Tax Tips | May 2023

Budget 2023 tax measures

For many years, the Government's Budget announcements have been relatively uneventful from a tax perspective. However, with the Government's publication of its report looking at the effective tax rate paid by high wealth individuals (HWI) just a few weeks ago (the HWI Report), there was speculation as to whether the Government would introduce tax changes in response to the findings of the HWI Report in this year's Budget.

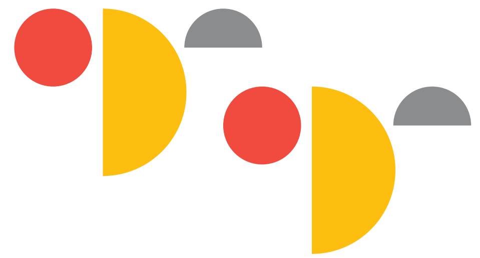
The HWI Report concluded that the median HWI family paid 8.9% of their economic income in tax (our April 2023 Tax Tips article included an overview of the methodology and findings of the HWI Report). While the immediate focus was on the absence of a comprehensive capital gains tax in New Zealand and its impact on the effective tax rate of HWIs, the Government ruled out the introduction of a capital gains tax or other major tax reform in the Budget. One technical change we indicated could be on the cards was increasing the trustee tax rate to 39% to align with the top personal tax rate.

This has now been confirmed in this year's Budget, with the introduction of the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill (the Bill) on Budget Day.

In addition to the increase in the trustee tax rate, the Bill also proposes to implement the Organisation for Economic Cooperation and Development's (OECD) new international tax framework to impose a global minimum effective tax rate of 15% on large multinational enterprises (MNEs) - also known as the OECD's 'Pillar Two' proposals.

The Government also introduced the Taxation Principles Reporting Bill (Tax Principles Bill) on the same day. In this edition of Tax Tips, we outline the Government's key tax announcements on Budget Day mentioned above.

The consultation period for the Bill and Tax Principles Bill is short, closing on 30 June and 9 June, respectively. If you would like to discuss the proposals in further detail or make a submission, please reach out to your usual PwC advisor.



Tax Bill introduced on Budget Day

Trustee tax rate increase

The Bill proposes to increase the trustee tax rate to 39% for the 2024-25 and later income years (for most trusts, this is likely to be from 1 April 2024).

Under current law, income earned by a trust that is paid or allocated to beneficiaries is taxed at the beneficiary's own personal marginal tax rate. Any income which is unallocated to a beneficiary is taxed at a flat 33% rate. Previously, the trustee rate was aligned with the top personal marginal tax rate of 33%. However, in 2020 a new top personal tax rate of 39% was introduced for income above $180,000. The Government considers that this gives rise to an ability to obtain a tax advantage by earning income through a trust. This was unlikely to be a surprise to the Government or Inland Revenue given the previous taxpayer response from 2000-2010 when the top personal tax rate was higher than the trustee tax rate (which Inland Revenue discusses in the Commentary to the Bill). However, rather than increasing the trustee tax rate at the same time as introducing the new 39% top personal tax rate in 2020, the Government instead brought in new information disclosure requirements for trustees. The new disclosures were intended to be used to assess compliance with the 39% rate and monitor the use of structures and entities by trustees.

Limited exceptions to the 39% trustee rate are proposed to address potential overtaxation:

- **Estates**: estate income distributed within 12 months would be taxed at the deceased person's marginal rate, rather than 39%.
- **Trusts settled for disabled persons**: as disability trusts often hold income for extended periods for non-tax related reasons, all trustee income for such trusts are proposed to be taxed at the disabled beneficiary's marginal rate.

New rules are also proposed to treat beneficiary income derived by some corporate trust beneficiaries as trustee income for the purposes of determining tax obligations. It is proposed that trustees cannot allocate beneficiary income to close companies (companies where five or fewer natural persons or trustees hold more than 50% of the voting interests in the company, when treating associated persons as one person) if the settlor of the trust has 'natural love and affection' for a direct or indirect shareholder of the company. Māori authorities and tax charities are excluded from this rule. This is an integrity measure intended to address the fact that the real beneficiary of the trust in certain circumstances (e.g. beneficiary companies with few shareholders) is the individual shareholder of the beneficiary company.

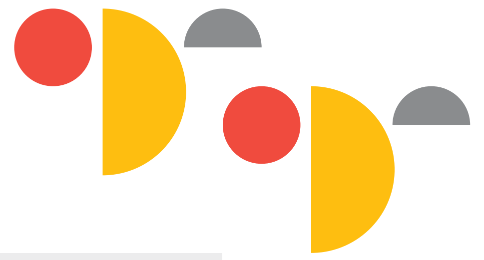
The increased trustee tax rate is expected to raise $1.1 billion over the Budget's forecast period (i.e. to the 2026-27 fiscal year).

PwC view

We have previously considered that while raising the trustee rate is unlikely to have a material impact on the progressivity of the tax system, there is a policy rationale to aligning the tax rates applied to income derived in different business structures as evenly as possible – i.e. removing distortions to the choice of investment vehicles.

To the extent that the proposed increase is intended to address the findings of the HWI Report, we do not expect the proposal will have a significant impact, as the HWI Report found that only 10% of HWIs' economic income is derived through trusts. While the change will result in some additional tax revenue (forecast to be $1.1 billion over the next four years), the biggest contributing factor to the effective marginal tax rate paid by HWIs on economic income is still the lack of a comprehensive capital gains tax in New Zealand.

It will also be interesting to revisit the rationale for the trustee disclosure requirements which have been in place from the 2021-22 income year. These reporting requirements were brought in with the stated purpose of monitoring compliance with the 39% personal tax rate. With the misalignment between the trustee rate and 39% rate now addressed, the reporting requirements should, in our view, be abolished to reduce the significant compliance costs that those information requirements have resulted for a large number of taxpayers.



New Zealand multinational taxpayers – OECD’s Pillar Two measures introduced

New Zealand’s Pillar Two legislation has been introduced through, for the most part, incorporating the OECD rules rather than drafting New Zealand specific legislation. Whilst an enactment date has not been confirmed, these rules could start coming into effect from 1 January 2024.

The OECD’s Pillar Two measures include the ‘GloBE’ rules which are a set of two interlocking rules that should result in a minimum effective tax rate of 15% being paid in each country that a large MNE operates. This is through either the parent entity paying a ‘top-up’ amount of tax for a low tax subsidiary or vice versa. The rules are complex to apply and mean that companies based in countries with high headline corporate tax rates can still fall short of the 15% effective tax rate.

The GloBE rules will apply to MNEs with annual global revenues above EUR750 million.

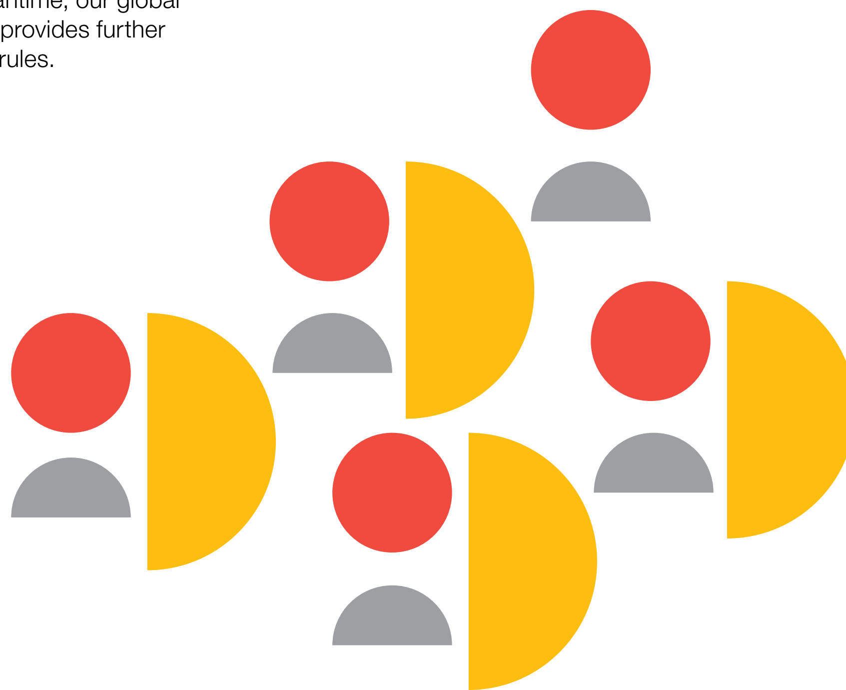
Even where an MNE does not have any top-up tax to pay, the reporting obligations are going to trigger a significant compliance burden on taxpayers globally. For affected taxpayers, understanding the data requirements of Pillar Two is pivotal in preparing for these upcoming changes and enabling compliance.

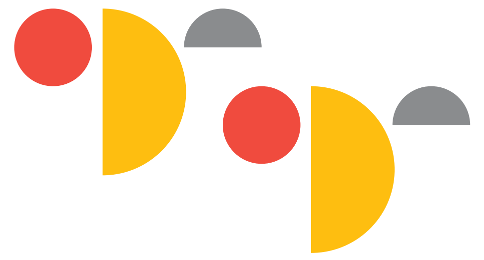
With New Zealand’s implementation of the Pillar Two rules fast approaching and potential penalties of up to $100,000 for failing to comply with the reporting requirements, groups within scope should act now to understand the obligations for their group, as well as determining whether their current data models, systems, technology and process can respond to the new regime’s requirements.

We will be sharing more insights in a separate Tax Tips shortly. In the meantime, our global Pillar Two Readiness page provides further insights and details on the rules.

Also in the Bill

- Alternative tax treatments for backdated lump sum ACC payments and Ministry of Social Development entitlements. We welcome this change as this will help prevent individuals from being artificially pushed into a higher tax bracket for a single year.
- Government payment of a three percent KiwiSaver contribution on amounts of paid parental leave received by KiwiSaver members, provided the paid parental leave recipient also paid a corresponding three percent KiwiSaver employee contribution.
- Temporary taxation rollover relief in response to the January and February 2023 North Island flooding events. Specifically the rollover relief defers the recognition of depreciation recovery income or income on a revenue account asset, provided there is a commitment to rebuild or replace the destroyed assets.
- Remedial changes to:
  - correct extra pay inaccuracy on termination;
  - ensure all charities registered under the Charities Act 2005 are automatically exempt from resident withholding tax for the duration of their registration; and
  - Clarify the meaning of ‘building’ for depreciation purposes.





Other tax insights from the Budget

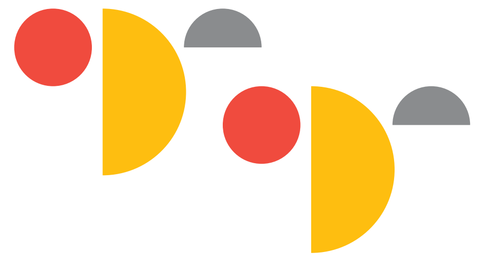
The Government is forecasting continued increases to its tax revenue, growing by an average of 6% every year to the 2026-27 fiscal year.

Much of the increase this year appears to be attributable to the current inflationary environment. Source deduction revenue (e.g. PAYE collected from salary and wage earners) is forecast to increase by 10% in 2022-23, mainly due to forecast growth in total salaries and wages of 9%. However, the Government expects average wage rates to continue to increase by more than 5% in each of the next two years despite a forecast increase in unemployment.

Company tax revenue is forecast to increase 3% in 2022-23 despite a forecast decrease in profits. This is mainly due to the tax benefit of many of the Government's Covid-19 related tax relief measures being phased out over time.

GST revenue is forecast to increase by 5% in 2022-23, mainly due to greater consumption. A significant portion of the increased GST revenue over the next four years is thought to be attributable to inflation (more expensive food and other goods and services).

The Government's funding of Inland Revenue investigations increases from c. $110.6 million in the 2022-23 fiscal year, to c. $133.8 million in the 2023-24 fiscal year. Whereas the Government's funding of Inland Revenue's policy advice function decreases from c. $16.6 million in the 2022-23 fiscal year to c. $13.4 million in the 2023-24 fiscal year.



Taxation Principles Reporting Bill

Amidst Budget 2023, the Government has also introduced the Tax Principles Bill into Parliament.

The Tax Principles Bill proposes a set of 'universally accepted tax principles' and requires the Commissioner of Inland Revenue to prepare an annual report on how the tax system aligns with these principles.

The origins of this proposal date back to a speech made by Minister of Revenue, David Parker last year where the Minister flagged his concerns with the fairness of our tax system, and proposed a reporting framework to assess our current tax system against a set of well-established core tax principles. The Minister's aim in proposing this framework was to promote a fact-based discussion about our current tax system and how we can improve it.

The recent release of the High Wealth Individuals Report (covered in our April 2023 Tax Tips), further discussed the overall fairness of New Zealand's current tax system, and the release of this Tax Principles Bill forms part of the Government's tax policy response to the findings in that report.

What is proposed

The Tax Principles Bill's purpose is to require the Commissioner of Inland Revenue to report on New Zealand's tax settings in relation to a set of the taxation principles. The main aim of this proposal is to enhance public understanding of the tax system in New Zealand and foster informed discussions about its future.

Tax principles reports would be produced using a hybrid reporting model, with annual interim reports and comprehensive full reports produced every three years. The full report would cover information from the previous three tax years and be provided by the end of the second calendar year of each Parliamentary term. The interim report would be provided at the end of each calendar year. The first full report under the reporting framework would be published in 2025. The Tax Principles Bill sets a commencement date of 1 July 2023, with the first interim report expected by 31 December 2023.

The proposed tax principles are intended to be universally accepted principles that have been used in numerous tax reviews in New Zealand and overseas. These include:

Taxation principle	Description
Horizontal equity	People with similar levels of income should pay similar amounts of tax. The time value of money matters when considering horizontal equity. The tax system should generally recognise the economic effect of income, not its name, while acknowledging there are important areas where exemptions to taxing economic income are justified in the pursuit of wider societal outcomes (eg. not taxing the imputed rent or gains on an owner-occupied home).
Efficiency	Tax revenue should be raised in ways that minimise distortions to the economy and the use of resources.
Vertical equity	The tax system should be progressive. Tax is progressive if people with higher levels of economic income pay a higher proportion of that income in tax. A progressive tax system does not mean that every tax should be progressive (eg. GST is regressive) but the overall system ought to be. In practice, wealthy people should at the very least pay no lower a rate of tax on their economic income than middle income New Zealanders already do.
Revenue integrity	The revenue system should be sustainable over time and minimise opportunities for tax avoidance and tax evasion.
Compliance and administrative costs	Compliance and administrative costs for taxpayers and the Government should be reasonable, but this is not justification for substantial unfairness in the tax system.
Certainty and predictability	People should be able to determine their tax obligations before they are due.
Flexibility and adaptability	The tax system should keep pace with changes in society, in particular technological and commercial developments, and changes in inequality.

Source: Schedule 1 of the Tax Principles Bill

Each principle is defined in the Tax Principles Bill and includes additional context. For example the definition of 'horizontal equity' notes that the time value of money should be considered when evaluating whether people with similar levels of income should pay similar amounts of tax.

The Tax Principles Bill proposes approved measurements that are relevant to the tax principles listed in the Tax Principles Bill. The commentary to the Tax Principles Bill notes that rather than being definitive on how the tax principles are assessed, the purpose of these measurements is to provide specific categories of information relevant to the principles. This will allow Inland Revenue to use the most appropriate analytical techniques to evaluate this information against the relevant tax principles. The measurements proposed in the Tax Principles Bill include:

- Income distribution and tax paid;
- Distribution of tax exemptions and lower rates;
- Perceptions of tax system integrity;
- Taxpayer compliance.

The Commissioner will have flexibility to include additional measurements beyond those listed in the Tax Principles Bill in its reporting on the tax principles, to help the framework to maintain pace with future developments. If additional measurements were considered appropriate by Inland Revenue, the Commissioner is required to publish these two months before inclusion in a report, to encourage transparency and invite public feedback.

Regarding information collection, we note that the Tax Principles Bill does not grant Inland Revenue any additional powers. However, Inland Revenue can rely on its existing information collection powers and it should be able to lawfully collect any additional information to enable accurate reporting on the principles. The Commissioner is also under an obligation to ensure all information published in the reports will be aggregated and anonymised to ensure that individual taxpayers cannot be identified.

The Tax Principles Bill specifies that its provisions, including the tax principles and reports, are not intended to extend beyond the reporting framework itself and should not influence the interpretation of other tax legislation and cannot be used as evidence in any matter of law or fact. The duties of the Commissioner and the rights and obligations of taxpayers are not affected, except for the confidentiality of taxpayers' information, which remains protected.

PwC view

We generally support the introduction of this Tax Principles Bill to help inform the public debate about our tax system and whether it is achieving its aims. Over time, we expect that reports published under this Tax Principles Bill to affect tax policy indirectly by highlighting any gaps within our current tax system.

We expect that the tax principles listed in the Tax Principles Bill should have a high degree of acceptance amongst the general public. However, we consider coherence should be included as another principle as this is an important lens to place on our overall tax system. In particular, it is possible that a tax reform, when viewed in isolation, may seem to make sense against a specific policy goal, but when considered in the context of the whole tax system, can become nonsensical. An example is the non-deductibility of interest for residential rental property when compared to the general ability to deduct interest for any other business.

Further, we query whether the descriptions of the principles need to include some value judgements and contested statements. For instance, the descriptions of the principles include the following statements in the Bill:

- Compliance and administrative costs: States that this principle should not be 'justification for substantial unfairness in the tax system'.
- Vertical equity: Notes that 'wealthy people 'should at the very least pay no lower a rate of tax on their economic income than middle income New Zealanders already do'.
- Horizontal equity: Acknowledges that 'there are important areas where exemptions to taxing economic income are justified in the pursuit of wider societal outcomes (eg. not taxing the imputed rent or gains on an owner-occupied home)'.

In our view, if the purpose of the framework is to promote public debate and allow our current tax settings to be assessed against core and well-accepted principles, then in our view, this could be achieved without referencing subjective statements such as 'substantial unfairness' on which the public is likely to have have different views. For instance, how much tax a person should pay in reference to their economic income is a subjective judgment. In our view, such statements should be removed from the description of the framework as it is New Zealand's democratic process that should determine the views of New Zealanders on such topics. The analysis in the report will provide context and information for everyone to make their own judgments. This would also help ensure the political longevity of this reporting framework.

Notwithstanding our general support, we are concerned about the truncated timeline for introduction and enactment of the Tax Principles Bill. The public has been provided with three weeks to submit and the Tax Principles Bill is expected to be passed prior to the general election to ensure Inland Revenue is empowered to produce the first interim report prior to 31 December 2023. This timeline is inadequate for a fundamental piece of legislation and creates a risk that there will be insufficient time for stakeholders to provide valuable feedback to help the Government refine and improve the tax principles reporting framework. In our view, this proposal should have gone through the generic tax policy process which would have required public consultation prior to this proposal being included in draft legislation.

While information will be aggregated and anonymised, these reports may focus on particular groups (particularly the wealthy), so privacy considerations will remain important going forward. It is unclear how much additional information that Inland Revenue will need to collect in order to produce its reporting on the tax principles reporting framework, and the additional burden this will place on taxpayers to provide this information. We suggest that to the greatest extent possible, this information collection is incorporated into existing methods that Inland Revenue uses to collect information.

Further, it is also uncertain how Inland Revenue will be resourced to produce the annual reports. In our view, Inland Revenue has limited resourcing to pursue remedial fixes to tax legislation and there is a risk that existing policy resources will be diverted into complying with the Commissioner's obligation to prepare an annual report under the Tax Principles Bill's framework. In our view, Inland Revenue should ensure that resources are not diverted from other important initiatives in order to produce the reports.

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