



Inland Revenue  
Te Tari Taake

## POLICY AND REGULATORY STEWARDSHIP

**Tax policy report:**      **High Wealth Individual Research Project: Rationale and intended work**

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<b>Date:</b>	26 May 2021	<b>Priority:</b>	Medium
<b>Security level:</b>	In Confidence	<b>Report number:</b>	IR2021/197

### Action sought

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	<b>Action sought</b>	<b>Deadline</b>
Minister of Revenue	<b>Note</b> the contents of this report	14 June 2021

### Contact for telephone discussion (if required)

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<b>Name</b>	<b>Position</b>	<b>Telephone</b>
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## **High Wealth Individual Research Project: Rationale and intended work**

### **Executive summary**

1. Inland Revenue received funding for its budget bid *Ensuring the tax system is operating fairly* for the two years to 30 June 2023.
2. In order to provide evidence-based policy advice and support perceptions of fairness about the tax system, it is necessary for Inland Revenue to be able to describe the progressivity of the tax system and accurately calculate the costs and benefits of any tax policy change.
3. However, a lack of information about forms of economic income which are generally non-taxable (especially capital gains) limits Inland Revenue's ability to provide evidence-based policy advice on the above issues. Estimates from overseas indicate that a disproportionate share of the income of High Wealth Individuals (HWIs) is capital gains, implying that the information gap is most acute for HWI customers. As a result, being able to calculate the economic income of this group would improve Inland Revenue's ability to provide advice.
4. Although internal and proprietary information can be used to partially construct measures of economic income across the income distribution, there are specific data gaps that require additional information to be collected from HWIs in order to reasonably estimate their economic income.
5. Inland Revenue intends to collect information to fill this gap using the new powers under section 17GB of the Tax Administration Act 1994 (TAA). The information collected will be directly relevant to calculating the economic income of HWIs. Furthermore, the information will only be used to provide advice for the development of policy for the improvement or reform of the tax system.
6. The information will be used to produce a comparison of the effective tax rates on economic income for HWIs. The HWIs that will be within scope for this research are those who are already in the compliance managed population, with an estimated net worth above \$50m in a given year or who meet other criteria indicating substantial net worth. This report will be used to improve future advice on tax policy and to publicly report on the progressivity of the tax system.
7. s 9(2)(f)(iv)  
[Redacted text]
8. Our intention is to collect the highest quality information from customers in a timely manner, while also minimising the costs of compliance and protecting the privacy of individuals.
9. In order improve the quality and timeliness of the information collection, Inland Revenue intends to:
  - Limit questions asked to those that are necessary and reasonable to ask (given compliance costs and existing information) and clearly match the policy purpose,

- Ring-fence the collected information,
  - Consult in order to increase buy-in and improve the clarity of the questions.
10. We plan to begin consulting with the tax community from 14 June. The focus of this initial consultation is to raise awareness with those potentially impacted by the project, this will help increase public buy-in and compliance.
11. s 9(2)(f)(iv)

### **Recommended action**

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We recommend that you:

12. **note** the contents of this report.  
Noted
13. **refer** a copy of this report to the Minister of Finance for their information;  
Referred/Not referred

s 9(2)(a)

### **Phil Whittington**

Chief Economist,  
Policy and Regulatory Stewardship  
26/05/2021

### **Hon David Parker**

Minister of Revenue  
/ /2021

## Background

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### Why is Inland Revenue undertaking this research?

14. A key gap in Inland Revenue's evaluation of *equity* and *efficiency* implications of the current tax system in an evidence-based way is information on *full economic income* – which is equal to an individual's ordinary income plus accrued capital gains.
15. An individual's economic income provides a more comprehensive view of their *ability to pay* than *ordinary income*, and by considering varying measures of income it is possible to more fully evaluate tax settings in an empirical manner in terms of efficiency, equity, and individual's ability to pay.
16. For this evaluation, in theory, Inland Revenue would want information on the full economic income of all New Zealanders. Such a process would be extremely time consuming, and for most of the population it is unlikely it would produce significant additional insights to the work currently underway at Treasury with respect to effective tax rates (ETRs) and economic income across the New Zealand population (noted in Appendix One).
17. After discussing the work currently underway across the New Zealand Government and evaluating gaps in our knowledge, Inland Revenue intends to focus on building a picture of the economic income for HWIs based on their individual information, the information of related entities, and where appropriate information on associated persons.
18. s 9(2)(f)(iv)
19. The below process outlines Inland Revenue's intended use of the approved funding over the 2022 and 2023 fiscal years cumulatively (\$5m). s 9(2)(f)(iv)
20. Inland Revenue wants to provide a high-quality report following best practice for data and analytics – in order to produce the strongest evidence base for future tax policy advice. Such a process requires:
  - Inland Revenue to use internal expertise to update complex entity mappings associated with HWIs, identify and incorporate proprietary datasets, undertake an information collection program, verify information, and follow up with non-respondents in order to ensure high quality information is available for analysis.
  - The use of experienced internal microdata researchers to undertake comprehensive and rigorous analysis of the information in a way consistent with overseas research.
21. s 9(2)(f)(iv)
22. The design process used could allow Inland Revenue to repeat the collection and report at regular intervals in the future. If longer-term funding was secured we aim to repeat this collection *every three years* to coincide with the regular Stats NZ

Household Economic Survey Wealth Module – allowing the Department to utilise insights from these data sources to build an understanding of tax paid as a proportion of economic income over the population as a whole.

23. An outline of other work underway across government on wealth and economic income distributions is provided in Appendix One.

### **Priority information gaps – capital gains and wealth information for HWIs**

24. The gaps in our current information and the impact this has was highlighted in the Tax Working Group (TWG) 2019 report. Two clear areas where Inland Revenue was unable to provide evidence-based policy advice were with regards to:

- The *progressivity* of the existing tax system based on definitions of ability to pay/income that are wider than taxable income (e.g. economic income).
- The *quantum* of accrued and realised capital gains in a given year, for both revenue estimates and measures of this specific income source.

25. Overseas it has been established that those with the greatest ability to pay (those with high economic incomes) tend to disproportionately earn their income from capital gains – and that high income earners receive a disproportionately large amount of total capital gains income. In Gravelle (2020)<sup>1</sup> it was shown that the top 0.001% (approximately 1,500 taxpayers) of those who earn income in the United States sourced 56.4% of their income from realised capital gains.<sup>1</sup> This can be compared with all income earners in the United States where 9.1% of income is sourced from capital gains.

26. Knowledge of the capital gains earned by high income individuals in New Zealand would contribute to the ability to analyse both questions highlighted during the TWG process.

27. Given Inland Revenue's current inability to provide a comprehensive answer to these questions, the TWG made the following recommendation:

To better understand the profile of capital income, wealth and its owners in New Zealand, the Group recommends that the Government:

- fund an oversampling of HWIs in existing wealth surveys
- include a question on wealth in the Census
- request the Department to regularly repeat its analysis of the tax paid by HWIs (Inland Revenue, 2016)
- commission research, using a variety of sources of data on capital income (including administrative data) to estimate the wealth of individuals.

28. To improve Inland Revenue's ability to answer questions related to economic income in the future, a time series of net worth profiles for the existing compliance managed HWI population and associated entities will be produced. For a population of around 400 compliance managed HWIs this corresponds to potentially as many as 30,000 entities that require valuation and attribution to the appropriate HWI group.

29. In building these profiles there will be significant investment in improving internal data availability and utilising external sources. However, there are **data gaps** that cannot be filled through existing processes related to HWIs or proprietary data on the New Zealand population. As established in report SNZ-MM2004, Stats NZ has

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<sup>1</sup> Gravelle, 2020. "Sharing the Wealth: How to Tax the Rich," National Tax Journal, National Tax Association; National Tax Journal, vol. 73(4), pages 951-968, December.

difficultly capturing representative information about the wealth of HWIs – and as the information collected is only for a point in time, they are able to say even less about capital gains income.

30. As noted in report T2020/2965 this gap in the wealth data reduces the ability to describe the wealth distribution in New Zealand, requiring government officials to impute data from unverifiable external sources (e.g. the NBR rich list) or based on the taxable income flow attributed to them. This creates significant uncertainty about how to measure capital gains income and thereby economic income. Furthermore, it generates uncertainty about the true wealth distribution in New Zealand.
31. As a result, additional wealth information for a period of time will need to be collected directly from HWIs for the policy purpose described above.
32. This information will be used to produce a public report on the *effective tax rate paid out of economic income* for HWIs, to be published in mid-2023 (the ETR report). This report will be used to answer questions related to the *progressivity* of the current tax system and the *quantum of capital gains income*, to provide an information base for future discussions about tax policy in New Zealand.

### Collecting information

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33. Information collected will be combined with other sources of data which are relevant for these purposes, including proprietary data and information already held by Inland Revenue or likely to be collected in the future in administration of the Revenue Acts. One example is the trust administration information which is planned to be collected at about the same time (during 2022) under new rules also enacted at the same time as section 17GB. The exact nature of the trust data (e.g. as to settlements, trustees, beneficiaries etc) is aimed at ensuring compliance with current trust income tax rules but will contain information of relevance to the wealth information exercise.
34. This internal information collation exercise should provide a strong initial basis for evaluating the economic income of HWI groups. However, there are still likely to be gaps in the Department's information about HWIs' economic income on the basis of non-taxed income. As a result, Inland Revenue intends to use section 17GB to collect this information from HWIs.
35. s 9(2)(f)(iv)  
[Redacted text]

### The information Inland Revenue intends to collect

36. Inland Revenue intends to collect information that it is currently unable to build a reasonable measure of. We will not know the exact questions that will need to be asked until internal data cleaning is undertaken.
37. However, the nature of the likely information is clear. There will need to be collection for a number of personal items, loans, and bank deposit information in order to accurately calculate both wealth and capital gains income over the period. Furthermore, where there are *non-tax paying entities* (e.g. trusts that do not have

taxable income) that hold assets it will be necessary to directly ask for information on the assets held in these trusts.

38. s 9(2)(g)(i)



39. Future collection could also occur on a three-yearly basis, matching the collection schedule of Stats NZ's Household Economic Survey Net Worth module. The information collected would refer to the prior three years, in order to generate a consistent annual time series that can be used for future policy reporting and estimates of tax progressivity.

s 9(2)(h)

40. s 9(2)(h)



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## Consultation

47. We plan on undertaking two levels of consultation for this work: *initial consultation* to communicate the rationale for the collection and *technical consultation* to socialise the design and questions asked.
48. The initial discussions will mainly be face to face with key groups and specialist practitioners. It is not proposed that we issue any major public discussion documents or undertake public awareness campaigns. These discussions are intended to be done quickly but are important from the point of view of maximising compliance with the requests for wealth information which will follow. The key goals are therefore:
  - Increasing public buy-in and compliance.
  - Understanding and minimising barriers to efficiently obtaining the information we require.
  - Refining the nature of that information.




49. The purpose of consultation is not to determine whether we should collect the information. It is to communicate that we are collecting this information and is focused on improving response rates and social buy-in for the collection.
50. First, a fairly short period of high-level and targeted consultation will take place as soon as practicable (termed "initial consultation"). This will mainly involve discussion with some key tax advocacy groups and the major tax advisers, with the goal of explaining how we propose to use the power. There will also be discussions with public sector agencies at this time, e.g. Treasury, Stats NZ, the Privacy Commissioner.
51. We intend to commence communicating and setting up the initial consultation no later than 14 June 2021 with a view to completing discussions and considering feedback by 30 August 2021.
52. The key areas to form the basis of discussion in initial consultation will be explaining:
  - that this collection will occur in early 2022;
  - the purpose of the proposed exercise;
  - how we intend to minimise compliance costs by focussing on our knowledge gaps;
  - how we intend to protect the private information of the HWIs and their families;
  - our proposals for ring-fencing, and the type of analytics to be used (and how that is severed from the Department's operational functions);
  - our intentions with respect to enforcement of the power;
  - how the information will be used – the end products - and whether any of it will be publicly reported.
53. The second period of consultation will be more focussed on the actual knowledge gaps we will seek to fill by using the new power. This will occur in two phases and is expected to stretch out until March 2022.
54. Inland Revenue also intends to publish operational guidance on how the Commissioner will use this power prior to any notices being issued.

### **Future reporting**

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55. We plan on reporting to you after key milestones. This would involve the following reporting timeline:
  - May 2021: This report outlining the purpose of the project and the intended collection method.

s 9(2)(f)(iv)



## Appendix One: Wealth work streams across government

Key for lead agency:

- IRD = orange
- Stats NZ = green
- Treasury = blue

Objectives	Workstreams	Planned deliverables
1. Improving wealth data collection	A. <u>Improved trust data collection</u> : this work aims to improve our understanding of the wealth held in trusts, and to identify potential integrity risks presented by trusts. Trusts will now need to provide details on settlements, distributions, persons connected to the trust and financial statement information as part of their annual returns.	<p><u>May 2021</u>: Targeted consultation on financial statement requirements.</p> <p><u>June 2021</u>: Public consultation</p> <p>s 9(2)(f)(iv)</p>
	<p>B. <u>Project Rawa (this project)</u>: this project aims to collect information on the wealth and economic income of high wealth individuals (HWIs). This will fill known data gaps and improve evidence on the progressivity of the tax system.</p> <p>Later stages of Project Rawa will use this information to undertake analysis of the effective tax rates (ETRs) paid by HWIs out of economic income</p>	s 9(2)(f)(iv)
	C. <u>Household Expenditure and Wealth Survey (HEW)</u> : this new survey will replace the net worth and expenditure surveys previously collected in the Household Economic Survey (HES). Modest improvements can be expected as slightly more wealthy households will be included in the survey sample.	s 9(2)(f)(iv)
2. Estimating the wealth distribution	D. <u>Statistical modelling</u> : Stats NZ is working with Treasury to improve measurement of the top end of the wealth distribution by using statistical modelling techniques. Preliminary modelling methods are currently being explored. The next HES net worth dataset will become available in February 2022.	s 9(2)(f)(iv)
	E. <u>Wealth distribution research</u> : this work seeks to correct for known limitations in the HES net worth survey. The Treasury is preparing a working paper and analytical note on the New Zealand wealth distribution, which will present the methods referred to in <a href="#">T2020/2965</a> .	s 9(2)(f)(iv)
3. Examining the progressivity of New Zealand's tax system	F. <u>Effective average tax rates (EATRs) by economic income</u> : this work will calculate EATRs across the economic income and net worth distributions. Economic income sources that are not typically collected in surveys (e.g. capital gains) will be added into distribution.	