

A TAX SYSTEM FOR NEW ZEALAND'S FUTURE

1 December 2009

Morning Session 1

Personal Income Taxes and Transfers: Key Reform Issues

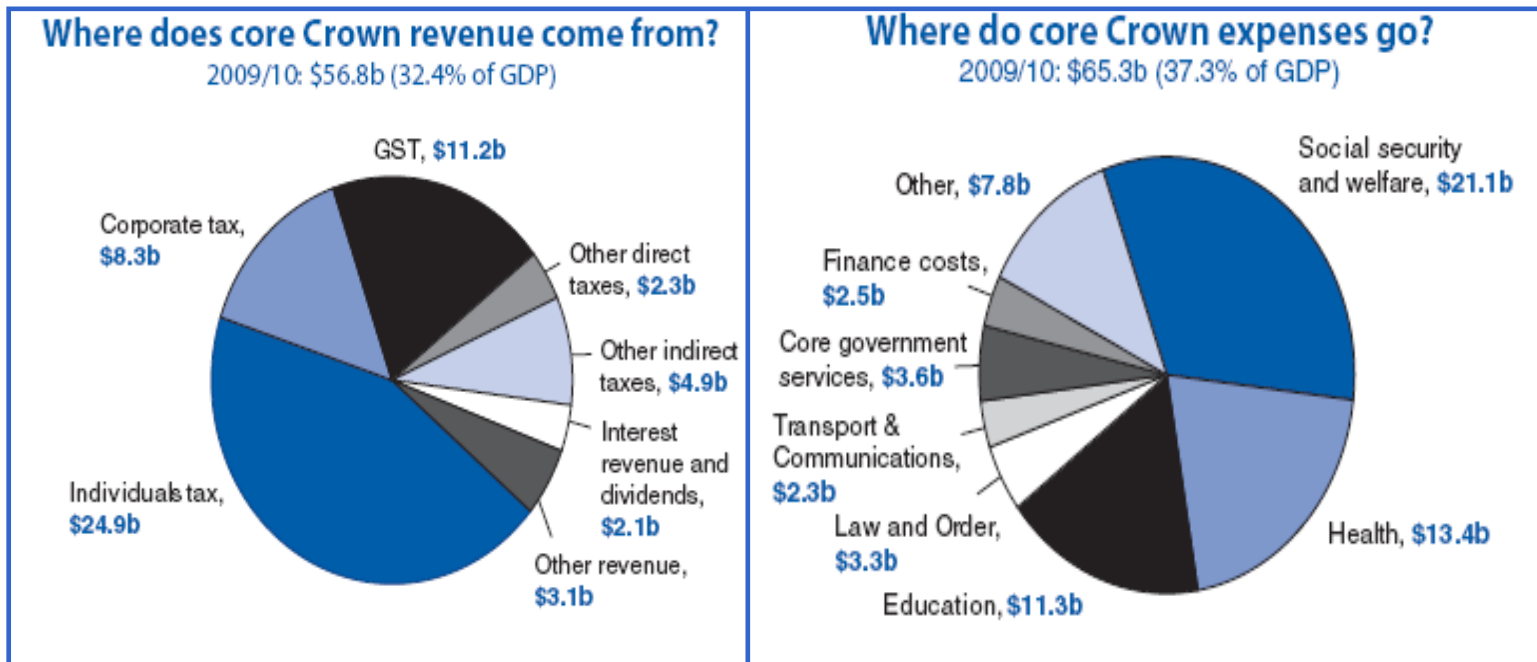
Norman Gemmell, Principal Adviser, Treasury

The key issue...

- NZ collects a large share of revenue from personal and corporate income taxes
- NZ pays out a large amount of personal tax credits, mainly to families with children \Rightarrow ...
 - Is this a problem?
 - Should we lower personal (&/or corporate) tax rates?
 - If so, which rates, and by how much?
 - How should it be paid for?

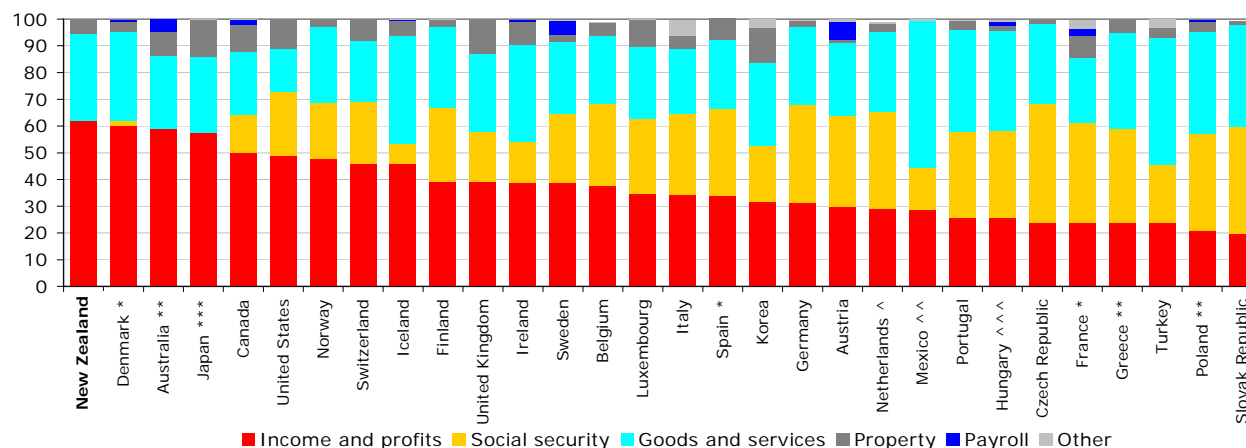
NZ Taxes & Spending

NZ collects a large share of revenue from personal and corporate income taxes... 2009



Tax Shares Across the OECD

NZ has no SSCs (tax on labour income) and instead levies income taxes on all income



Note: Countries are ranked from highest income and profits tax revenue as % of total tax revenue to lowest.

* The total tax revenues have been reduced by the amount of capital transfer. The capital transfer has been allocated between tax headings in proportion to the reported tax revenue.

** Data is for 2006.

*** Central government taxes only.

^ OECD estimates have been made for other taxes.

^^ Central government and social security funds only.

^^^ Cash basis.

Source: OECD

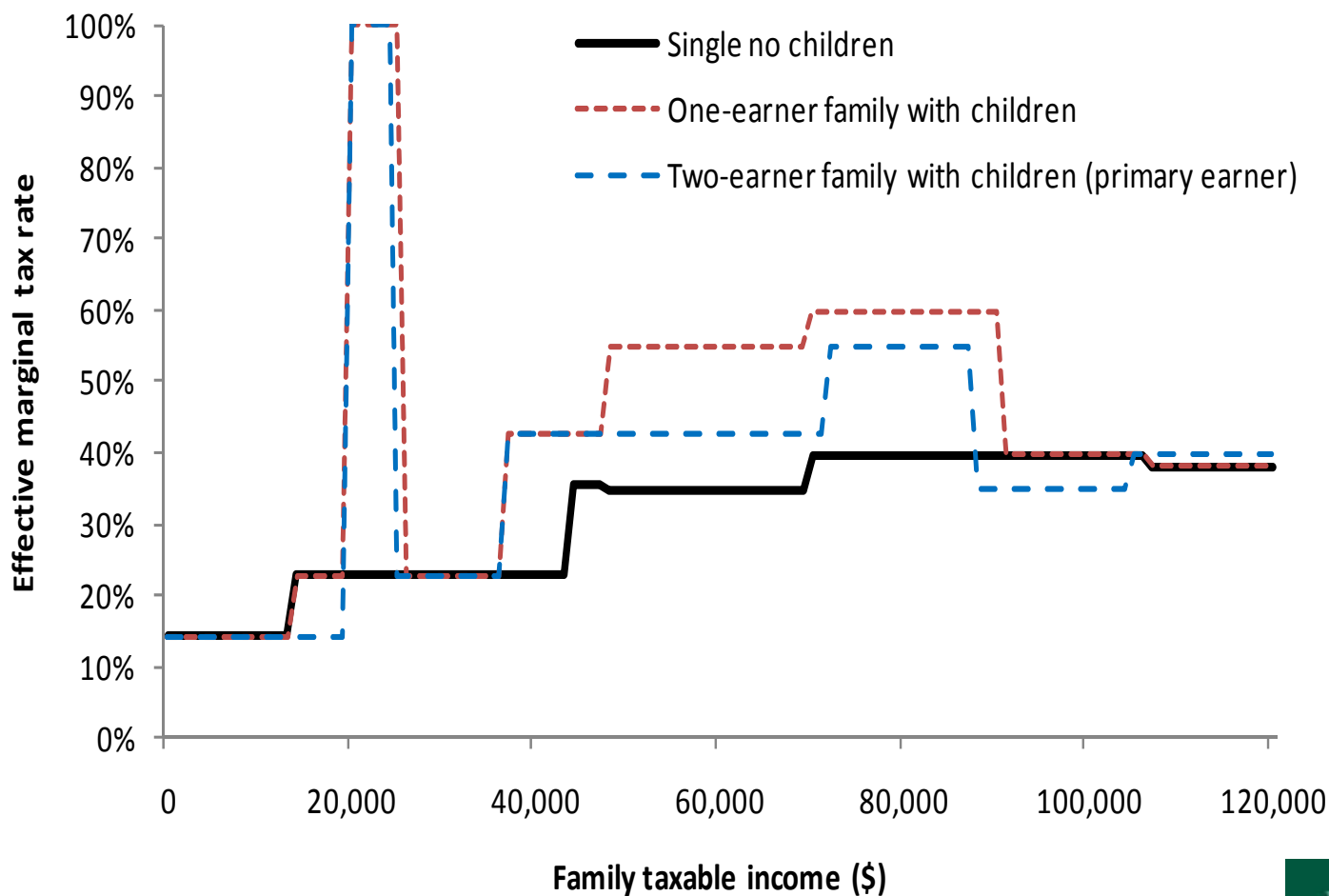
The Transfer System

- NZ uses tax credits (negative taxes) for social welfare, e.g.
 - Family tax credits
 - In-work tax credit
 - Independent earner tax credit
- These are 'abated' (withdrawn) as family incomes rise – the withdrawal acts just like an additional 'tax' – WFF at 20c per additional \$ of family income earned
- NZ tax rates become (plus ACC):

	\$0-14k	\$14-48k	\$48-70k	>\$70k
Without WFF:	12.5%	21%	33%	38%
With WFF:	32.5%	41%	53%	58%

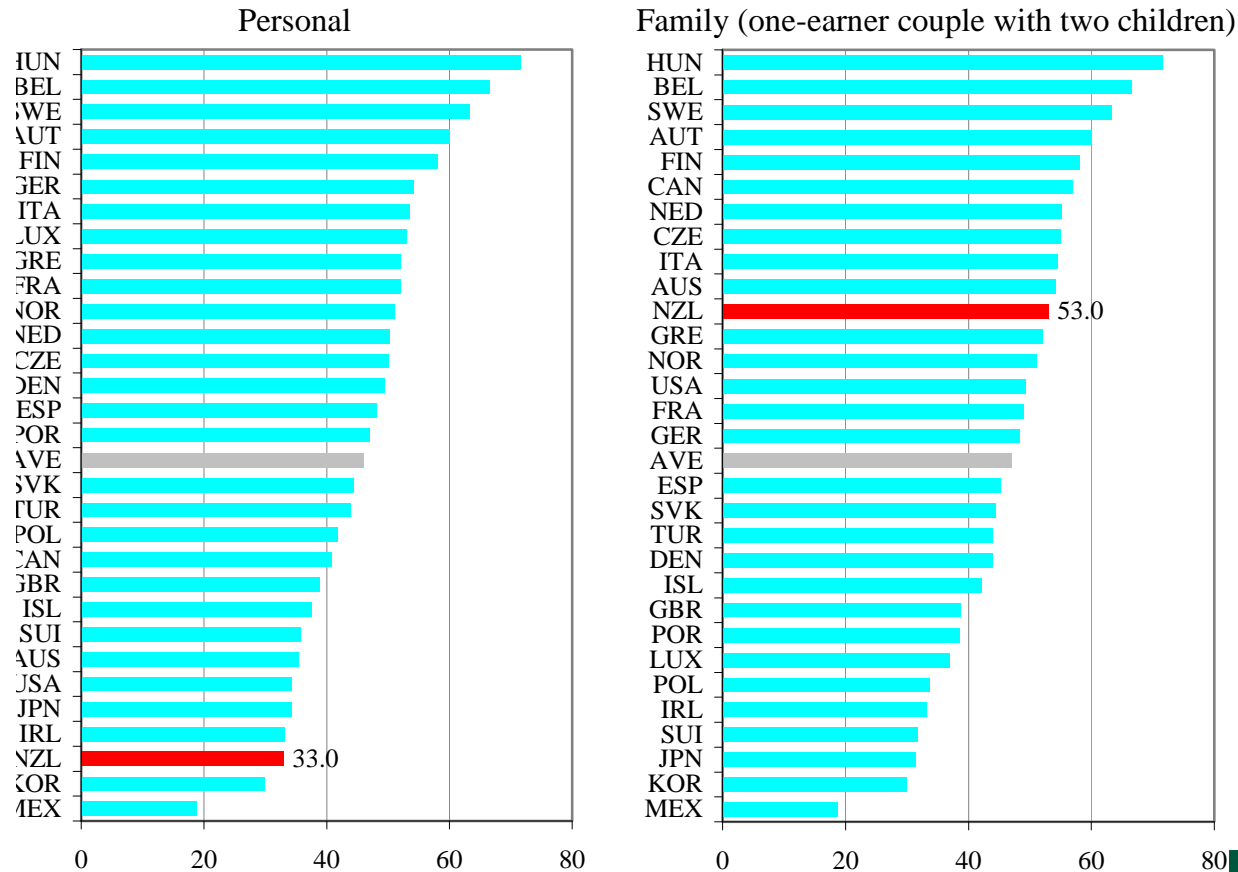
(above family income ≈ \$36,800)

Effective Marginal Tax Rates



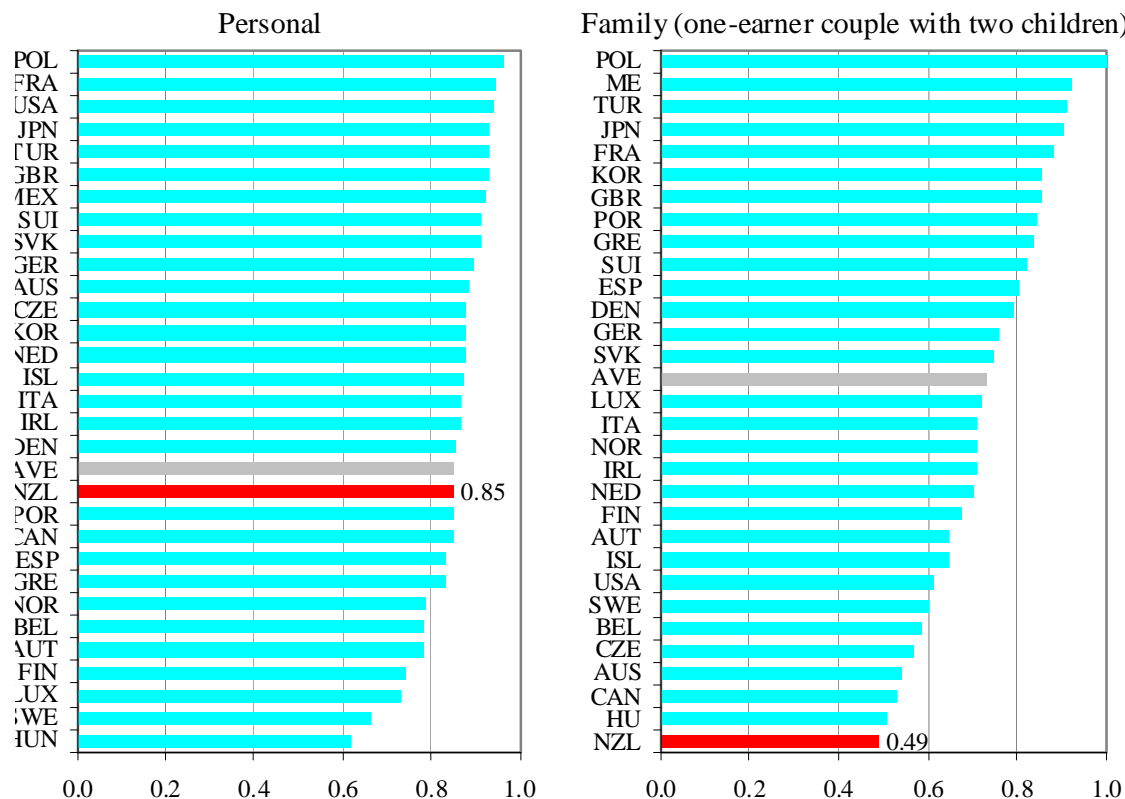
Are NZ's MTRs High? (at average wages)

Effective marginal tax rates (as a percent of labour costs)



OECD: Percent Increase in After-tax Income (for 1% rise in average gross income)

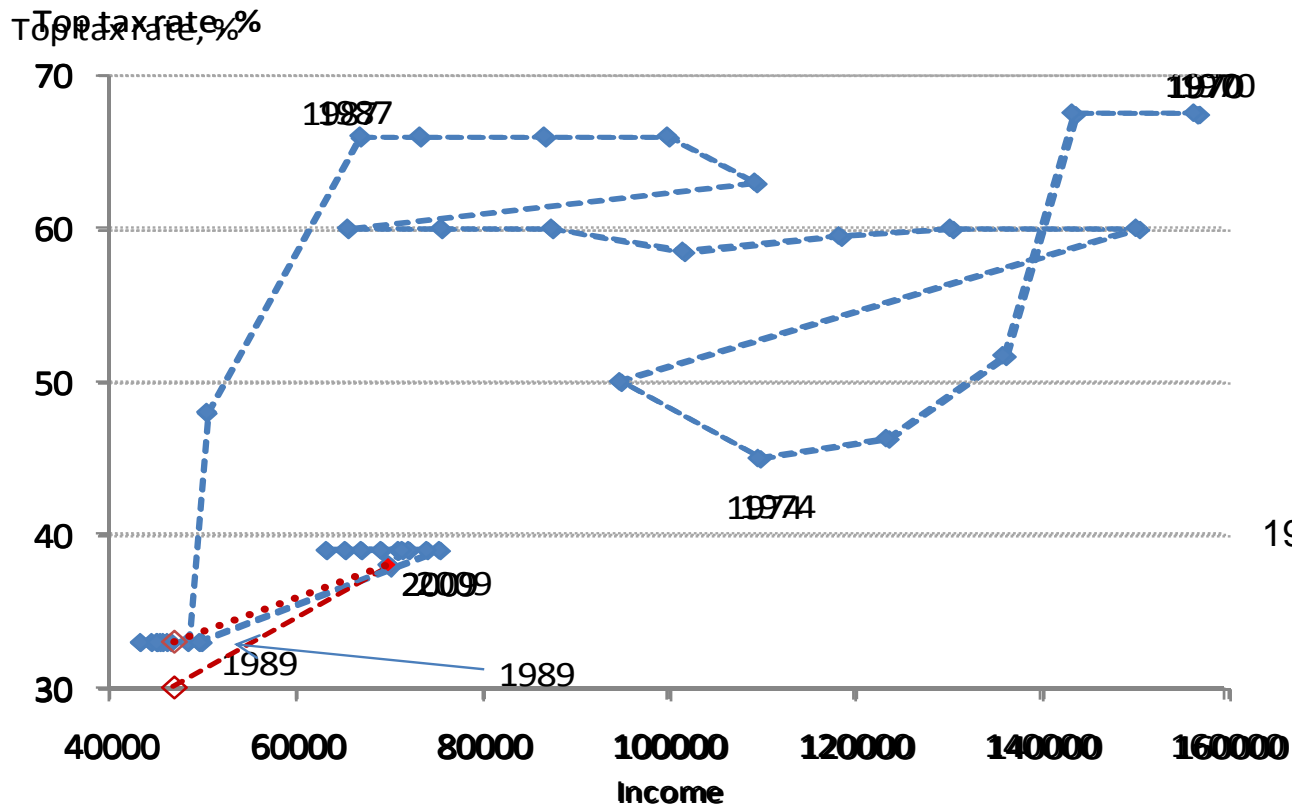
Increase in net income after 1% rise in personal and family gross wages (in percent)



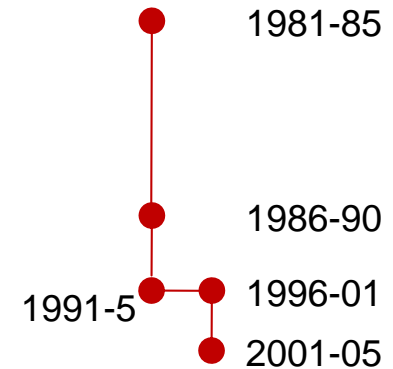
Should we lower PIT rates?

- Could NZ's income taxes be hindering economic performance?
- High PIT rates may:
 - Distort work/earning and other choices \Rightarrow raise 'deadweight costs'
 - Discourage savings
 - Discourage participation in the labour market
 - Encourage Trans-Tasman & other migration
 - Discourage higher education choices
 - Do they help achieve greater equality of income?
 - International and NZ trends are downwards for the top PIT rate ...
- 'High income' country average: from 58% (1981-5) to 39% (2001-5)

Trends in the Top Personal Tax Rate & Threshold

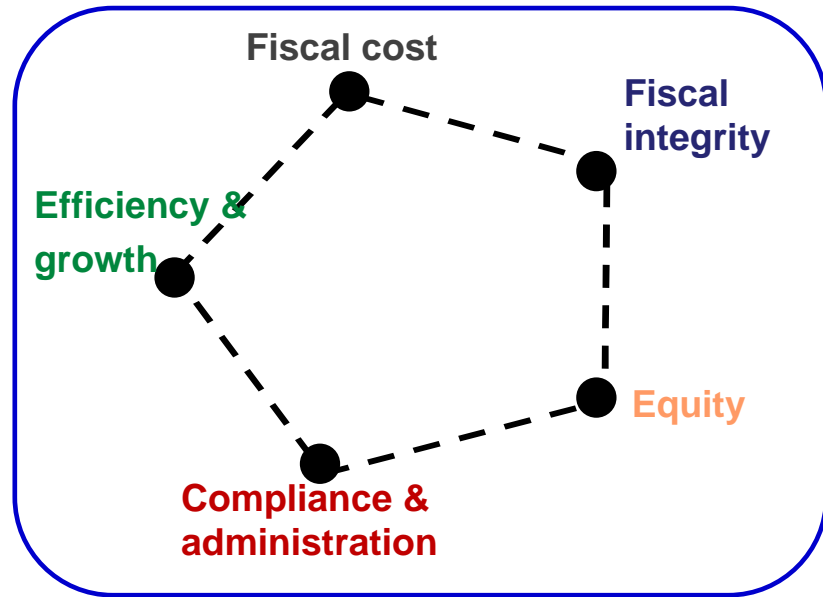


Internat. Trends

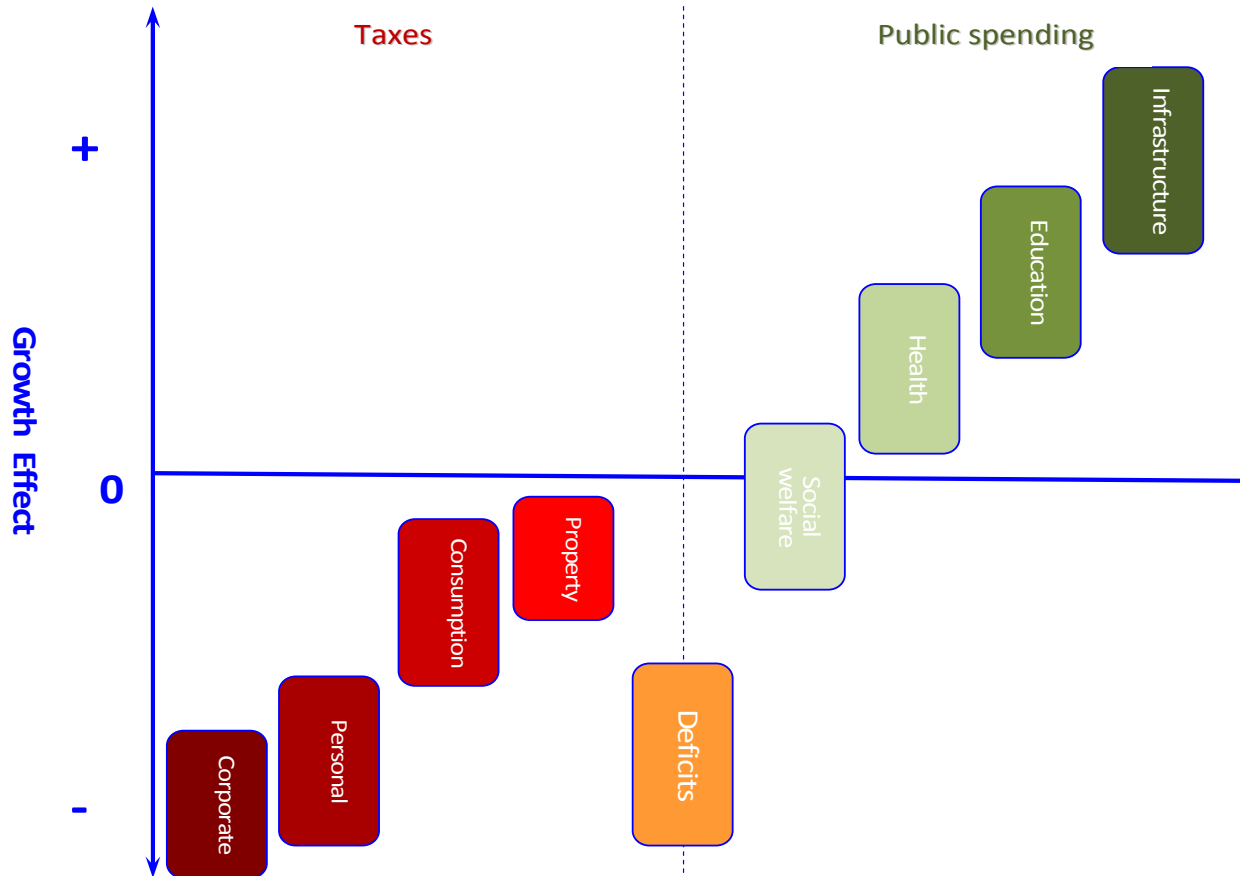


Should we lower PIT rates?

- Need a framework to assess reform choices:
- ‘pentagon’ of 5 objectives or principles of a good tax system
- Value judgements & trade-offs are required
- How do you weight objectives?
- Which ones will reform ‘improve’ or ‘worsen’?
- Focus on efficiency/growth and equity ...



Efficiency: Growth effects – international evidence



Efficiency: Deadweight Costs

- Distortionary costs: value on changes to behaviour due to the tax (that otherwise would be less preferred)
- $D = a t^2$: i.e. deadweight costs approximately quadruple as the tax rate doubles
- Few deadweight costs estimates for NZ but some plausible values suggest (for each \$ of tax collected):

Response to 38% tax rate	low	high
Income diverted to avoid all tax	\$0.65	\$1.43
Income diverted to 30% company tax rate	\$0.09	\$0.14

Efficiency: Taxes and Savings

- Effect of saving \$1 at different rates of return:

	Rates of Return:			
	Pre-tax	Post-tax (at 38%)	Post-tax (at 50%)	Post-tax (at 30%)
	10%	6.2%	5%	7%
After: 5 years	\$1.61	\$1.35	\$1.28	\$1.40
10 years	\$2.59	\$1.82	\$1.63	\$1.97
20 years	\$6.73	\$3.33	\$2.65	\$3.87
30 years	\$17.50	\$6.08	\$4.32	\$7.61

Key Issues: Equity

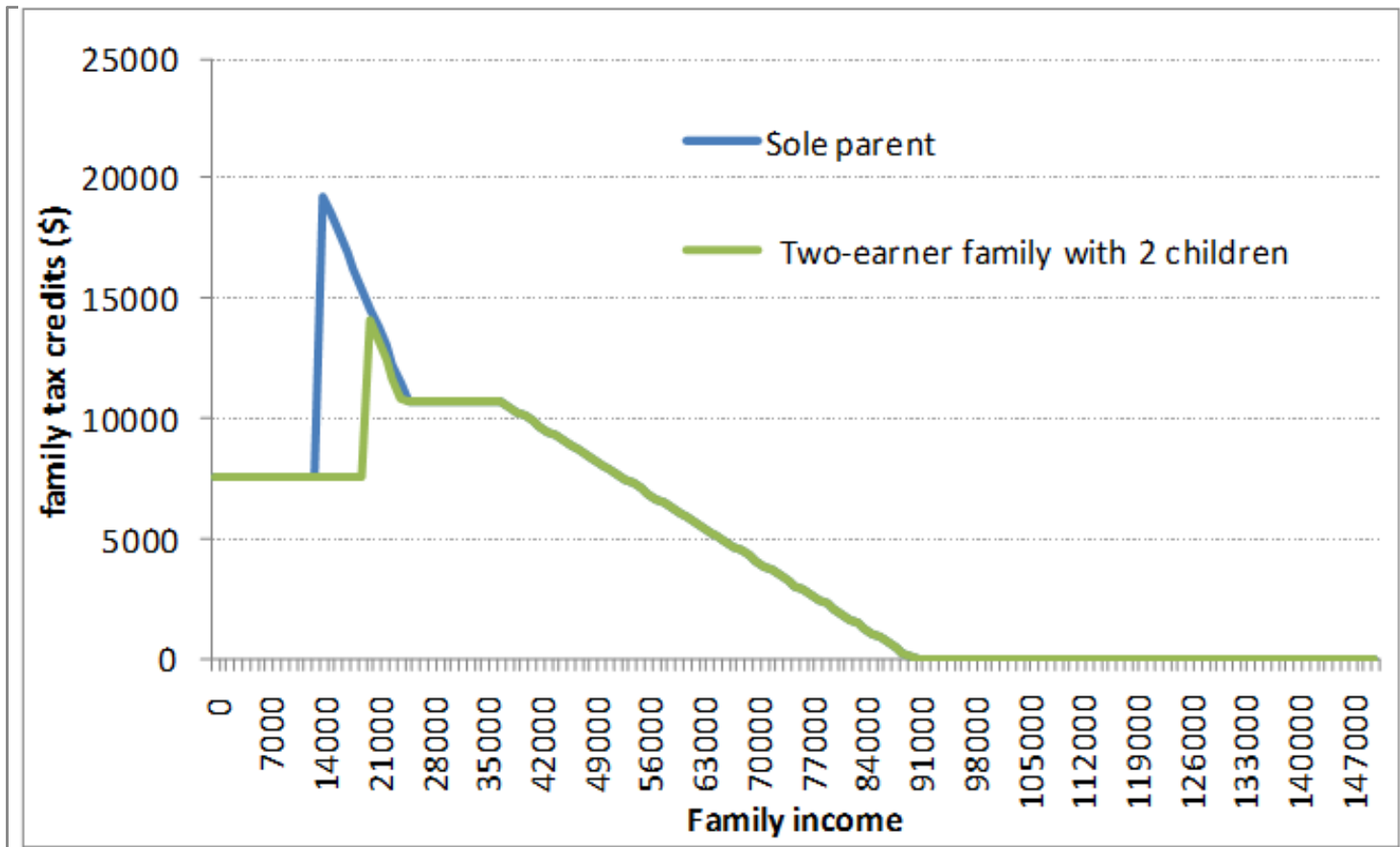
Do **higher** PIT rates help achieve greater equality of income?

- What is fair? How much income tax 'progression' *desirable*?
- How much progression is *feasible*? (trade-offs with incentives and revenue cost)

Social welfare:

- Low income support – which is better: cash transfers or non-cash support (health, education)?
- How much 'support' and to whom? (children? all low income families? aged?)
- WFF provides large amounts of income support for children (\$2.9billion to around 665,000 adults in 410,000 families)
- Around \$10,000 p.a. for working parents with 2 children

Working For Families



NZ income tax – is it equitable?

Who pays income tax... and how much?

Annual individual taxable income (\$)	Number of people		Tax paid	
	(000)	%	(\$m)	%
Zero	241	7	0	0
1 - 10,000	448	14	257	1
10,000 - 20,000	819	25	1,675	7
20,000 - 30,000	407	12	1,624	7
30,000 - 40,000	375	11	2,290	10
40,000 - 50,000	316	10	2,612	11
50,000 - 60,000	236	7	2,601	11
60,000 - 70,000	167	5	2,451	11
70,000 - 80,000	83	3	1,468	6
80,000 - 90,000	67	2	1,447	6
90,000 - 100,000	40	1	1,008	4
100,000 - 150,000	72	2	2,482	11
150,000+	46	1	3,415	15
All	3,317	100	23,330	100

46%

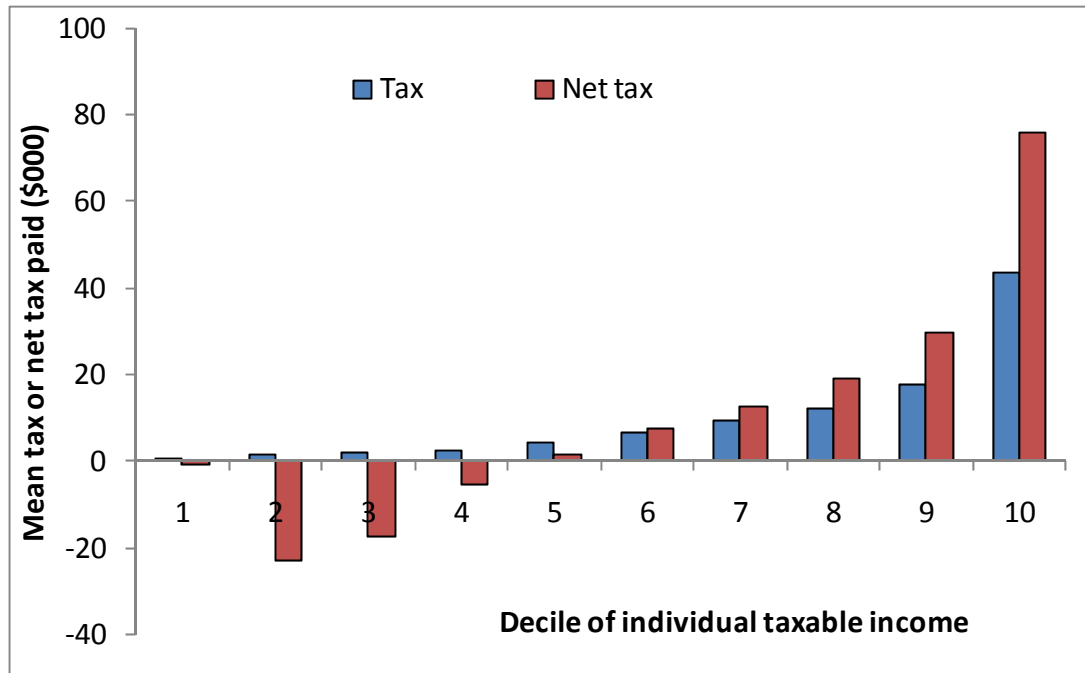
8%

9%

42%

Ten typical Kiwi taxpayers go out for a few beers ...

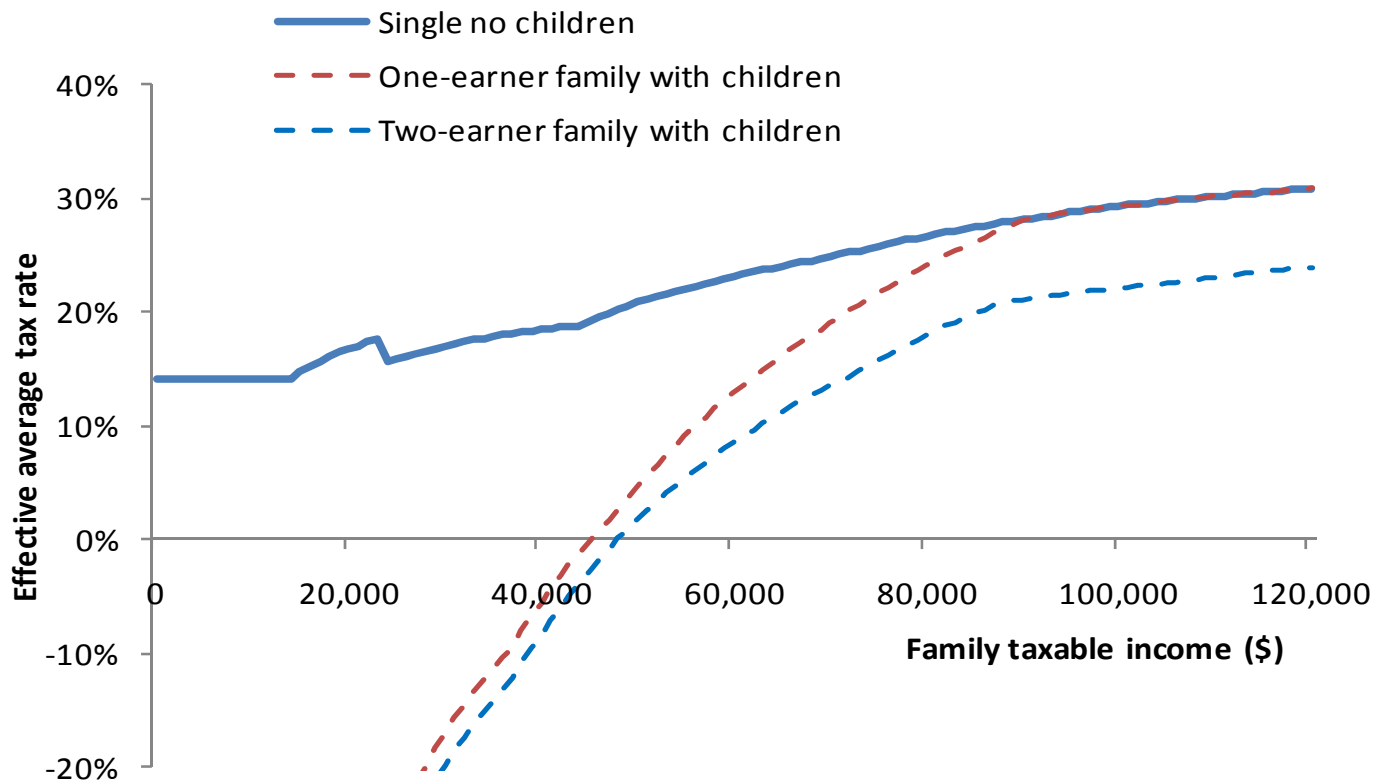
... they decide to split the \$100 bill between them in line with their personal tax bills...



	Tax	Net tax
1	\$ 0.05	-\$ 0.72
2	\$ 1.70	-\$22.86
3	\$ 1.89	-\$17.16
4	\$ 2.27	-\$ 5.54
5	\$ 4.39	\$ 1.42
6	\$ 6.78	\$ 7.39
7	\$ 9.20	\$12.67
8	\$12.27	\$19.16
9	\$17.86	\$29.75
10	\$43.61	\$75.89
All	\$100	\$100

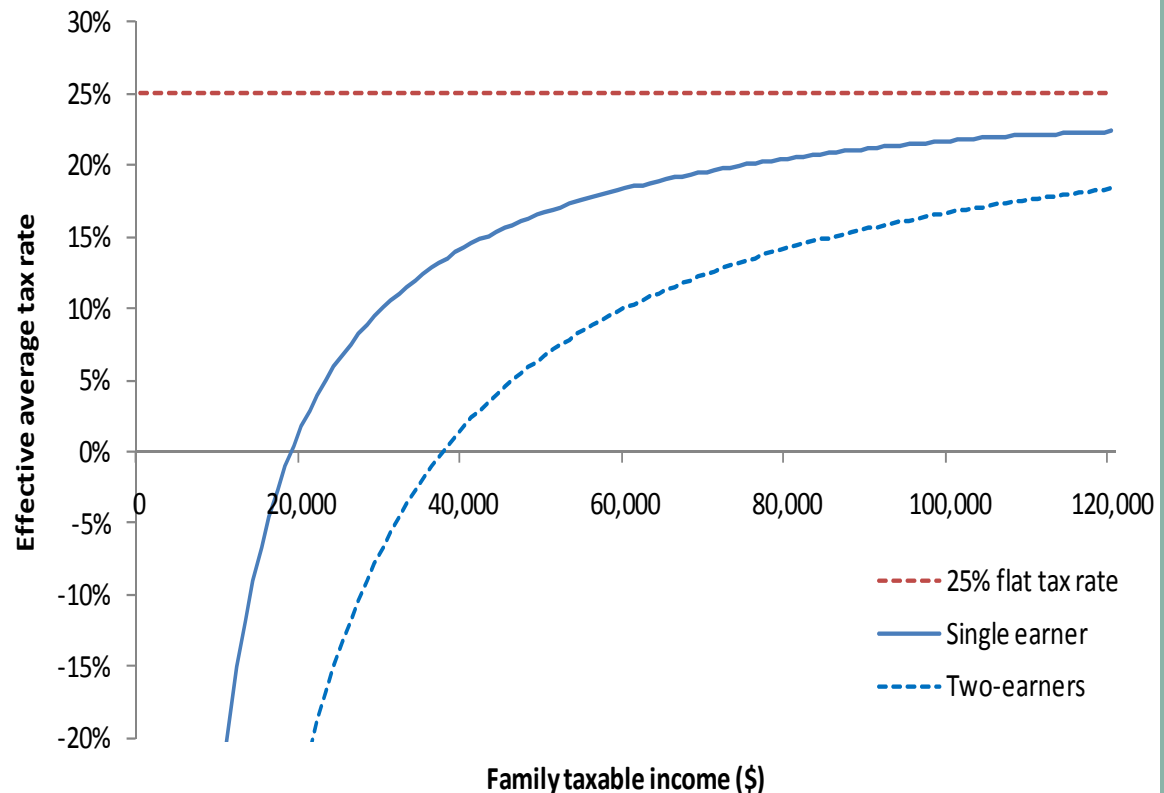
Equity: Average tax rates rise

Rising average tax rates, not marginal, tax rates is what makes the income tax progressive...



Progressive MTRs not necessary for equity ...

- Rising marginal rates are not required
- But without them rising average rates can get expensive...
- A 25% flat tax with/with-out a \$5000 per person M.I.G.
- cost ≈ \$12 billion less \$3 billion WFF



Options for reform?

- *Reduce top income tax rate* : 38% to 30% and fund by base broadening that falls mainly on incomes > \$70k?
- *Switch towards GST*: Reduce all income tax rates by 2-3% and 38% to 33% or 30% and fund with GST to 15% (WFF, benefits, NZS protected) plus base broadening?
- *Reform WFF to reduce abatement?* (10c/\$ abatement or semi-universal?: but all go to those on *higher* incomes) ...
- *Target WFF more* at lower incomes: this will increase MTRs at low incomes but remove WFF (& abatement) from middle incomes.
- Why choose new top rate of **30%** except to improve integrity via aligned 30-30-30 option?