

# The Treasury

## Budget 2021 Information Release

### August 2021

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- [36] 9(2)(h) - to maintain legal professional privilege
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
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**Tax Policy Report:** Formulation of the Government's revenue strategy

<b>Date:</b>	9 February 2021	<b>Report No:</b>	T2021/85 & IR2021/052
		<b>File Number:</b>	SH-13-9

**Action Sought**

	<b>Action Sought</b>	<b>Deadline</b>
Minister of Finance (Hon Grant Robertson)	<b>Discuss</b> the content of the revenue strategy with officials  <b>Direct</b> officials to provide a draft revenue strategy	11 February 2021
Minister of Revenue (Hon David Parker)	<b>Discuss</b> the content of the revenue strategy with officials  <b>Direct</b> officials to provide a draft revenue strategy	11 February 2021

**Contact for Telephone Discussion (if required)**

<b>Name</b>	<b>Position</b>	<b>Telephone</b>	<b>1st Contact</b>
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Emma Grigg	Policy Director, Inland Revenue, Policy and Strategy	[23]	

**Actions for the Minister's Office Staff (if required)**

Return the signed report to Treasury.

Note any feedback on the quality of the report

**Enclosure:** No/Yes (attached) OR Yes (iManage links)

## **Tax Policy Report: Formulation of the Government's revenue strategy**

### **Executive Summary**

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#### ***The Government is required to formulate a revenue strategy...***

Cabinet will need to approve a revenue strategy prior to the Budget, so that it can be incorporated into the Government's fiscal strategy report.

A revenue strategy is a requirement of the Public Finance Act (PFA). It is also an opportunity to set the strategic direction of revenue policy. The revenue strategy helps to inform the development of priorities for the tax policy work programme (TPWP).

#### ***...and officials seek your direction on its content***

The Ministers of Finance and Revenue are meeting with officials on 11 February to discuss the revenue strategy. Officials seek your direction on the broad content of the revenue strategy. This will enable officials to draft a revenue strategy for your consideration. Following your direction on the revenue strategy, officials will provide advice on the TPWP.

#### ***Officials have proposed key issues to be addressed in the revenue strategy...***

Officials suggest that the revenue strategy is structured around four parts:

- the economic strategy;
- the fiscal strategy;
- objectives for the revenue system and revenue policy; and
- tax policy framework.

The revenue strategy should be consistent with the Government's wider economic and fiscal strategy.

Specifying the Government's objectives is a requirement of the PFA. It is an opportunity to provide clear and coherent objectives to guide policy development.

Table 1 sets out the key questions for your feedback. Officials propose that this is used to structure your feedback on the Joint Ministers meeting on 11 February.

[33]

## TABLE 1: FORMULATING A REVENUE STRATEGY

Objective: Formulate the Government's revenue strategy to set strategic direction, prioritise the tax policy work programme and meet requirements of the Public Finance Act.

### Economic strategy

With an overall goal of wellbeing, we understand that the Government's areas of focus are:

- Responding to COVID-19
- Accelerating the economic recovery
- Lay the foundations for a better future

**Are there specific wellbeing priorities that should inform the revenue strategy?**

For example: climate change, housing affordability and child poverty.

### Fiscal strategy

The Government's overall fiscal objectives include stabilising and reducing debt to prudent levels over the medium term.

**Does the Government wish to signal consideration of raising additional revenue in the longer term?**

**Do you wish to consider revenue-reducing measures in the shorter term to support the recovery?**

### Revenue objectives

**What are the objectives for tax policy and tax system?**

Officials recommend framing objectives in terms of:

- Raising sufficient revenue
- Efficiency
- Fairness

**How specific does the Government want to be in its objectives?**

The Government could provide further detail on its objectives for revenue, efficiency and fairness. For example, an indication of how the Government views fairness in the tax system.

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### Policy Framework

**What is the overall strategic framework for tax policy?**

The principles that have guided the system have been: broad base, low rate; rate alignment; and neutrality. However, the system is not fully meeting these principles and may not be achieving the Government's objectives.

**How does the Government respond to pressures on the current framework?**

Option 1: Keep the framework, focus on ensuring integrity and improving fairness and neutrality.

Option 2: More strategic consideration of overall coherence of the system. Consider merits of fundamental reforms, such as "Nordic" dual income tax system.



## TAX POLICY WORK PROGRAMME

Officials will come back with further advice on priorities based on revenue strategy.

## Recommended Action

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We recommend that you:

- a **discuss** the content of the revenue strategy with officials (refer to questions in Table 1);
- b **direct** officials to provide a draft revenue strategy and advice on the tax policy work programme;
- c **note** the following timeline for development of the revenue strategy and TPWP.

	<b>Milestone</b>	<b>Date</b>
1	Joint Ministers meeting on the revenue strategy and TPWP	11 February
2	Joint report to Ministers attaching draft revenue strategy and TPWP Cabinet paper	Week beginning 22 February
3	Draft revenue strategy and TPWP Cabinet paper is consulted on and lodged	4 March
4	DEV considers revenue strategy and TPWP paper	10 March
5	Cabinet confirms revenue strategy and TPWP Cabinet paper	15 March
6	Publishing of the Fiscal Strategy report (which includes the revenue strategy)	May 2021

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# **Tax Policy Report: Formulation of the Government's revenue strategy**

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## **Purpose of Report**

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1. Cabinet will need to approve a revenue strategy prior to the Budget. This is an opportunity for the Government to set out its revenue objectives and principles for the tax system, which will in turn assist with creating a tax policy work programme to give effect to these objectives and principles. This report seeks Ministers' direction so that officials can draft a revenue strategy.

## **Background on the revenue strategy**

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2. The main purposes of the revenue strategy are to:
  - a. provide a strategic policy framework so that revenue policy is guided by clear objectives and principles;
  - b. ensure revenue policy is consistent with the Government's economic and fiscal strategy;
  - c. guide the setting of priorities for the TPWP; and
  - d. communicate the Government's policy framework and objectives to stakeholders to support transparency, inform private decisions and contribute to stable and predictable economic environment.
3. Formulation of the revenue strategy is part of the strategic phase of the generic tax policy process (GTPP). The GTPP's strategic phase involves the development of an economic strategy, fiscal strategy and revenue strategy.<sup>1</sup> Following the strategic phase, the tactical phase involves the development of a three-year work programme and an annual resource plan to implement the revenue strategy.

### ***Relevant legislation***

4. The Public Finance Act (PFA) requires transparency regarding the Government's revenue strategy and revenue objectives, and these must have regard to the principles of responsible fiscal management.
5. The key requirements in the PFA relating to revenue are the following:
  - a. The Government must set a revenue strategy – the PFA requires the Government to release a fiscal strategy report with the Budget. The report must include “details of the Government's revenue strategy, including the Government's objectives for the tax system and tax policy”.
  - b. The Government must set an objective for total Crown revenue – the fiscal strategy report must state the Government's long-term objectives for total operating revenues, as well as other fiscal variables.
  - c. In formulating the fiscal strategy, the Government must have regard to the principles of responsible fiscal management (set out in full in Appendix 1). The principles include the requirement that, when formulating the revenue strategy, the Government will have regard to efficiency and fairness, including the predictability and stability of tax rates. This principle will need to inform Ministers' decision-making on development of the revenue strategy.

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<sup>1</sup> <https://taxpolicy.ird.govt.nz/how-we-develop-tax-policy>

6. The fiscal strategy report must also cover the following matters:
  - a. Explain how the long-term fiscal objectives accord with the principles of responsible fiscal management and state the period for which those long-term objectives relate.
  - b. For the financial year to which the report relates and at least the next two financial years, indicate explicitly, by the use of ranges, ratios, or other means, the Government's short-term intentions for revenue, and other fiscal variables.
  - c. Include scenario projections. The fiscal strategy report must also contain fiscal projections of trends in the fiscal variables, including revenue. The projections must illustrate, for stated significant assumptions, likely future progress towards achieving the long-term fiscal objectives.
7. The Budget Policy Statement (published no later than 31 March in each financial year) must state any changes to the long-term fiscal objectives or short-term fiscal intentions from those stated in the most recent fiscal strategy report.

### **Process and timeline**

8. The revenue strategy is first agreed by Joint Ministers of Finance and Revenue and then taken to Cabinet for approval. The revenue strategy is incorporated into the drafting of the fiscal strategy report, which is published on Budget day.
9. Officials are working to the following timeline for the development of the Government's revenue strategy and TPWP:

	<b>Milestone</b>	<b>Date</b>
1	Joint Ministers meeting on the revenue strategy and TPWP	11 Feb
2	Joint report to Ministers attaching draft revenue strategy and TPWP Cabinet paper	Week beginning 22 Feb
3	Draft revenue strategy/TPWP Cabinet paper is consulted on and lodged	4 March
4	DEV considers revenue strategy/TPWP paper	10 March
5	Cabinet confirms revenue strategy/TPWP Cabinet paper	15 March
6	Publishing of the Fiscal Strategy report (which includes the Revenue Strategy)	May 2021

### **Scope of the Government's revenue strategy**

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10. The scope of the revenue strategy is a matter for the Government. The only legislative requirement is that it must cover the Government's objectives for tax policy and the tax system. We suggest that the scope include overall Crown revenue, recognising that non-tax sources of revenue are important for the Government's fiscal and economic objectives (e.g. revenue from the Emissions Trading Scheme).
11. Set out below are four broad parts to be addressed within the strategy: economic strategy; fiscal strategy; objectives for the revenue system and revenue policy; and policy framework. The four parts interact and are intended to flow logically.



12. A final element is setting the TPWP. We have included some preliminary comments on the possible parameters for the TPWP without detailed proposals at this stage, given the need to ensure the TPWP is informed by the revenue strategy.
13. By way of example, a copy of the Government's 2018 and 2020 revenue strategy is set out in Appendices 2 and 3<sup>2</sup>.

### ***Economic strategy***

14. The revenue strategy should be consistent with, and contribute to achievement of, the government's overall economic strategy.
15. The Government's three broad economic and wellbeing goals are to keep New Zealanders safe from COVID-19, accelerate the economic recovery and lay the foundations for a better future. Wellbeing will continue to be a priority for the Government with a focus on reducing child poverty, tackling climate change and addressing housing affordability.
16. Raising sufficient revenue is important for contributing to the Government's wider wellbeing goals. This suggests a focus on ensuring longer-term revenue sustainability and avoiding policy measures that would create permanent revenue holes.
17. The tax system can play a role in supporting the economic recovery.
  - The main way that the tax system can support economic recovery is by maintaining a stable and efficient tax system. This would minimise distortions to investment and employment, and not impede capital and labour being re-allocated to their most productive opportunities in the recovery.
  - Depending on economic and fiscal conditions, there could also be a role for temporary tax measures to provide greater encouragement for productive business investment and/or broader demand stimulus.
  - There could also be consideration of whether reforms to the tax system could promote longer-term productivity.
18. Ministers may wish to consider whether the revenue strategy should address specific Government priorities, such as housing, climate change and child poverty as follows:
  - a. Housing affordability – this has been a focus in the last few months for you and there will be ongoing focus on this work in the TPWP.
  - b. Climate change – the Emissions Trading Scheme, which raises Crown revenue, is the primary policy instrument to support the government's mitigation objectives. The Government may want to signal its objectives in this area, including the potential level and use of the ETS revenue, or the investigation of other environmental taxes.
  - c. Child poverty – a role of the tax system in addressing child poverty could be to raise sufficient revenue to fund government expenditure (including benefits and other transfers) targeted toward Government priorities, including child poverty. It will also be important that the tax and transfer systems are coherent and that they collectively achieve the government's objectives for equity and efficiency.
19. It will be important to consider whether tax policy is the appropriate instrument for progressing any objective. Taxation is a relatively blunt instrument and cannot always be appropriately targeted. In many cases, government transfers, expenditure or regulatory reform will be more appropriate instruments.

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<sup>2</sup> The 2018 Revenue Strategy articulates the priorities of the new Government whilst the 2020 Revenue Strategy is the annual refresh of the Revenue Strategy.

## Economic strategy

With an overall goal of wellbeing, we understand that the Government's areas of focus:

- Responding to COVID-19
- Accelerating the economic recovery
- Lay the foundations for a better future

**Are there specific wellbeing priorities that should inform the revenue strategy?**

## Fiscal strategy

20. Given revenue is integral to the wider fiscal strategy, the revenue strategy needs to be consistent with the Government's overall fiscal strategy. This section sets out the fiscal context and suggests how fiscal strategy is likely to interact with revenue strategy. Further advice on the fiscal strategy will be provided in the coming weeks to support discussions about Budget 2021.
21. The Government's fiscal strategy is set out in the short-term intentions and long-term objectives published in the *Budget Policy Statement*. In the short term, the intentions acknowledge that debt will rise, but commits to "reduce deficits over the forecast period as conditions allow". The long-term fiscal strategy is anchored around the objective to "stabilise net core Crown debt as a percentage of GDP by the mid-2020s and then reduce it as conditions permit (subject to any significant shocks)".
22. The short-term intention for revenue is to ensure consistency with the operating balance objective. The long-term objective for revenue is to ensure consistency with the debt and operating balance objectives. There is no specific objective to maintain revenue at a certain level or within a certain range.
23. This fiscal strategy can be achieved with a wide range of possible revenue and expenditure paths. Within the HYEPU forecasts, the reduction in OBEGAL deficits is primarily due to the withdrawal of temporary COVID-19 expenditure and tight operating allowances in future budgets. Tax revenue as a share of GDP is expected to remain relatively stable.
24. In the medium-term projections published alongside the *Budget Policy Statement*, net core Crown debt steadily reduces as a share of GDP. Again, this is supported by restraining expenditure growth as a share of GDP, while tax revenue (by assumption) remains around its historical average as a share of GDP.
25. The fiscal forecasts and projections indicate that the debt objective will be achieved principally through constraining spending growth, low interest rates and economic growth, with a minimal role for increasing revenue as a share of the economy. This approach carries risks, particularly as the intended level of spending constraint may be challenging to achieve given long-run cost pressures, particularly in healthcare. Restraining spending growth may also compromise your broader economic objectives.
26. Given these pressures, you may wish to prepare options for raising revenue in the medium term. This would enable meeting your fiscal objectives while supporting a higher level of public expenditure than currently planned. The potential need for revenue raising initiatives to meet fiscal objectives could be signalled through the revenue strategy, or addressed as part of the TPWP.
27. The macroeconomic outlook remains uncertain. Early signs, particularly labour market data, indicate the economy is recovering faster than forecast, and that the scarring from COVID-19 could be less than expected. A stronger economy could support higher expenditure than currently planned while still meeting fiscal objectives, and without the

need for revenue-raising measures. However, it would be prudent to prepare revenue options to support fiscal sustainability in the event of slower growth or higher expenditure requirements than currently forecast.

28. As continued support for the recovery, the “automatic fiscal stabilisers” should generally be allowed to operate over the economic cycle, especially if there are downside shocks. This supports “cushioning” of households and businesses from economic cycles. You may also wish to consider the scope for temporary revenue-reducing measures to help accelerate the economic recovery, depending on economic and fiscal conditions. Longer term, you may want to investigate strengthening the automatic stabilisers to support macroeconomic stability, especially given the constraints on monetary policy.
29. In the short-to-medium term, the TPWP could focus on building the analytical base for a long-term revenue objective. A work programme based on this objective could include analysis of the long-term outlook for government revenue, and how long-term economic and fiscal trends will impact on the government revenue requirements. This work could ensure the Government has a range of tax policy options available to respond to longer-term challenges. Such a work programme could feed into the Treasury’s long-term fiscal statement (to be published in 2021) and Treasury’s and IR’s long-term insights briefings.

### **Fiscal strategy**

The Government’s overall fiscal objectives include stabilising and reducing debt to prudent levels over the medium term.

**Does the Government wish to signal consideration of raising additional revenue in the longer term?**

**Do you wish to consider revenue-reducing measures in the shorter term to support the recovery?**

### ***Objectives for the revenue system and revenue policy***

30. The PFA requires that the revenue strategy state the Government’s objectives for the tax system and tax policy. [33]
31. The Government’s tax principles should be a key part of the revenue strategy. Therefore, the PFA already provides for a process to articulate tax principles. [33]
32. Clear articulation of the outcomes that the Government is seeking from the revenue system serves two main goals: it supports revenue policy development to be coherent and have regard to consistent objectives.
33. Such objectives could be framed in several ways. One option is to articulate core tax policy principles as the over-arching objective, such as “to raise sufficient revenue in an efficient and fair manner”. The Government may wish to provide more detail on how the Government understands these key objectives – sufficient revenue, efficiency and fairness – to provide greater meaning and clarity about the Government’s priorities.

## **Sufficient revenue**

34. The revenue objective should be consistent and coherent with the overall fiscal strategy. As discussed above, this consistency could simply be asserted (implying revenue should be consistent with operating balance and debt objectives) or a more specific objective for the level of revenue could be determined.

## **Efficiency**

35. The Government's efficiency objectives for the tax system could start with the Government's objective to improve wellbeing of New Zealanders. The tax system's key contribution to wellbeing is that it raises revenue that is necessary to fund the provision of public goods. Taxes create behavioural distortions – such as by reducing the returns to entrepreneurship, investment or work – that reduce wellbeing. Wellbeing is enhanced when the social benefits of government expenditure exceed the costs of raising revenue.
36. In some cases, taxes can improve efficiency by aligning social and private returns to an activity. This is in situations where there are 'externalities'. Examples of the use of 'corrective' taxes include the R&D tax credit where the social returns to R&D investment are thought to be greater than private returns, due to knowledge spillovers. At present, New Zealand makes relatively limited use of taxation as an instrument for achieving specific policy goals by influencing behaviour. There are profound challenges to using the tax system to influence behaviour, in particular the limits of policymakers' knowledge about the existence and size of externalities and whether tax policy is the most effective instrument to target the problem. There are fiscal risks as the prevalence of potential externalities could lead to a patchwork of tax incentives and subsidies that is ultimately incompatible with the Government's revenue and fairness objectives.
37. The tax system can aim to minimise the efficiency costs of raising revenue, subject to achieving the Government's revenue and fairness goals. It may be useful to articulate in broad terms the principles to achieve efficiency:
  - a. Minimising economic distortions from raising revenue, subject to achieving the Government's revenue and distributional objectives.
  - b. Neutrality in the tax treatment of different forms of income and investments as a guide to minimising distortions.
  - c. Corrective taxes should only be used where there is clear evidence of an externality, taxation is the most appropriate instrument and fiscal risks can be managed.
  - d. Stable and predictable tax settings, which enables the smoothing of tax rates across time. This supports both microeconomic efficiency and macroeconomic stability by allowing the automatic stabilisers to operate over the economic cycle.
38. As part of efficiency, the revenue strategy could also comment on administrative efficiency, compliance costs, and integrity. In particular, the objective of ensuring taxpayers pay the correct amount of tax with minimal compliance and administrative costs. The strategy may want to comment on the objectives of the Business Transformation programme and any other specific priorities for tax compliance and administration.
39. The soon to be completed Business Transformation programme has put Inland Revenue in a position where it can more easily make policy changes, both through more flexible technology and an agile workforce. We now better understand what these capabilities mean for Inland Revenue, both now and in the future. The Government has invested significantly in this transformation, and a key part of the strategy would be to maximise the benefits of transformation.

40. Given the near completion of Inland Revenue's Business Transformation programme, and the combination of the impacts of COVID-19 and the changing nature of the economic and social environment, it seems an opportunity to leverage the new system and consider impacts to the administration of the tax and transfer system. Ministers may wish officials to consider what opportunities and challenges exist and what changes to the administration of the system Inland Revenue should focus on. This could take the form of a green paper developed through extensive consultation with a wide range of stakeholders. Officials propose to discuss this with Ministers separately.

### ***Fairness***

41. The revenue strategy should comment on the Government's overall objectives for fairness in the tax system. This will require judgement from Ministers about the desired level of specificity in the revenue strategy.
42. Although fairness matters inherently, fairness can also be related to other aspects of wellbeing. In the Treasury's Living Standards Framework, fairness is related to social capital through its impact on trust and social cohesion. Trust is important for voluntary compliance with the tax system.
43. There are two standard principles used in tax policy to express fairness:
  - a. Horizontal equity: The principle that people that are in the same position should pay the same amount of tax.
  - b. Vertical equity: The principle that those with higher income, or higher ability to pay, should pay a greater amount of tax.
44. The Government may wish to express its fairness objectives with more specificity.
45. For vertical equity, transfer expenditure (ie, welfare benefits and tax credits) are particularly important for distributional outcomes. Therefore, it would be appropriate to specify any objectives in terms of the overall tax and transfer system. The Government may wish to consider its vertical equity objectives in terms of the following concepts:
  - a. Progressivity – the degree of progressivity of the tax system and how the government defines progressivity;
  - b. Re-distribution – the degree of re-distribution of the tax (and transfer) system. The degree of income re-distribution is a function of both progressivity and the size of taxes and transfers.
  - c. Inequality or poverty – the outcome from the tax system in terms of the distribution of income, wealth or consumption, including measuring the extent to which the tax and transfer system reduces inequality.
46. The objectives may refer to particular bases (eg, income, wealth or consumption), units of focus (eg, individuals, families or families with children) or time periods (eg, annual or lifetime). Measurement can be a significant challenge, owing to the limitations of survey and administrative data. Improving measurement and analysis of distributional issues could be a priority for the TPWP, and officials are focused on a programme to understand whether NZ's tax system is sufficiently progressive which is the subject of a budget bid.

[33]

47. [33]

## Revenue objectives

### What are the objectives/principles of tax policy and tax system?

- Raising revenue
- Efficiency
- Fairness
  - o Vertical equity: Distributional and progressivity goals
  - o Horizontal equity
- Other considerations: social capital and voluntary compliance.

### How specific does the Government want to be in its objectives?

The Government could articulate specific principles of a good tax system, such as about the level of progressivity.

[33]

## Policy framework

48. Once the broad objectives for the tax system are set, the revenue strategy could articulate the framework, or key principles, that underpin the tax system. This can help to communicate to stakeholders how the tax system will operate and guide policy development.
49. New Zealand's tax framework has been based around three general principles over the last three decades:
  - a. broad bases and low rates;
  - b. rate alignment across entities and forms of income; and
  - c. neutrality.
50. These principles have been considered desirable to raise revenue in an efficient and coherent manner and to maintain integrity. Distributional objectives were primarily achieved using targeted transfers (main benefits, supplementary assistance and Working for Families tax credits). While the core features of New Zealand's tax framework have generally remained intact, and broadly been endorsed by various reviews, there has been some erosion of the framework over time, and there has been a lack of reform that could have further broadened tax bases. In other words, New Zealand's tax settings do not fully adhere to these principles:
  - a. New Zealand's tax bases are not as broad as they could be, notably with the absence of most capital gains.
  - b. New Zealand's tax rates are not particularly low. The company tax rate is amongst the highest in the OECD.
  - c. There is no longer rate alignment across forms of income, with different tax rates applying to income in the form of personal income (top rate is 39%), companies (28%), Portfolio Investment Entities (PIEs) (28%) and trusts (33%).
51. The deviations from the 'broad base-low rate'/'alignment'/'neutrality' framework appear to have been driven by the following trends:
  - a. greater concern for progressivity and re-distribution that has created upward pressure on the top personal tax rate;
  - b. global tax competition that has put downward pressure on the company tax rate;

- c. concern about household saving that has led to lower effective tax rates on certain saving vehicles (KiwiSaver and PIEs in general); and
  - d. Lack of expert and political consensus about the direction of tax reform and base-broadening reforms.
52. The above issues could point to areas for longer-term consideration of New Zealand's tax system, including the following questions:
- a. What are the effects of the non-alignment of tax rates and what should be the strategic policy response?
  - b. Whether there are base broadening reforms that could contribute to improving efficiency and/or fairness?
  - c. Whether New Zealand should make greater use of corrective taxes, such as the development of an environmental tax framework?
  - d. Whether New Zealand's business tax settings, including the company tax rate, are appropriately set to maximise wellbeing?
  - e. Whether New Zealand's approach to the taxation of income from saving, including the taxation of saving, is appropriate?
    - i. In particular, the main coherent alternative to a comprehensive income tax approach is the 'Nordic' or 'dual income tax' approach that taxes labour income at higher rates than capital income.
53. Some of the above issues could be picked up in the TPWP, subject to resource constraints and other priorities. For completeness, it is noted that you can still preserve a broad base low rate framework and advance progressivity where there is non-alignment of rates by bolstering integrity measures. A top tax rate of 39% is still relatively low by world standards, and you can ensure that the 39% top rate sticks by introducing additional taxes at a shareholder level to ensure income earned through companies (at 28%) cannot be used to circumvent desired progressivity.
54. The revenue strategy could express the policy framework by noting the main revenue bases and other key principles of a desirable tax system. The main judgement call required from Ministers is whether you wish to affirm the main features of the current system, or want to signal any directions for change or emphasise any particular objectives.
55. A second judgement concerns the level of detail within the policy framework. In formulating the revenue strategy, there is a trade-off to be made between transparency and flexibility. You might prefer to articulate high-level elements of the system, which will ensure that the revenue strategy provides flexibility when later setting priorities for the TPWP. Conversely, you may wish to more clearly identify priorities from among those noted above, particularly where there is a tension between competing objectives. This will provide stakeholders with greater transparency regarding the potential direction for revenue policy and the subsequent setting of the TPWP, but would limit flexibility going forward as commitments would be more entrenched.

## Policy Framework

### What is the overall strategic framework for tax policy?

The principles that have guided the system have been: broad base, low rate; rate alignment; and neutrality. However, the system is not fully meeting these principles and may not be achieving Government's objectives.

### How does the Government respond to pressures on the current framework?

Option 1: Keep the framework, focus on ensuring integrity and improving fairness and neutrality.

Option 2: More strategic consideration of overall coherence of the system. Consider merits of fundamental reforms, such as "Nordic" dual income tax system.

## Tax Policy Work Programme

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56. The TPWP should be informed by the Government's revenue strategy. We will subsequently provide you with advice on the TPWP that will make this connection. The preceding discussion highlights potential priorities that you may wish to consider including on the TPWP.
57. Building up the evidence base about the tax system could be a particular focus for the work programme. Ensuring that the tax system raises revenue from those with the ability to pay is a key part of a well-functioning tax system. As part of this, a progressive tax system where people believe everyone is paying their fair share is required to support trust in the tax system and government in general. As part of the TPWP, further work on whether the New Zealand tax system is sufficiently progressive (including both data collection and research) will be undertaken and communicated publicly. This will help to support public faith in the tax system, highlight areas where the current system is unfair and may require change and thus support greater understanding by policymakers and the public about options for future tax reform.
58. Against that background, strategic issues for tax policy include:
  - a. **Fiscal sustainability:** ensuring the tax system generates sufficient revenue in the context of the Government's fiscal strategy.
  - b. **Accelerating economic recovery:** ensuring tax settings support economic recovery and longer-term productivity and wellbeing. If there is limited appetite for revenue-reducing measures to help accelerate the economic recovery, officials suggest this is signalled as part of the TPWP to help manage private sector expectations.
  - c. **Integrity and fairness:** ensuring the tax system is robust and minimises opportunities for tax avoidance, and helps ensure that personal income is taxed at progressive tax rates, including strategic responses to the non-alignment of tax rates.
  - d. **Distributional analysis:** understanding the effective progressivity and distributional incidence of the tax and transfer system and how it impacts inequality.
  - e. **International integrity:** ensuring the international tax settings remain robust to the digitalisation of the economy and multi-national companies pay their fair share of New Zealand tax.
  - f. **Environmental frameworks:** ensuring the revenue system appropriately supports environmental objectives.
  - g. **Housing market:** improve understanding of how the tax system affects the housing market, including impacts on housing demand and supply.



59. There will be other issues that the TPWP will likely need to be resourced for. These include:
  - a. Maintenance of existing tax bases.
  - b. Reform of tax administration to take advantage of Inland Revenue's Business Transformation programme.
  - c. Other government initiatives – such as implementation of top personal tax rate and any measures targeted at the housing market.
  - d. Supporting other government work programmes – including the welfare system overhaul and consideration of social insurance approaches.

### **Generic tax policy process**

60. The development of the revenue strategy is also part of the first phase of the generic tax policy process (GTPP). This phase is known as the 'strategic phase'. The development of the TPWP is the second 'tactical' phase. The tactical phase involves consultation on the development of a work programme, to ensure that stakeholder views on tax policy issues are considered and to promote transparency of government objectives.
61. The later stages of the GTPP are the operational phase (which covers detailed design and also includes a strong consultative component), the legislative phase and the implementation/review phases.
62. New Zealand has had a GTPP since 1994. The purpose of the GTPP is to ensure that we create a tax system that is widely accepted by taxpayers and responds to New Zealand's changing needs.
63. There will be a need to prioritise matters in the work programme given limited policy resources. We recommend that the Government prioritise and manage these trade-offs within the constructs of the existing generic tax policy process (GTPP).
64. Taxes are complicated and unintended consequences can arise if proposals are not carefully considered. It can be difficult to know about potential inconsistencies or other problems without the benefit of consultation. Submitters are closer to the coalface and will often have better access to information on the size and nature of the problem and how the issues can be solved. This consultative component of policy development allows the private sector to question officials about the reasons for different changes and inform the public about the Government's intentions in making changes. Even if the private sector do not agree with proposals, they have an interest in making sure any new rules are workable in practice. Their insights in this regard increases the durability of reforms. For submitters, having a better understanding of the Government's reason for making changes promotes transparency. This is important in getting broad buy in to changes and in limiting lobbying for special concessions.

**Principles of responsible fiscal management**

- (1) The Government must pursue its policy objectives in accordance with the following principles (the *principles of responsible fiscal management*):
  - (a) reducing total debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of total debt in the future by ensuring that, until those levels have been achieved, total operating expenses in each financial year are less than total operating revenues in the same financial year; and
  - (b) once prudent levels of total debt have been achieved, maintaining those levels by ensuring that, on average, over a reasonable period of time, total operating expenses do not exceed total operating revenues; and
  - (c) achieving and maintaining levels of total net worth that provide a buffer against factors that may impact adversely on total net worth in the future; and
  - (d) managing prudently the fiscal risks facing the Government; and
  - (e) **when formulating revenue strategy, having regard to efficiency and fairness, including the predictability and stability of tax rates; and**
  - (f) when formulating fiscal strategy, having regard to the interaction between fiscal policy and monetary policy; and
  - (g) when formulating fiscal strategy, having regard to its likely impact on present and future generations; and
  - (h) ensuring that the Crown's resources are managed effectively and efficiently.
- (2) However, the Government may depart from the principles of responsible fiscal management if—
  - (a) the departure from those principles is temporary; and
  - (b) the Minister, in accordance with this Act, states—
    - (i) the reasons for the departure from those principles; and
    - (ii) the approach the Government intends to take to return to those principles; and
    - (iii) the period of time that the Government expects to take to return to those principles.

## Appendix 2: The Government's 2018 Revenue Strategy

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This revenue strategy sets out the Government's objectives for the tax system and tax policy, in the context of its economic and fiscal strategies.

### *Economic Strategy*

The Government is committed to improving the well-being and living standards of all New Zealanders through productive, sustainable and inclusive growth. We will focus on lifting productivity and wages, transitioning to a net zero emissions economy, helping our regions thrive, updating and building infrastructure, growing exports, supporting Māori and Pasifika aspirations, and reducing child poverty. We will measure our success in terms of how we protect our environment, improve our skills and health, strengthen our communities and deliver shared prosperity.

### *Fiscal Strategy*

Underpinning our economic strategy is our commitment to responsible fiscal management within five Budget Responsibility Rules which include ensuring that New Zealand has a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy. We will ensure we raise sufficient revenue to achieve our fiscal objectives of delivering a sustainable operating surplus and ensuring net debt falls to 20 per cent of GDP within five years of taking office. We will do this while maintaining government operating expenditure to within the recent historical range of spending as a ratio of GDP, and prioritising investments to address the long-term financial and sustainability challenges facing New Zealand.

### *Objectives for the tax system*

The primary function of the tax system is to raise revenue to fund government expenditure, in a way that supports economic and fiscal goals.

The Government has established the Tax Working Group to consider what could improve the structure, fairness and balance of the tax system.<sup>3</sup> The Group's Terms of Reference include an exploration of a wide-ranging set of issues that interact with the tax system, such as the changing nature of work and the role of taxes in improving environmental outcomes. After the Group provides its final recommendations in February 2019, the Government will focus on considering its recommendations and making changes that will improve the structure, fairness and balance of the tax system.

The Government has the following objectives for the tax system:

- A system that is efficient, fair, simple, coherent and collects the tax that is due, on time and in full
- A progressive tax and transfer system for individuals and families.
- A system that promotes the long-term sustainability and productivity of the economy
- A system that supports a sustainable revenue base to fund government operating expenditure around its historical level of 30 per cent of GDP
- A system that treats all income and assets in a fair, balanced and efficient manner.

Another objective of the Government is to continually improve public confidence in the tax system and Inland Revenue. The system should help people meet their obligations, be fair, and inspire confidence. The Government is committed to raising revenue in ways that meet these objectives. The Government supports a sustainable broad-base low-rate framework for

the tax system. This helps ensure that taxes are fair and efficient, and that they impede economic growth as little as possible. It also helps keep compliance costs low and minimises opportunities for avoidance and evasion. The Government also believes the interface between the tax and welfare systems should support social policy objectives, including reducing child poverty. The progressive tax and transfer system should be as simple as practicable, easily accessible and understandable, cost-effective, support transitions into employment and empower New Zealanders to make informed decisions. The Government intends to establish a Welfare Expert Advisory Group to consider the fundamentals underpinning the welfare system and how to improve the interactions between welfare and tax systems, including a review of Working for Families payments.

The Government believes that the tax system can help in delivering positive environmental and ecological outcomes, especially over the longer term.

The Government will ensure that tax policy development is inclusive, consultative and transparent. This includes making the work programme publicly available, and undertaking regular stakeholder consultation on changes to tax settings.

### *Tax policy priorities*

The Government's tax policy priorities under this revenue strategy include:

- Considering the recommendations of the Tax Working Group, which is due to report to
- Ministers by February 2019, and the Welfare Expert Advisory Group.
- Improving public confidence in the tax system and helping people understand that the tax
- system can help support wellbeing.
- Continuing to update, simplify and improve the integrity of the tax system through Inland
- Revenue's business transformation programme.
- Where possible, work in a multilateral way to strengthen the national and global tax system
- (such as working with the OECD on base erosion and profit shifting).
- Delivering other priorities in the Government's coalition and confidence and supply
- agreements.
- Delivering other items from the Government's tax policy work programme, including:
  - social policy;
  - enhancing and maintaining the broad-base, low-rate tax system including ongoing work to improve the integrity of the tax system;
  - international tax and work to address base erosion and profit shifting; and
  - business transformation and information sharing.

## Appendix 3: The Government's 2020 Revenue Strategy

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*A fair, balanced and progressive tax system will promote the long-term productivity and sustainability of the economy*

The primary function of the tax system is to raise revenue to fund government expenditure. It should do this in a way that supports this Government's overall economic and fiscal objectives.

Our long-term objectives for the tax system are as follows:

- A system that is efficient, fair, simple, coherent and collects the tax that is due, on time and in full.
- A progressive tax and transfer system for individuals and families.
- A system that promotes the long-term sustainability and productivity of the economy.
- A system that supports a sustainable revenue base to fund government operating expenditure.
- A system that treats all income and assets in a fair, balanced and efficient manner.

The Government remains committed to these objectives. We support a sustainable broad-base low-rate framework for the tax system. This ensures that taxes are fair and efficient and that they do not impede economic growth. It also helps keep compliance costs low and minimises opportunities for avoidance and evasion.

At the same time it is important that people and businesses pay their fair share of tax. This includes multinational companies and those in the digital services field. As part of these efforts the Government will continue to participate in multilateral negotiations, convened by the OECD, on the future of the international tax framework.

The Government also aims to continue improving public confidence in the tax system and Inland Revenue. With this in mind the Government will ensure that tax policy development continues to be inclusive, consultative and transparent. We will also continue the modernisation and simplification of New Zealand's tax system through Inland Revenue's Business Transformation programme.

*The key priority for tax policy at present is to support the COVID-19 response*

The tax system has a key role to play in supporting the Government's COVID-19 response and recovery efforts.

In the short run the tax system must help to cushion the impact of COVID-19 on the economy. It is critical to ensure that the tax and welfare systems work together appropriately to deliver income support to affected businesses and workers. The Government is also taking policy and administrative measures to increase cashflow and reduce compliance pressures on businesses.

Tax policy will help position the economy for recovery by supporting investment and job creation. The Government has already announced business tax changes that will promote investment, reduce compliance costs and support cashflow.

These measures include:

- The reinstatement of depreciation deductions for commercial and industrial buildings.

- An increase in the threshold for provisional tax.
- An increase in the threshold for writing off low-value assets.
- A time-limited discretion for the Commissioner of Inland Revenue to remit use of money interest (interest charged on the amount a taxpayer owes) if a taxpayer is unable to pay on time due to the impacts of COVID-19.