# Taxation (Income Tax Rate and Other Amendments) Bill

*Commentary on the Bill*

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# Overview of the Bill

## BILL OVERVIEW

The Taxation (Income Tax Rate and Other Amendments) Bill introduces a proposed new top personal income tax rate of 39% for the 2021–22 and later income years. This would apply to annual personal income that exceeds $180,000. The Bill would also amend other tax rules to ensure that the proposed new top personal tax rate would apply consistently across the personal tax system.

The Government's objective for this Bill is to raise revenue to allow the Government to continue providing public services while supporting New Zealand's economic recovery (a revenue objective), in a way that increases the progressivity of the tax system (a distributional objective).

The Bill would clarify the legislation to ensure that the Commissioner of Inland Revenue (the Commissioner) can collect information for tax policy purposes. It would also introduce a rule to allow for the collection of information from trustees to assess compliance with the 39% rate and to understand and monitor the use of structures and entities by trustees.

The Bill would also set the minimum family tax credit (MFTC) threshold for the 2020–21 and later tax years.

### Introducing a new top personal income tax rate and other consequential changes

A number of tax rules are being amended to incorporate the proposed new top 39% personal income tax rate, including:

- PAYE rules
- fringe benefit tax (FBT)
- resident withholding tax (RWT) on interest
- employer's superannuation contribution tax (ESCT)
- residential land withholding tax (RLWT)
- retirement savings contribution tax (RSCT), and
- the taxable Māori authority distributions non-declaration rate.

The consequential changes to the PAYE rules, FBT, ESCT, RLWT, RSCT and the Māori authority distributions non-declaration rate would apply from 1 April 2021. The higher RWT rate on interest would take effect from 1 October 2021 to ensure that interest payers are able to implement the required systems changes.

### Information-gathering measures

The Bill includes two proposed information-gathering measures:

- increased information required on trustee annual returns from the 2021–22 income year (including the ability for the Commissioner to request this for some prior years), and
- clarifying the information-gathering powers of the Commissioner.

These measures would ensure that the Commissioner has access to the information required to provide high quality tax advice.

**Minimum family tax credit**

The minimum family tax credit (MFTC) is a mechanism of government support for low-income families. It provides assistance to low-income families, to ensure they are better off in the workforce than being on a benefit. From 1 April 2020, main benefit payments were increased by $25 per week, but adjustments to the MFTC were not made.

The proposed amendments would retrospectively increase the MFTC threshold for the 2020–21 tax year to $29,432 per ($566 per week), a $32 per week increase.

# Introducing a new top personal income tax rate

## INTRODUCING A NEW TOP PERSONAL INCOME TAX RATE

***(Clauses 5 – 31)***

### Summary of proposed amendment

The proposed amendments would introduce a new top personal income tax rate of 39% on annual income exceeding $180,000. The proposed new statutory income tax rates for individuals would be:

| **Taxable income** | **Tax rate** |
|---|---|
| $0 – $14,000 | 10.5% |
| $14,001 – $48,000 | 17.5% |
| $48,001 – $70,000 | 30% |
| $70,001 – $180,000 | 33% |
| $180,001 upwards | 39% |

The Bill proposes to amend a number of tax rules to incorporate the proposed new 39% personal income tax rate, including:

- the PAYE rules
- fringe benefit tax (FBT)
- resident withholding tax (RWT) on interest
- employer's superannuation contribution tax (ESCT)
- residential land withholding tax (RLWT)
- retirement savings contribution tax (RSCT), and
- the taxable Māori authority distributions non-declaration rate.

### Application date

The proposed new top personal rate of 39% would apply for the 2021–22 and later income years. For most taxpayers the 2021–22 income year starts on 1 April 2021.

Consequential changes to taxes that apply on a transaction basis would largely apply from 1 April 2021. The proposed changes to the PAYE rules, FBT, ESCT, RLWT, RSCT and the Māori authority distributions non-declaration rate would apply from 1 April 2021. An exception is the new proposed RWT rate on interest, which would apply from 1 October 2021.

### Key features

The Bill introduces a proposed new top personal income tax rate of 39% for the 2021–22 and later income years. The proposed amendment would apply to annual income in excess of $180,000.

The Bill also proposes amendments to other basic tax rules to ensure the proposed new rate is applied consistently on all types of personal income. These consequential changes would generally apply from 1 April 2021, with the exception of a proposed new RWT rate on interest, which would apply from 1 October 2021.

## Background

New Zealand's personal income tax rates are progressive. The greater a person's taxable income, the higher the proportion that is taxed. Currently, the top personal income tax rate is 33% and applies to the part of a person's income that exceeds $70,000.

The tax rates that apply to personal income differ from the flat tax rates that apply to entities, such as companies. A flat rate means the rate does not increase as income increases. Portfolio investment entities (PIEs), which includes KiwiSaver funds, are subject to a progressive tax scale, but at rates different to those that apply to personal income.

## Detailed analysis

Table 1 in part A of schedule 1 of the Income Tax Act 2007 sets out the basic income tax rates that apply to personal income. The Bill introduces a new row to accommodate the proposed 39% rate:

| Row | Taxable income | Tax rate |
|---|---|---|
| 1 | $0 – $14,000 | 10.5% |
| 2 | $14,001 – $48,000 | 17.5% |
| 3 | $48,001 – $70,000 | 30% |
| 4 | $70,001 – $180,000 | 33% |
| 5 | $180,001 upwards | 39% |

The statutory income tax rates set out the rates at which personal income is taxed in New Zealand. A number of other tax rules are also being amended to reflect the proposed new top personal income tax rate of 39%.

***Secondary tax codes (clauses 23, 30, and 31)***

This Bill would amend the PAYE rules to introduce a proposed new tax code (SA) for secondary-income earners whose total PAYE income payments (total income subject to PAYE) are greater than $180,000.

The current top secondary tax code (ST) would still apply for secondary employment earnings for an employee whose total income subject to PAYE is more than $70,000, but would only apply up to $180,000. Where an employee's total income subject to PAYE is greater than $180,000 the SA new code would apply from 1 April 2021.

| Tax deduction code | Withholding tax rate | Who should use this code |
|---|---|---|
| ST | 0.330 | For secondary employment earnings for an employee whose total PAYE income payments are more than $70,000 but not more than $180,000. |
| SA | 0.390 | For secondary employment earnings for an employee whose total PAYE income payments are more than $180,000. |

***Extra pay (clauses 5, 6, and 24)***

Lump sums earned in the course of employment ("extra pays") such as bonuses, back pay, redundancy and retirement payments are generally taxed at the employee's marginal rate. The Bill introduces a proposed new 39% tax rate on extra pays if a person's taxable income is expected to exceed $180,000.

***Fringe benefit tax (clauses 7 – 13, and 17)***

FBT is paid by employers on non-monetary benefits provided to employees, such as motor vehicles. The rates and thresholds are calculated using the after-tax value of a benefit paid to an employee and takes into account the PAYE which would otherwise been paid had an employee received an equivalent amount as salary or wages instead of the fringe benefit. It is for this reason FBT rates and thresholds differ from the basic personal income tax rates and thresholds. The FBT rate is calculated using the formula:

$$\frac{\textit{tax rate}}{1 - \textit{tax rate}}$$

To account for the introduction of the proposed new top personal tax rate of 39%, the Bill would amend table 1, part C of schedule 1 to the Income Tax Act 2007 to introduce a proposed new top FBT rate of 63.93% applying to all-inclusive pay exceeding $129,680.

| Row | Range of dollar in all-inclusive pay | New rate |
|---|---|---|
| 1 | $0 – $12,530 | 0.1173 |
| 2 | $12,531 – $40,580 | 0.2121 |
| 3 | $40,581 – $55,980 | 0.4286 |
| 4 | $55,981 – $129,680 | 0.4925 |
| 5 | $129,681 upwards | 0.6393 |

Certain parts of the FBT rules refer to the current top FBT rate (49.25%) as well as the current second highest FBT rate (42.86% or 43%). These references would be updated to 63.93% and 49.25% respectively.

The proposed FBT changes would apply to fringe benefits provided or granted on, or after, 1 April 2021, for the 2021–22 and later income years.

***Resident withholding tax rates on interest income for individuals (clauses 19, and 20)***

The Bill introduces a proposed new RWT rate for individuals who receive interest income. This mirrors the proposed new top personal rate of 39%. Individuals would be able to elect this proposed new rate on interest earned from 1 October 2021.

The proposed new RWT rate on interest has a later application date than other proposed amendments in the Bill to ensure that interest payers are able to implement the required systems changes.

The non-declaration rate would remain at 45%. This applies if an individual does not give their IRD number to the interest payer.

***Employer's superannuation contribution tax (clauses 14, and 18)***

ESCT applies to superannuation contributions made by a person's employer. The rates are set at the same rate as basic income tax rates, but only one single ESCT rate applies to the amount of the contribution. The ESCT thresholds are therefore grossed up to minimise the risk that employers' superannuation contributions are taxed at a higher rate than the rest of an employee's salary and wages. In most cases, the ESCT rate threshold amount is the amount of salary and wages earned by the employee and their gross employer's contributions made in the preceding tax year.

The Bill would introduce a proposed new ESCT rate of 39% on superannuation contributions made for an employee whose ESCT rate threshold amount exceeds $216,000.

The rate of ESCT that applies to the employer's superannuation contribution would be 39% if the contribution is made for the benefit of one or more past employees or if the employer chooses the rate of 39% and the contribution is made to a defined benefit fund.

***Residential land withholding tax (clause 15)***

RLWT applies to sales of residential property by offshore persons made within five years of acquisition.

From 1 April 2021, the RLWT rate would be 39%, except for where the vendor is a company. If the vendor is a company, the RLWT rate would remain at the company rate of 28%.

***Retirement scheme contribution tax (clauses 22, 25, and 27)***

A proposed new RSCT rate of 39% would apply where the other rates notified under section 28C of the Tax Administration Act 1994 do not apply.

***Taxable Māori authority distributions non-declaration rate (clause 21)***

Under the Bill, the payment of a taxable Māori authority distribution that is more than $200 where the Māori authority does not have a record of the member's IRD number would be subject to a tax rate of 39%. The current non-declaration rate is the existing top rate of 33%.

The standard rate for a taxable Māori authority distribution is 17.5%, which is not changing.

# Information-gathering measures

## INCREASED INFORMATION REQUIRED IN TRUSTEES' ANNUAL RETURN

***(Clauses 34, 35, and 38)***

### Summary of proposed amendment

The Bill proposes to collect more information on income earned by trusts and on the financial positions of trusts, remedying a current deficit in information collected and held by the Commissioner. This additional information would be required from the 2021–22 income year onwards. The Bill also proposes that the Commissioner is able to request this information from certain trustees in relation to the prior seven years.

This would support the Commissioner's ability to assess compliance with the new 39% personal income tax rate. It would also assist the Commissioner in understanding and monitoring the use of structures and entities by trustees.

### Application date

The proposed amendment would apply for trustees' annual returns for the 2021–22 and later income years.

### Key features

The Bill would introduce a requirement to collect information from trustees about the financial position of trusts as part of a trustee's tax return. This would include financial information for the trust and information on settlements and distributions relating to the trust.

The proposal would apply to trustees of all trusts who have taxable income and therefore are currently required to file a return under section 59(3) of the Tax Administration Act 1994. Proposed section 59BA would replace section 59(3).

This proposal would not apply to the following types of trusts:

- non-active trusts that are not required to file pursuant to section 43B of the Tax Administration Act 1994
- charitable trusts incorporated under the Charitable Trusts Act 1957
- trusts eligible to be a Māori authority, or
- resident trustees of foreign trusts.

The Bill includes the ability for the Commissioner to request information for certain prior years.

### Background

Trustees are already required to provide a return under the Tax Administration Act 1994 where they have derived income for an income year.

As part of the return, trustees are required to include information on allocations to beneficiaries and identifying information for the beneficiaries.

Some types of trusts, such as trading trusts, already return financial statement summary information. The Bill would expand this current obligation in order to provide Inland Revenue with more information on the use and financial position of trusts, and to remedy the current information deficit.

Existing provisions to exempt non-active trusts from the requirement to file would remain unchanged.

## Detailed analysis

### *Information required to be provided*

The Bill would require financial accounting information to be provided by trustees on an ongoing basis. This would include:

- profit and loss statements
- balance sheet items, and
- other information to be specified by the Commissioner (for example any transfers to the trust by associated persons).

The Commissioner would prescribe additional information relevant to trusts which must be provided as part of the return information, such as loans to or by related parties.

Trustees would also be required to provide information on distributions and settlements made during the income year and include that in their return.

*Distributions*

For distributions, the information required would include identifying information for beneficiaries such as their name, IRD number and date of birth. This is set out in proposed section 59BA(2)(d).

The information required for distributions is similar to the information Inland Revenue collects about beneficiaries as part of the current tax return process, where there is an allocation of income to the beneficiary.

The Commissioner may require other information relating to distributions to be reported, which could include, for example, the source of the distribution.

*Settlements*

The information required for settlements over the year would include identifying information for settlors such as name, IRD number and date of birth, as well as the amount and nature of each settlement. In addition, it is intended that for the 2021–22 return year, trustees provide names and details of settlors from prior years. This is achieved in proposed section 59BA(2)(c) by requiring details for those settlors whose details have not previously been supplied to the Commissioner.

Inland Revenue does not currently collect information on subsequent settlements on a trust. This is an information gap which means that Inland Revenue is not capturing information on the true settlor. This is a key piece of information, as New Zealand has a settlor-based trust taxation regime.

*Other relevant persons*

Proposed section 59BA(2)(e) would require trustees to provide information on those with the power under the trust to appoint or dismiss a trustee, to add or remove a beneficiary, or to amend the trust deed.

Requiring this information is necessary as "appointers" or those with power to amend the trust deed would not be disclosed otherwise. The reference to the power arising "under the trust" is intended to ensure this does not capture beneficiaries where they have one of the above powers only if all beneficiaries agree.

This would form part of a trustee's annual return requirements and therefore existing penalty provisions would apply as appropriate, if the information is not provided or false information is provided. No additional or specific penalty is proposed.

***Power for the Commissioner to request the information for prior years***

The Bill would allow the Commissioner to collect information as part of the increased disclosures for prior years, where such information exists. This is necessary because even if more information is provided going forward, there would still be an information deficit relating to years prior to the 2021–22 income year.

This provision is necessary to assist with assessing compliance with the proposed new top personal income tax rate of 39%. Information for income years prior to 2021–22 is expected to assist in understanding and monitoring the changes in the use of structures and entities by trustees in response to the new 39% rate.

Rather than requiring prior year information for all trusts, the Commissioner would be able to determine for which trusts the information is likely to be the most useful in order to minimise compliance and administration costs. The Commissioner must notify a trustee if they are required to provide prior year information.

This provision would be limited to the prior seven years to align with record keeping rules. However, it is recognised that record keeping rules would not necessarily have applied for the requested information. Proposed section 59BAB(1)(c) makes it clear that trustees are only required to provide the requested information if it is within the knowledge, possession or control of the trustee.

While this would not form part of a return, it would be information required to be provided to the Commissioner under tax law.

***Exempt trusts***

The proposed provisions would not apply to certain types of trusts:

- Non-active trusts are automatically carved out as they are not required to file a trust return pursuant to section 43B.

- Charitable trusts incorporated under the Charitable Trusts Act 1957 are also not required to file a return of income. In addition, many of these trusts are registered with the Charities Services which has its own set of reporting requirements.
- Trusts eligible to be a Māori authority under section HF 2 of the Income Tax Act 2007, this includes Māori land trusts constituted under the Te Ture Whenua Māori Act 1993.
- Resident trustees of foreign trusts, as they already provide information to Inland Revenue as part of the foreign trust disclosure rules.

## CLARIFYING THE INFORMATION-GATHERING POWERS OF THE COMMISSIONER

***(Clause 33)***

### Summary of proposed amendment

The Bill clarifies that the Commissioner of Inland Revenue's information-gathering powers include being able to require persons to provide information solely for the purpose of tax policy development. This would be achieved by inserting new section 17GB into the Tax Administration Act 1994.

### Application date

The proposed amendment would apply from the date the Act comes into force, which will be the date it is enacted.

### Key features

The Bill inserts proposed new section 17GB into the Tax Administration Act 1994, to clarify that the Commissioner's information-gathering powers extend to requiring information for the purpose of tax policy development.

Proposed new section 17GB provides that the Commissioner may require information to be provided for the development of policy for the improvement or reform of the tax system.

The wording is similar to that used in section 18D of the Tax Administration Act 1994. The term "tax system" is intended to include social policy products administered by the Commissioner.

### Background

Existing section 17B of the Tax Administration Act 1994 provides the Commissioner with the ability to requisition information where the information is required under the Inland Revenue Acts or the information is required for any other function lawfully conferred on the Commissioner.

The proposal in the Bill would remove any uncertainty that the Commissioner can require persons to provide information solely for tax policy development purposes, by inserting a new express power, proposed new section 17GB. Having access to information is critical to providing good tax policy advice.

# Minimum family tax credit

## MINIMUM FAMILY TAX CREDIT

***(Clause 37)***

### Summary of proposed amendment

The minimum family tax credit (MFTC) is a payment to low-income working families. The purpose of the MFTC is to ensure that the incomes of families who work full-time (defined as 20 hours for sole parents and 30 hours for couples) and do not receive a benefit are always higher than what their income would be if they continued to receive a benefit.

The proposed amendments would increase the MFTC threshold for the 2020–21 tax year to $29,432 per annum ($566 per week) from $27,768 per annum ($534 per week).

### Application date

As the MFTC is an annualised credit, the proposed 2020–21 MFTC threshold would apply retrospectively from the start of the current tax year (1 April 2020).

### Key features

The proposed increase to the 2020–21 MFTC threshold reflects the $25 increase to benefits made in March 2020 in response to COVID-19. Due to timing pressures, the MFTC threshold was not updated at the time of this change. The proposed change would increase the 2020–21 MFTC threshold to $29,432 ($566 per week).

The proposed increase to the 2020–21 MFTC threshold would provide an additional $32 to families in each week that they receive the MFTC in the 2020–21 tax year. Inland Revenue administrative data suggests approximately 3,600 families would benefit.

### Background

In response to COVID-19, main benefits were increased by $25 per week from 1 April 2020. Due to timing pressures, the MFTC threshold was not updated at the time of this change. The MFTC is now being adjusted retrospectively to reflect the $25 increase to main benefits.

The MFTC threshold is set above the maximum income a two-parent family could receive on a benefit. It is therefore sensitive to changes that impact how much income a family can receive on a benefit, such as benefit rates, benefit abatement thresholds and the minimum wage. The MFTC threshold has been adjusted each year since 2006 to reflect changes to these settings.