, tax paid by trusts, as well as GST.

Then we can understand how the system works overall. The detailed analysis by Inland Revenue has done that.

When all sources of income and tax are included for the family, the median of the effective tax rates for the high-wealth group (excluding GST) is 8.9%.

That is the median tax rate (excluding GST) paid by the wealthiest in this country.

That includes the tax they pay personally and through company tax and trustee tax.

If GST is added, that effective tax rate rises to just 9.5%. I will shortly cover why the GST-related increase in those figures is so small.

In contrast, a person earning an $80,000 salary, with no other income, pays 22% income tax. If you add on the GST they pay, their effective tax rate is around 30%

Our citizens like tradies, nurses, school teachers, hospitality workers, hairdressers, cleaners, engineers and small business owners all pay a much higher effective tax rate than their wealthier fellow Kiwis.

Highly paid CEOs and professionals who earn large salaries pay a higher rate.

The much lower rate paid by the very wealthy is driven by two main factors: capital income (mainly capital gains), and GST.

High-wealth individuals more often earn their income from returns on investments – largely non-taxable returns - received through trusts or companies rather than directly.

The report shows that 67% of the high-wealth population’s economic income was derived through trust structures either as trustee income or in capital gains.

As I said, just 1% of households hold more than a quarter of all the financial assets in New Zealand.

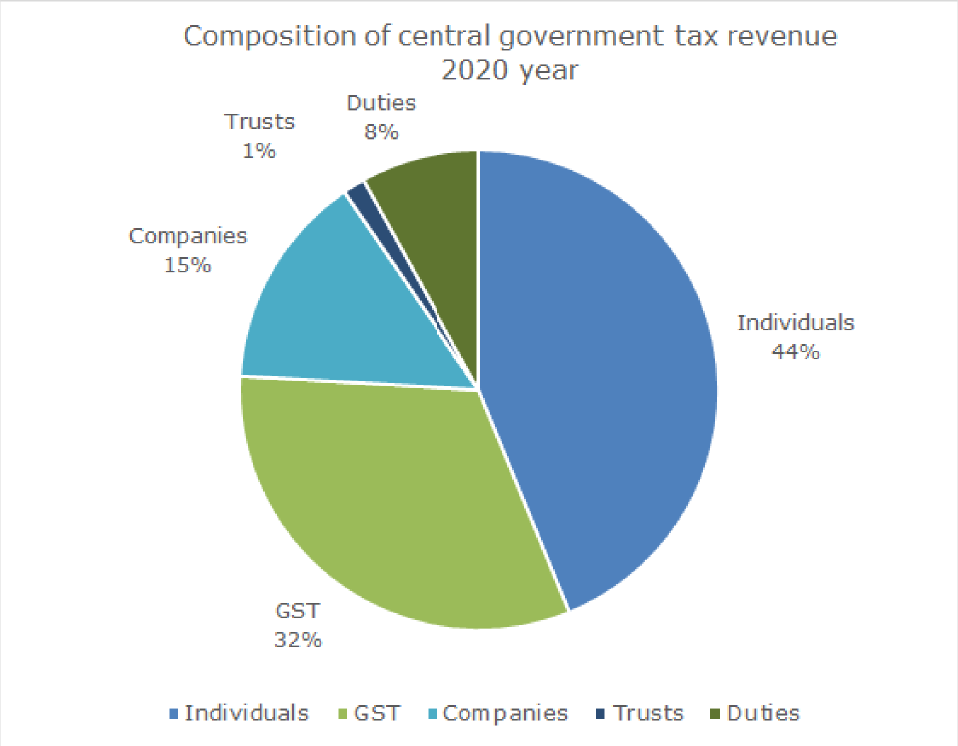
If income earned from capital is taxed at a lower rate than the tax people pay on their income from salaries and wages, then that tax advantage will be concentrated at the top end.

This study proves that is what is happening in New Zealand.

GST

Let's look also at GST.

GST makes up 32% of total tax in New Zealand, so who pays what is important.

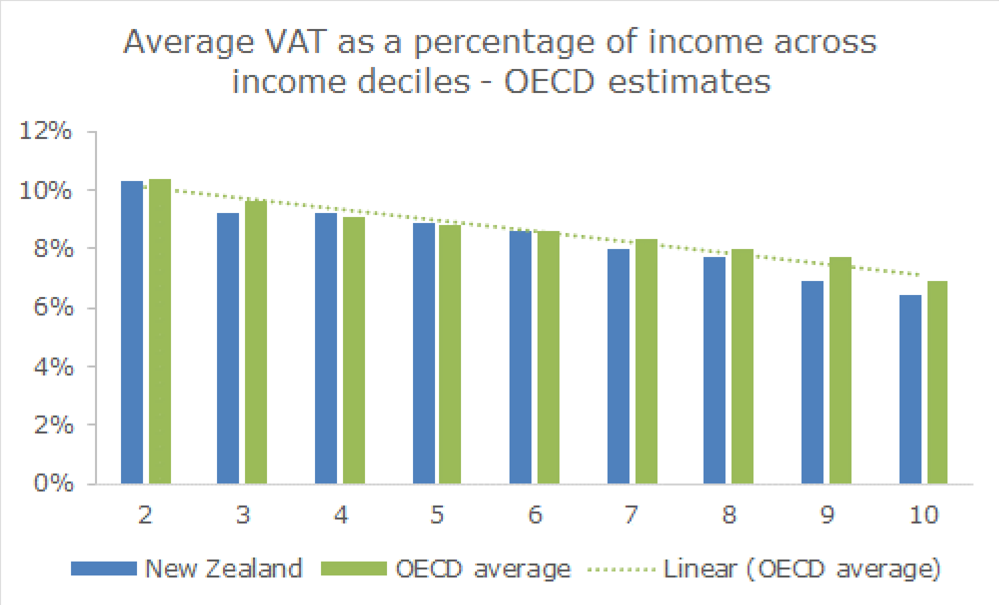


Source: Inland Revenue and Treasury

GST is a significant part of the taxes most of us pay. As you know, GST is levied at a flat rate of 15% on most goods and services, with few exemptions. We pay it when we spend.

The OECD has looked at GST as a percentage of income as measured in household surveys.

It's a fairly consistent story across different countries. Consumption taxes like GST are a higher proportion of the incomes of less wealthy people.

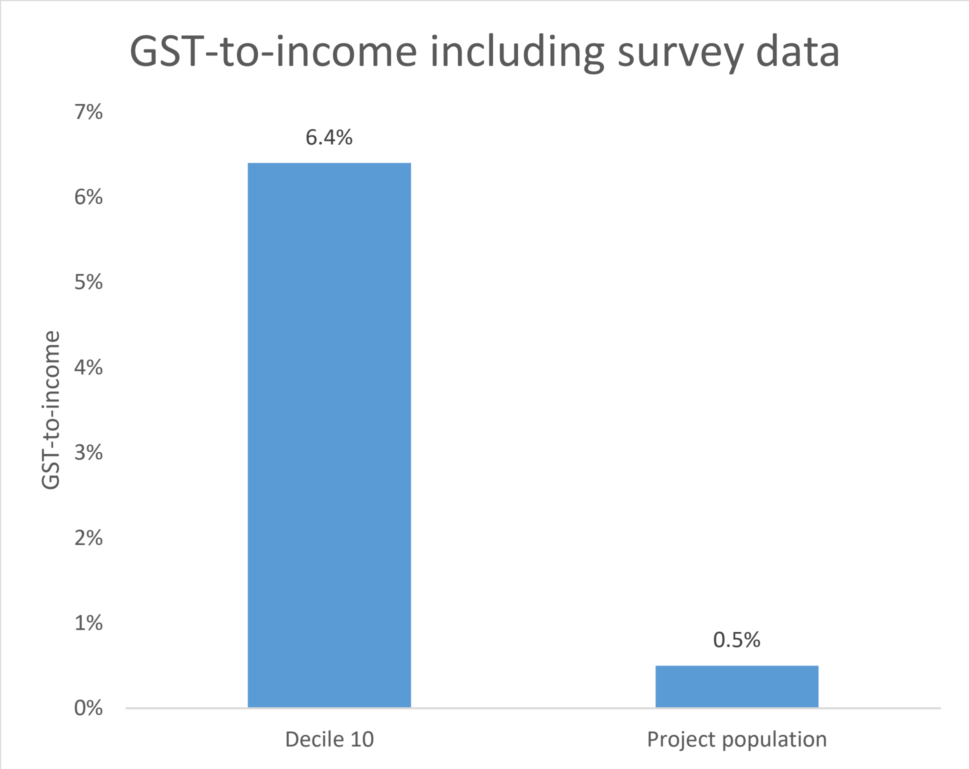


GST is a bit more regressive in NZ in deciles 2 to 10 compared with the OECD generally, but not hugely so.

For reasons such as the effect of tax losses, the decile 1 numbers are a little hard to interpret. Nevertheless, for deciles 2 to 10 the picture is clear.

Most people are spending on average just under two thirds of their salaries on GST inclusive goods and services. In other words, the effective tax rate of GST as a portion of their income, not counting capital gains, is 8 or 9%.

However, GST paid as a portion of income drops sharply at the top end. The average person in the sample population spent just 0.5% of their overall income on GST. That is a substantial and poorly understood difference.



So the wealthiest New Zealanders not only pay much lower proportions of their income on income taxes, they also pay a much lower proportion of their income on GST.

I will come back to their total tax rate including GST, but first I want to cover the Treasury report that is also out today.

The Treasury Report

The Treasury report accompanying the IRD report looks at the entire population.

Unlike the IRD report, which is based on individual data, the Treasury report is modelled on data based on representative surveys and economy-wide analyses of income and tax.

This enables us to make comparisons between the findings of the High Wealth Individuals Report and other New Zealanders.

It outlines the effective average tax rates on comprehensive measures of income across the population. It is also a quality piece of work, and I thank the Treasury officials who have done it.

The report includes multiple scenarios such as transfer payments, people with dependent children, different investments and housing differences.

Some are complex, and for me a little unworldly or academic. For example, some of the scenarios include as income the imputed rents and capital gains on an owner-occupied house.

I don’t put much weight on such scenarios, for several reasons. That deemed income or capital gain can’t normally be spent – you need to live in a house. I am also happy to exclude the higher imputed rents and capital gains on the more expensive houses naturally owned by those who are wealthier.

I prefer estimates of income that exclude imputed rents and capital gains on the owner-occupied home, at all income and wealth levels.

I mention this both to avoid misrepresentation, but also to show that even when such scenarios are used, middle income homeowners are still paying much higher rates of tax than the wealthy.

The Treasury scenarios show tax rates paid by middle New Zealanders (including GST) are between 6.8 and 10.8 percentage points higher than the estimates for the high-wealth population.

Or put another way, even when a broad definition of economic income is used for middle income New Zealanders, they are still paying twice the rate of tax on their income (again including GST).

This report and the Treasury work considers the GST impost for the high wealth population and the rest of the community relative to their economic income – that is, all their income, including their capital gains.

This report shows that the amount of GST paid by the average high wealth family is around 0.5 percent of their overall income.
0.5 per cent– now that really is very regressive.

This means that, including GST, the effective tax rate of the high-wealth population is 9.5%.

The Treasury study finds that, taking account of all income sources, the middle-income earner has an effective tax rate including GST of around 20%.

So the Treasury's alternative analysis, which sits as a companion to the IRD work, again shows middle new Zealanders paying more than double the rate of tax of the wealthy.

There are other interesting findings from these reports.

For example, on average the higher the ownership interest a wealthy person has in a private company, the lower its tax and dividend rate.

This is further evidence of the incentive to reduce taxable income, and instead focus on capital growth and tax free share sales or capital distributions.

Other countries

New Zealand is not the only country doing work in this area. The increasing concentration of wealth and the lower rates of tax paid by the very wealthy is of concern in many countries.

For instance, the OECD's Centre for Tax Policy has a project that looks at stylised effective tax rates under different compositions of labour and capital income. This work is due to be published soon.

Those models shows that in many countries, people earning income from labour have higher effective tax rates than those with a mix of income from labour and capital.

Inland Revenue followed a similar methodology to that OECD report, but it used actual data instead of modelled scenarios.

Some of those other OECD countries have less extreme differences than in New Zealand. You have to look at a country like the USA to find extremes similar to us.

In 2021, the United States Council of Economic advisors undertook a study on the effective tax rates of the 400 wealthiest US families. It estimated that the average Federal effective tax rate for income tax for the period 2010-2018 for these families was 8.2%.

That is remarkably similar to the result found in this Inland Revenue report.

Some American states also have other taxes, so the outcome in New Zealand may be more extreme than even some states in the USA.

This survey will be of great interest to the OECD, and other jurisdictions, because it is grounded in actual facts, not models or scenarios.

What next?

We now know that wealthier New Zealanders on average pay under half the rate of tax paid by middle income earners.

But what, if anything, do we do about that here in New Zealand? We’re not providing the answers today. That is for the future.

The findings of this report will contribute to an informed debate on the fairness of our tax system.

It will allow future tax policy to be based on better data and solid evidence.

I know that some of you here today have helped guide and support officials in conducting the research, and that your work with your clients has helped in achieving the high response rate to the survey.

I thank you for that. It has been all of our interests to make sure that this work was as good as it can be.

This report brings a greater degree of transparency to our tax system.

This has not been about attacking the very wealthy. But it is asking a proper question: who is or is not paying their fair share?

Tax Principles

So, what happens next?

I believe most New Zealanders will always want to know if the tax system is fair.

They know their own tax affairs are simple and that they and IRD understands their income well.

The Labour government believes Inland Revenue needs to continue to monitor and report on how the tax system is in fact operating across all strata in society.

The Government is currently working on introducing a series of tax principles.

These tax principles will require tax policy officials to regularly report on key fundamentals of the tax system.

Lots of people have strong views on what tax policy should seek to uphold.

Surely we can find high level, common ground upon which information can be reported and the debate can be had.

Successive tax enquiries in New Zealand, and overseas, have described the main principles for a good tax system.

All want a modern tax system to operate efficiently and effectively by keeping administrative and compliance costs low. In New Zealand, we try to deliver workable tax policy through our Generic Tax Policy Process and public consultation.

A good tax system incentivises work and avoids distortions through uneven tax treatment of business and investments.

Above all tax systems seek to uphold that most core value of New Zealand - fairness.

Fairness has two main aspects. Horizonal equity, that should ensure people in similar positions contribute similar amounts. And the vertical aspect, that should achieve progressivity (or at least avoid regressivity) of the tax system.

The High Wealth Individuals report finds our system is regressive at the top end, meaning that very wealthy New Zealanders pay much lower rates of tax than middle income Kiwis.

This new reporting framework to be created by the Tax Principles Bill will seek to provide information on the tax system related to these principles, to help provide for an informed debate.

Our proposal is to require officials to periodically report on the operation of the tax system, using the principles set out in the legislation as the basis for their reporting.

This will build up a time series showing how the tax system is changing in relation to those core principles.

By providing information to the public, like that presented in the High Wealth Individuals report today, we can have an informed debate on tax using solid evidence.

The debate around this high wealth report, and the tax principles work adding in the requirement for ongoing public information, will result in a stronger economy, a fairer tax system, and a better New Zealand.

I appreciate you taking the time to be here today.

Thank you.