



Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: High Wealth Individual Research Project: Progress Update

Date:	6 September 2021	Priority:	Medium
Security level:	In Confidence	Report number:	IR2021/352

Action sought

	Action sought	Deadline
Minister of Revenue	Note the contents of this report and the attached draft Technical Consultation document, which is being provided to stakeholders this month.	10 September 2021

Contact for telephone discussion (if required)



Name	Position	Telephone
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6 September 2021

Minister of Revenue

High Wealth Individual Research Project: Progress update

Executive summary

1. The High Wealth Individual Research Project (the Project) is progressing to schedule. A report on the effective tax rate (ETR) on economic income for High Wealth Individuals (HWIs) will be finished by June 2023. Collection of the substantive financial information is planned to begin in April or early May 2022.
2. Our focus over the last few months has been on bedding down the methodology we will use to calculate ETRs, putting in place internal systems and processes, and collating the data on the high wealth individual population that is already available to Inland Revenue.
3. s 18(c)(i)

4. ETBs will be constructed for a range of income measures, including economic income and comprehensive income (which is economic income excluding imputed income). Material progress has been made on identifying what information is needed to construct these measures of income. The components of economic income (the most exhaustive measure) that will be used can be summarised as *taxable income*, *accrued capital gains*, *imputed income*, and *windfall gains*. Broadly, this information will be sourced as follows:
 - Taxable income: Taxable income of the entities and individuals. Information is being sourced internally from tax returns.
 - Accrued and realised capital gains: In short, this is the annual change in value of net assets held by a HWI family unit. Most of the information will need to be sourced from HWIs during the 2022 collection exercise. Values relating to listed companies and residential property will be sourced from external databases.
 - Imputed income: Imputed income is essentially the consumption benefit of owned assets. Only imputed income from residential accommodation will be calculated for the economic income measure. This information will be estimated using property value estimates from an external proprietary database.
 - Windfall gains: Primarily gifts received by an individual. This information will be requested from HWIs during the 2022 collection exercise.
5. A significant focus for the project is creating accurate and complete "entity maps". Entity maps link an HWI family unit with all the entities they have beneficial ownership in.
6. s 9(2)(h), s 18(c)(i)


s 9(2)(h), s 18(c)(i)

7. We intend to undertake an information collection exercise this year that will seek information solely on an HWI's entities. This is planned to begin in November this year and to be completed before the 2022 collection exercise.

8. s 9(2)(h)

9. The next stage of stakeholder communications will begin in September. This round of discussion is aimed at tax agents and experts and is intended to build understanding and buy-in to the Project. This is important as the information collection will be completed by tax agents. We plan on sending out the attached communications document to stakeholders as part of this next stage.

10. Upcoming milestones for the Project include (a full list can be found in paragraph 66):

- the collection and confirmation of the entities HWIs have beneficial ownership in, to begin in November 2021, and
- estimating HWIs' economic income that is generated from listed companies (BN2021/331 refers), already begun.

11. s 9(2)(f)(iv)

Recommended action

We recommend you:


13. **note** the contents of this report and the attached draft Technical Consultation document.

Noted

14. **refer** a copy of this report to the Minister of Finance for their information.

Referred / Not referred

s 9(2)(a)



Felicity Barker

Policy Director, Wealth Research Project
Policy and Regulatory Stewardship

Hon David Parker

Minister of Revenue



/ /2021

Purpose

15. This report provides details on the progress made on the High Wealth Individual Research Project (the Project). The Project will construct and collect information to produce a report by June 2023 on the effective tax rate (ETR) on economic income for High Wealth Individuals (HWIs).
16. To date, progress has been made on:
 - identifying the population, the family unit, and their entities (“entity mapping”)
 - sourcing and preparing internal and publicly available data and identifying where gaps exist
 - setting up internal processes to improve the response rate and quality of responses to the upcoming information request, and
 - completing the initial consultation and starting the technical consultation.
17. Timelines and future milestones are also provided within this report.

Identifying the population, the family unit, and their entities

Population

18. s 18(c)(i) 
19. This population is not necessarily the wealthiest individuals, nor a representative sample of the top of the income or wealth distribution. A HWI includes family members and associated entities (see below).
20. For this Project, tax non-residents are being excluded from the population under analysis. Non-residents largely fall outside New Zealand’s tax base and therefore including them would provide little insight in describing the progressivity of New Zealand’s tax system.
21. Individuals on the HWI list that have been identified as deceased will not be included. However, if a successor can be linked to the wealth, that successor will be included.
22. s 18(c)(i) 
23. No further exclusions to the Project’s population are currently being considered. Excluding non-residents and the deceased, we expect the Project’s population to be approximately 350 lead individuals.


Family unit

24. Consistent with the academic literature, this research will look at Economic Family Units (an individual, their spouse, and dependent children¹) to define the HWIs of interest. However, we do recognise the limitations of defining HWIs in this way, as families do not only share resources one way.

Entities

25. Determining the entities that HWIs are linked to, and derive economic income from, is one of the most important aspects to get accurate.

s 18(c)(i)



29. The new financial reporting requirements for domestic trusts (focused on monitoring compliance with the 39% rate) is expected to collect the type of information needed for entity mapping. However, these new requirements are only for the 2021–22 and later income years, whereas this Project is collecting information for the 2016 to 2021 tax years (BN2021/331 refers). Furthermore, the trust project will not collect all the information this Project requires. For this reason, the Project will collect trust information as well.

The beneficial ownership gaps will be filled through a separate information collection exercise to begin this year.

30. We will request information from HWIs on the entities and structures to which they are linked (see Appendix 1 – Entity Links). Under this request, we will provide HWIs with the entity maps we have created through collating and refining publicly available information and provide them an opportunity to verify and add to the entity maps.
31. This entity mapping information request is planned to begin in November this year and to be completed before the substantive financial information request (scheduled for late April/early May 2022). By understanding the HWIs' entities before the substantive request next year, we will be able to design a more targeted notice that should lower compliance costs for HWIs in 2022, while at the same time reducing the opportunity for interpretative differences.
32. The November request for entity information will not be made under a legal provision (that is, it will be a voluntary collection). However, to support response rates and quality, we propose that the information received will be ringfenced in the same way that information collected pursuant to section 17GB of the Tax Administration Act 1994 (TAA) will be (that is, only accessible to the Project). If

¹ The definition of dependent child used for the Project is that used by Stats NZ within their household survey: a child in a family who is aged under 18 years and not in full-time employment.

HWIs do not respond to the November request, we will assume their existing entity map is accurate. Nevertheless, we propose to include questions regarding entities as part of the compulsory notice in 2022.

33. HWIs will have until early February 2022 to provide the entity mapping information.

Sourcing and identifying internal and public information, and identifying where gaps need to be filled

Information required to estimate ETRs

34. An ETR is equal to the tax paid by an individual and the entities they have an interest in divided by a measure of the income earned by the individual and those entities.
35. While the tax paid by the HWIs can be accurately obtained, calculation of the ETR requires us to determine the appropriate measure of income. The final report will calculate ETRs for different measure of income – including economic income. Calculating and comparing various income bases helps provide context and allows for a number of views of a person’s ability to pay tax (see Appendix 2 – Other income bases) for a description of the income bases we will use).
36. The primary components we will use to calculate these incomes measures are:
- taxable income
 - accrued and realised capital gains
 - windfall gains, and
 - imputed income.


Sources of this information (gifts, taxable income, and accrued capital gains)

37. The only income source for which we have a complete picture is taxable income. Taxable income of the HWI population and entities (explained below) for the period of analysis is being sourced internally from tax returns.
38. Some information on capital gains can be sourced from external databases, and the Project will seek to use these registers and databases where available. The use of public registers and databases increases the accuracy of the data we use and reduces the compliance costs on individuals. The registers that have been identified as worthwhile investigating include:
- residential property titles
 - Companies Office register data
 - listed company ownership registers and share prices – Bloomberg, and
 - other more bespoke registers, including aircraft and carbon credit registers.
39. In most cases, however, we will seek information from HWIs to estimate capital gains. To calculate an HWI’s accrued capital gains, we will seek to collect information on, or to estimate, **all net assets** that the HWI has available to them (in effect, creating a personal income statement and balance sheet). We can then estimate the change in net assets year-on-year that cannot be explained by gifts or taxable income. This is equal to the HWI’s accrued capital gains.
40. Imputed income is, broadly, the consumption value of assets a person owns. It cannot be measured accurately as it is purely an imputed value. For this Project,

we will provide income measures with and without imputed income. However, only the imputed income from residential accommodation will be included in the income measure. This will be estimated based on the annual value of property from external proprietary databases.

41. Information on the value of windfall gains (for example, gifts) received during the 2016 to 2021 tax years ("the period of analysis", BN2021/331 refers) will be requested from HWIs.

Calculating change in net assets


42. As discussed, we will estimate capital gains from the change in net assets. Net assets will need to be **estimated in many cases**. We have divided net assets into eight broad categories:
 1. Consumer durables/personal assets; for example, jewellery, art, and car collections.
 2. Real estate.
 3. Unlisted companies.
 4. Listed companies.
 5. Non-corporate businesses; for example, sole proprietors and partnerships.
 6. Personal financial investments; for example, share portfolios and bank accounts.
 7. Trusts (including entities held in a trust).
 8. Foreign-held entities.
43. Indicators to support valuing these assets vary within each category. We have currently identified over 200 unique indicators that would be useful in estimating an HWI's net assets. During the next three months, we will identify what data points are necessary and, therefore, what information we will request from HWIs.
44. We will not be asking HWIs to seek independent valuations of personal items or the businesses or property they hold.
45. Using internal valuation expertise, we have begun creating valuation models to use to estimate the value of unlisted/private companies and non-corporate businesses. Valuations of private businesses will always be an inexact art, but these models will help to ensure comparability and consistency to the extent possible.
46. For example, in the case of unlisted companies, information will be gathered on earnings for each year within the period of analysis. A range of valuation methods will be used to estimate the value of the company. This will then be compared to subsequent annual estimates to calculate a change in value of the company.
47. For trusts, we will collect information on all relationships an HWI has with a trust (trustee, settlor, power of appointment, and beneficiary) and impute a range of ownership values based on these relationships where the income cannot be accurately collected.
48. 

49. Various statistical methods and assumptions will need to be made to estimate an economic income range and, subsequently, an ETR range for the Project's population. Because an HWI' net assets (unlike taxable income) cannot be observed, using various methods and creating a range will reduce the level of scrutiny and should therefore increase the recognition of the final result.

Internal preparation of systems and processes

50. The substantive collection of financial account and personal item information to occur in late April or early May 2022 will be undertaken under Inland Revenue's formal information-gathering powers (specifically section 17GB of the TAA). As previously reported to you (BN2021/331 refers), this will collect information for the 2016 to 2021 tax years. We have put in place internal processes for undertaking this collection.

s 9(2)(h)



54. To help ensure the information is properly ringfenced, work has been completed on preparing internal processes for collection.
- Our collection and analysis platforms are secure, monitored, and ready for the quantity and type of non-tax data we expect to collect. Both platforms sit outside Inland Revenue's tax collection application (START).
 - Only a small team of named data analysts, support staff and survey administrators will be able to view the individual responses.
 - We are working alongside the Office of the Privacy Commissioner to draft and publish a Privacy Impact Assessment for the Project.

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

Compliance strategy

56. Ensuring good quality data and a high response rate will require a clear collection and compliance strategy. Our compliance strategy is designed to reflect best practice consistent with the Commissioner's general policy.
57. The strategy will seek to deliver the highest possible level of voluntary compliance from the Project's population. This will best ensure timeframes can be met.
58. A key part of our compliance strategy has been working with tax agents and other key stakeholders, such as the Law Society, in advance. During collection, support to HWIs (as well as advisors and agents) will need to be provided to answer queries. This will mainly be in the form of written/email communications. Phone support will be available where issues cannot be resolved by email, and this will be followed up with written confirmation.
59. s 18(c)(i)
60. This messaging will outline that we may seek court orders and, in extreme cases, may prosecute for failure to provide the information. These options are a last resort, but the existence of these remedies may assist compliance with the notices.


Communications with stakeholders

61. We have completed initial consultation on the Project with key stakeholders, including CA ANZ, the Office of the Privacy Commissioner, and the Law Society. The purpose of this consultation was to raise awareness that a research project was forthcoming and to open relevant channels of communication with key players. As the collection will likely be completed by tax agents, we consider that improving their understanding and meeting their concerns will improve later response rates.
62. The consultation has been, and will continue to be, very targeted to a select group. Members of this group are either directly involved in assisting with the information collection exercise (tax advisors and umbrella groups) or stakeholders that will assist in ensuring the Project's timelines are maintained (legal practitioners and advisory groups).
63. The consultation so far has been constructive, with stakeholders willing to engage and provide insights as to the best way to collect the needed information. Stakeholders are concerned the quality and timeliness of responses may be impacted by factors such as:
- whether Inland Revenue are truly able to protect client information and privacy
 - high compliance costs in collating the information sought, and
 - the feasibility of collecting and analysing this amount of information.
- They are also concerned that this is the first time Inland Revenue has used the new information collection powers and therefore special care should be made around privacy.

64. The next stage of communications will begin in September. This phase will reach a wider group of advisors and stakeholders. It will involve considerably greater detail, and so it should build on the work done so far with stakeholders. It will focus on how the collection exercise will be run and how the information gathered should be dealt with, but it will also still address the reasons for the exercise and the statutory issues, such as privacy.
65. We plan on sending out the attached communications document to stakeholders as part of this next stage.

Timelines and next steps

s 9(2)(f)(iv)



Appendix 1 – Entity Links

68. As part of our entity collection, we plan on requesting HWIs to provide information where they (or someone within their family unit) have any of the following types of entity links. These entity links have not been finalised, but they are based on similar exercises completed by the Australian Tax Office.
69. Requesting these entity links allows us to collect information on the wealth held in those entities and attributed to an HWI. However, this list does not include all assets held by an HWI (for example, residential property held in their own name and portfolio investments). These will also be requested from the HWI as part of the substantive net asset request.

Entity type	Requested link of anyone within the economic family (or another person holding on behalf of someone within the economic family unit)
Unlisted company	<ul style="list-style-type: none"> - Shareholder and shareholding % - Officer or director - Control or interest (describe)
Trust	<ul style="list-style-type: none"> - Appointer - Beneficiary - Trustee - Administrator or executor - Settlor - Power of appointment - Control the affairs of the Trust (describe)
Partnerships and non-corporate businesses	<ul style="list-style-type: none"> - A partner - In a joint venture - Other non-corporate business
Other entities	<ul style="list-style-type: none"> - Control or interest (describe)

Appendix 2 – Other income bases

In calculating ETRs the Project will use a range of income measures

The starting point – full economic income

70. Ultimately, economic income seeks to measure the amount of real goods a person can consume. This is because real consumption is the best indicator of material well-being.
71. A person's economic income can be measured as the amount they spend on consumption plus their change in wealth. A person's change in wealth is included because wealth can be viewed as deferred consumption. The person could have increased their consumption but chose to defer it by saving it, thereby increasing their wealth.

Economic income = consumption + increase in wealth

72. Direct savings² plus capital gains determine a person's increase in wealth. This can be reflected within the calculation of economic income.

Economic income = consumption + direct savings + accrued capital gains

73. Consumption and direct savings are the person's monetary outflows; that is, what the person allocates their money to, plus imputed income (which is part of consumption). The monetary outflows are equal to the monetary inflows to the person; that is, how much money they receive. Calculating a person's monetary inflows (taxable income and windfall gains) is simpler than their outflows. Overall, four components are needed to calculate an HWI's economic income:

Economic income = imputed income + windfall gains + taxable income + accrued capital gains

We can adjust full economic income in measuring an individual's ability to pay

74. The final report will calculate ETRs for different measures of income. Each of these measures gives a different perspective on an individual's ability to pay. For example, while economists generally think owned assets give rise to a stream of consumption benefits (imputed income), this does not give rise to monetary income from which an individual could pay tax.
75. A brief description is provided of the five other income base measures (alongside economic income) and how they differ from each other.³
1. **Money income:** This is income that a person can readily retrieve. Liquid money that can be turned into consumption easily. Tax systems are generally based off this definition.
 - Income from labour (wages) and capital (dividends and rents). Realised capital gains, money gifts and public and private transfers received are also included. Excluded are imputed income and accrued capital gains.
 2. **Market income:** This is income obtained by the person transacting in the economy. The person has sacrificed something to receive this income (for example, selling your time or expertise).

² Direct savings – for example, putting money in the bank or purchasing more assets.

³ An example of imputed income is imputed rent (the amount a person would be willing to pay in rent to live in their owner-occupied property). "Gifts" encompasses inheritances and gifts in kind.

- Money income minus all gifts and transfers received.
3. **Disposable income:** Money available to the individual after transfers and taxes.
- Market income after tax and all transfers received.
4. **Comprehensive income:** Similar concept to economic income.
- Economic income excluding imputed income from the consumption of owned assets.
5. **Taxable income:** Defined within legislation and country specific.
- As defined under section BD(1) of the Income Tax Act 2007.
76. Because imputed income is notoriously difficult to accurately measure and understand (even imputed income from residential accommodation), comprehensive income is likely to be the income base most widely recognised.