

Insight



Most better off under new tax structure

Likely tax changes in the upcoming Budget will leave most households better off. NZIER's preliminary estimates suggest the median household earning \$65,000 a year can be better off by around \$12 a week. This is the impact of a likely reduction in personal income tax and increase in GST.

Tax changes need to be part of a bolder set of reforms

Improving tax incentives, by encouraging work and discouraging consumption, will be important for New Zealanders' long-term economic prosperity. These changes would be a step in the right direction, but need to be part of a broader package of policy reforms to raise New Zealand's growth potential¹.

This tax package will not have a meaningful impact on the economic outlook over the next year as the benefits of personal income tax and GST changes will be offset by other costs (likely changes in investment property treatment, reduction in Working for Families, etc).

NZIER Insights are short notes designed to stimulate discussion on topical issues or to illustrate frameworks available for analysing economic problems. They are produced by NZIER as part of its self-funded Public Good research programme.

NZIER is an independent non-profit organisation, founded in 1958, that uses applied economic analysis to provide business and policy advice to clients in the public and private sectors.

While NZIER will use all reasonable endeavours in undertaking contract research and producing reports to ensure the information is as accurate as practicable, the Institute, its contributors, employees, and Board shall not be liable (whether in contract, tort (including negligence), equity or on any other basis) for any loss or damage sustained by any person relying on such work whatever the cause of such loss or damage.

Impact of likely tax changes on weekly household budget⁽¹⁾

Single income household

Household income (annual)	Income tax reduction ⁽²⁾	Increase in GST ⁽³⁾	Total ⁽⁴⁾
Superannuitant ⁽⁵⁾	\$15	-\$7	\$7
Under \$19,600	\$8	-\$7	\$0
\$19,600 to \$28,699	\$11	-\$9	\$2
\$28,700 to \$37,099	\$14	-\$12	\$2
\$37,100 to \$49,899	\$18	-\$14	\$5
\$49,900 to \$62,099	\$24	-\$15	\$10
\$62,100 to \$75,599	\$32	-\$17	\$14
\$75,600 to \$89,999	\$45	-\$20	\$25
\$90,000 to \$109,899	\$61	-\$24	\$37
\$109,900 to \$145,999	\$88	-\$28	\$61
Over \$146,000	\$126	-\$36	\$90

Notes: (1) Illustrative impacts only, 2009 income and expenditure estimates based on 2007 HES data adjusted for wage and price inflation (2) Reduction in income tax rates (%) from 12.5/21/33/38 to 10/19/30/33 and assuming no threshold changes (3) Increase in GST rate (%) from 12.5 to 15 (4) Numbers may not sum to totals due to rounding (5) Income tax reduction includes the effect of a proposed 2% increase in superannuation

Source: NZIER

The estimates above are illustrative, intended to allow households and businesses to assess and debate the proposed changes. A fuller assessment will be possible after the details of tax changes and their timing are announced in the Budget.

Our calculations are explained in the Technical Notes at the end of this paper. The table above is for a single income household. Double income households can calculate the impact by adding the income tax benefit for each earner and subtracting the GST increase for total household income.

The rich will pay the same share of taxes

High income earners will benefit the most from income tax cuts and the proposed GST increase. This is because high income earners pay more tax, both in absolute terms and as a percentage of their income (they earn more and spend more). Our estimates by broad income groups suggest the tax burden (income tax and GST) will remain broadly unchanged:

- Top 20% income households will continue to pay around 46% of all income tax and GST.
- Top 50% income households will continue to pay around 80% of all income tax and GST.
- Bottom 30% income households will continue to pay around 8% of all income tax and GST.
- Higher income earners are likely to spend some of their windfall gains on consumption, which will attract GST, and they may pay more tax than now.

We anticipate that there will be other tax changes, to ensure the whole tax package is fiscally neutral. These other changes are more likely to impact on high income earners rather than low income earners, although we cannot estimate their specific costs without further details:

- Investment properties are generally owned by higher income households, who may face a higher tax bill as a result of likely changes to the tax treatment of investment property.
- As a result of changes to investment property tax treatment, landlords may seek to increase rents, which would impact more on lower income households. However, large rent increases are not likely.
- Changes to Working for Families will most likely be aimed at denying high income households access to social welfare, and so this may reduce the net gains to these households.

Technical notes

How we estimated the impacts

Step 1: We used the 2007 Household Economic Survey (HES) to identify household spending by income group.

Step 2: We updated this data to represent the current situation by applying wage and price changes since then (to approximate December 2009 wages and prices).

Step 3: We calculated the impact of income tax changes on household income (assuming that it is a single income family, the tax rates change as summarised below and that thresholds remain unchanged).

Step 4: We calculated the impact of a 15% GST rate to the spending that attracts GST (around 80% of total spending).

Step 5: The reduction in income tax, increase in GST and the net impact are summarised by income group in Table 1.

Key assumptions, caveats and data sources

We had to make several simplifying assumptions due to data limitations. The key points are:

- We used 2007 HES data and adjusted for wage and CPI subgroup inflation to estimate December 2009 wages and prices.
- We used single income family to simplify the analysis, but we are aware that multi-income families are common and the impact of tax changes will vary.
- We assume personal income tax rates change from 12.5/21/33/38 to 10/19/30/33 and no threshold changes.
- We identified GST free spending (around 20% of spending, includes spending on housing, rent, loans/mortgages free of GST).
- Income may be under-represented in the HES, particularly from capital gains and trusts that do not accrue to an individual.
- Potential changes to Working for Families not included, as we do not know the details yet.
- Potential changes to investment property not included. Details are not yet available and potential impacts are unknown.
- We have assumed the lowest income group in HES data, who spend well in excess of their income, represents superannuitants.
- We have not modelled changes to work, consumption, and other choices that would result from these tax changes.

ⁱ Our views on the Tax Working Group's recommendations and the immediate reactions it generated are available at http://www.nzier.org.nz/Site/Publications/NZIER_Insight.aspx