Raising Revenue and Ensuring Equity

Increasing the Rate of GST and Introducing a GST Refund Tax Credit in New Zealand

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Word Count (Excluding Footnotes): 3996

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Aotearoa New Zealand (NZ) is facing a systemic fiscal deficit, as Crown spending is projected to significantly outgrow Crown revenue in the long-term.[1] Simultaneously, NZ has comparatively high levels of inequality,[2] and material hardship, especially for families.[3] Together, these two issues present a significant problem; how can NZ raise more revenue, whilst ensuring that raising that revenue does not negatively impact low-to-middle income NZers? I propose that NZ should increase the rate of the Goods and Services Tax (GST) to 17.5% and introduce a targeted GST refund tax credit for low-to-middle-income individuals.

The case for increasing the rate of GST

According to the NZ Treasury's most recent long-term insights briefing the NZ Crown's future fiscal position is concerning, as Crown spending is projected to outgrow Crown revenue by more than 15% of gross domestic product (GDP) by 2060.[4] Not only will this result in an inability to meet the costs of every day societal needs, but it also puts NZ in a weak position to manage future disasters, pandemics and economic shocks. Revenue raising measures will play a vital role in addressing the deficit.

It is important that measures which seek to increase Crown revenue do not push the NZ tax system away from principles of good taxation. Alignment with these principles will ensure revenue raising measures operate at least cost and aide the growing of the economy. The principle of broad base low rate (BBLR) is fundamental to an effective and efficient tax system.[5] Tax regimes that do not provide reliefs or exemptions, and thus are able to apply low rates, generally increase the economic efficiencies of tax by decreasing distortions and increasing total output.[6]

1. The New Zealand Treasury, *He Tirohanga Mokopuna* (Wellington: The New Zealand Treasury, 2021), 19, https://www.treasury.govt.nz/publications/ltfp/he-tirohanga-mokopuna-2021#new-zealand-s-long-term-fiscal-position.
2. The Ministry of Social Development, *The Social Report 2016 – Te Pūrongo Oranga Tangata* (Wellington: The Ministry of Social Development, 2016), 133, https://socialreport.msd.govt.nz/documents/2016/msd-the-social-report-2016.pdf.
3. The Ministry of Social Development, *Child Poverty in New Zealand* (Wellington: The Ministry of Social Development, 2022), https://www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/research/child-poverty-in-nz/2022-child-poverty-report-overview-and-selected-findings.pdf.
4. The New Zealand Treasury, *He Tirohanga Mokopuna,* 19.
5. Mcleod Rob, "Collecting Taxes," *Victoria University of Wellington Law Review* 33, no. 3 and 4 (2002): 793 – 812.
6. Organisation for Economic Development and Cooperation, "Broad Base – Low Rate Approach: Scope and Limitations" in *Choosing a Broad Base – Low Rate Approach to Taxation.* OECD Publish, 2010. https://read.oecd-ilibrary.org/taxation/choosing-a-broad-base-low-rate-approach-to-taxation/broad-base-low-rate-approach-scope-and-limitations_9789264091320-4-en#page19.

NZ's GST regime strongly aligns with the BBLR principle as it has few exemptions and applies to a very broad range of goods and services.[7] This can be best highlighted by the fact that NZ has the highest Value Added Tax (VAT) Revenue Ratio score, which measures the broadness and effectiveness of a consumption tax, scoring over double the Organisation for Co-operation and Development (OECD) average.[8]

NZ's rate of GST is comparatively low, sitting well below the OECD average of 19.2%, meaning there is scope for a modest rate increase. [9] This scope is strengthened by NZ's lack of a capital gains tax, and its low average tax rate on wages.[10] In other words, NZ's comparatively low GST rate is not offset by comparatively higher rates within other regimes. This is especially important given GST is, in essence, an indirect and deferred tax on labour.[11]

I propose that the rate of GST is increased by 2.5% to 17.5%. This rate would abide by the low-rate principle, still sitting nearly 2% below the OECD average. I also propose that the GST base remain untouched, allowing it to maintain its broadness. Although the revenue this would generate will be contingent on various dynamic factors such as inflation and consumption patterns, if a 17.5% GST rate was to have applied in the 2022-23 tax year, it would have generated approximately an additional $4 billion in revenue.[12]

Using GST to leverage a shifting tax base

NZ's population is ageing. This is resulting in a decreasing proportion of earners within the population, putting pressure on, and shifting, the NZ tax base.[13] As the population gets older, the proportion of GST within the tax base is likely to increase as retirees consume, drawing on

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7. Inland Revenue, *The New Zealand tax system and how it compares internationally* (Wellington: Inland Revenue, 2017), 6, https://www.ird.govt.nz/-/media/project/ir/home/documents/about-us/who-we-are/our-minister/the-new-zealand-tax-system-and-how-it-compares-internationally.pdf.
8. Organisation for Economic Co-operation and Development, *Consumption Tax Trends 2022: VAT/GST and Excise, Core Design Features and Trends* (Paris: Organisation for Economic Co-operation and Development Publishing, 2022), 58, https://doi.org/10.1787/6525a942-en.
9. "OECD Consumption Tax Trends 2022: Consumption Tax Trends – New Zealand," Organisation for Economic Co-operation and Development, 2022. https://www.oecd.org/tax/consumption/consumption-tax-trends-new-zealand.pdf.
10. "Taxing Wages – Comparative Tables," Organisation for Economic Co-operation and Development, accessed June 2024, https://stats.oecd.org/index.aspx?DataSetCode=AWCOMP.
11. Tax Working Group, *Changing the Rate of GST: Fiscal, Efficiency and Equity Considerations* (Wellington: Victoria University of Wellington, 2009), 5, https://www.wgtn.ac.nz/cagtr/events/past-events/tax-working-group-2009/publications/gst-paper.pdf.
12. The data utilised to make this calculation was sourced from: Inland Revenue, *Annual Report 2022- 23,* (Wellington: Inland Revenue, 2023), 8, https://www.ird.govt.nz/-/media/project/ir/home/documents/about-us/publications/annual-and-corporate-reports/annual-reports/annual-report-2023.pdf.
13. The New Zealand Treasury, *The Economic Impacts of an Aging Population in New Zealand,* (Wellington: The New Zealand Treasury, 2021), https://www.treasury.govt.nz/sites/default/files/2021-09/ltfs21-bp-economic-impact-ageing-population-nz.pdf.

savings, whilst earning less taxable income.[14] Increasing the rate of GST presents an opportunity to leverage this shift in the tax base. Furthermore, it is also an opportunity to capture revenue on existing wealth as increasing the rate of GST is in-effect a one-off taxation on all the wealth that exists within NZ at the time of the increase (the collection of this revenue will not be immediate and is contingent on consumption occurring in NZ).[15] Leveraging GST will help to partially negate the revenue implications of an ageing population and partially shift the tax burden away from those participating in the labour force.

Impact on economic growth

Typically, increasing tax rates or introducing new taxes has a negative impact on economic growth and GDP as tax increases distort economic decisions, resulting in a shift in the allocation of resources, and creating deadweight costs.[16] However, an increase in the rate of GST will have a smaller impact than other tax increases would.[17] This is in part due to the fact that GST is applied at the point of consumption rather than the point of accumulation or earning, thus deferring taxation and allowing for more savings and investment, both of which grow the economy.[18]

The behavioural and price elasticity impacts of increasing the rate of GST is difficult to quantify due to the lack of empirical evidence in NZ, as well as the fact that different goods and services will experience different responses.[19] Although elasticity responses may have an impact on both economic growth and revenue, they are also partially mitigated by the fact that the base of GST is broad and therefore difficult to avoid, and that such responses are mostly negated when rate increases are accompanied with compensation measures (which will occur through this proposal).[20]

As GST does not decrease an individual's net return from labour or investment, an increase in the rate of GST does not have a perceived impact on marginal tax rates. This is of particular

14. Ibid.
15. Kaldor, N. *An Expenditure Tax*. (London: Routledge 2003). https://doi.org/10.4324/9781315823973.
16. Department of the Treasury, *Economic and Fiscal Effects of Rising Average Tax Rates*, (Canberra: Department of the Treasury Australia: 2016), https://ministers.treasury.gov.au/sites/ministers.treasury.gov.au/files/2019-05/2016-005-Economic-Fiscal-Effects-of-Rising-Average-Tax-Rates.pdf
17. Macek, R, "The Impact of Taxation on Economic Growth: Case Study of OECD Countries," *Review of Economic Perspectives* 14, no. 4, (2015): 309–328.
18. Milesi-Ferretti, G and N Roubini. "Growth Effects of Income and Consumption Taxes." *Journal of Money, Credit and Banking* 30, no. 4 (1998): 721–44. https://doi.org/10.2307/2601126.
19. Tax Working Group, *Changing the Rate of GST: Fiscal, Efficiency and Equity Considerations*, 2-3.
20. Please note the following source is a seminar abstract that relates to a working paper which is preliminary and unfinished. Cashin, D, *The Intertemporal Substitution and Income Effects of GST Rate Increases: Evidence from New Zealand* (Wellington: Victoria University Wellington, 2011), https://www.wgtn.ac.nz/sacl/research/seminars/david-cashin-intertemporal-substitution.pdf.

importance given the high micro and macro-economic cost that are associated with high marginal tax rates, which impact an individual's work decisions.[21]

Impact on inflation

An increase in the rate of GST will have an inflationary impact. This is because the full cost of a GST increase is typically passed on to consumers, meaning the cost of goods and services will increase by the same rate at which GST is increased.[22] Before the 2010 GST rate increase was implemented, it was modelled that the consumer price index (CPI) would increase 2.02% within 3 months of the application of the new rate, reflecting an immediate 2.5% price increase in the cost of all taxable supplies. This figure excluded increases in the price of GST exempt supplies, such as rents, as these price responses are more inelastic, hard to quantify and are lagged.[23] Although it is difficult to analyse the exact impact the 2010 increase had on CPI, data from the time shows a 2.3% increase 3 months from application of the new rate.[24]

Exempt supplies now constitute a smaller portion of the total CPI than they did in 2010.[25] It can, therefore, be expected that the immediate inflationary impact of a 2.5% GST rate increase in 2024 may be higher than 2.02%, but still below 2.5%. Although this inflationary impact should be noted, the Reserve Bank has the discretion to look through temporary inflation shocks, and not reflect these in the official cash rate.[26] Although unlikely, if the Reserve Bank was not to look through this temporary inflation, the potential 2 to 2.5% impact falls within the Reserve Bank's medium-term inflation targets,[27] and also falls within the optimal range of inflation for economic

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21. The New Zealand Treasury, *The Role of Tax in Maintaining a Sustainable Fiscal Position*, (Wellington: The New Zealand Treasury, 2013), https://www.treasury.govt.nz/sites/default/files/2013-01/ltfep-s3-02.pdf.
22. The New Zealand Treasury, *Aide Memoire: Impact on CPI from Raising the GST Rate to 15%,* (Wellington: The New Zealand Treasury, 2010), https://www.treasury.govt.nz/sites/default/files/2010-07/b10-am-tsy-cpigst-8mar10.pdf
23. Ibid.
24. "Prices (M1)", Reserve Bank of New Zealand, last modified 16 August 2024, https://www.rbnz.govt.nz/statistics/series/economic-indicators/prices.
25. Sourced from both "Prices (M1)", Reserve Bank of New Zealand, last modified 16 August 2024, https://www.rbnz.govt.nz/statistics/series/economic-indicators/prices and "Household income and housing-cost statistics: Year ended June 2023", Statistics New Zealand, last modified 22 February 2024, https://www.stats.govt.nz/information-releases/household-income-and-housing-cost-statistics-year-ended-june-2023/#:~:text=In%20the%20year%20ended%20June%202023%2C%20for%20households%20with%20expenditure,from%20%24410.70%20(up%204.0%20percent).
26. New Zealand Parliament, *Monetary Policy and the Policy Targets Agreement*, (Wellington: New Zealand Parliament, 2018), https://www.parliament.nz/mi/pb/library-research-papers/research-papers/monetary-policy-and-the-policy-targets-agreement/#:~:text=Inflation%20variations%20around%20target%20%E2%80%93%20The,have%20a%20short%2Dterm%20impact.
27. "OCR 5.50% - Inflation Approaching Target Range", Reserve Bank of New Zealand, last modified 10 July 2024, https://www.rbnz.govt.nz/hub/news/2024/07/ocr-5-50-inflation-approaching-target-range#:~:text=Restrictive%20monetary%20policy%20has%20significantly,second%20half%20of%20this%20year.

growth in NZ,[28] meaning a GST rate increase could be utilised as an effective monetary tool during a low inflation or deflation period.

Administration and business impacts

As this proposal is simplistic and will maintain GST's broad base, the increased rate is realistic for Inland Revenue to implement and will not create on-going additional administration, particularly in relation to determinations, rulings and court proceedings. Although GST has a greater compliance cost for businesses in NZ than other taxes,[29] increasing the rate is relatively simple and is unlikely to create additional on-going costs beyond the necessary transition, system and pricing changes required upon the new rate's introduction. It is important to note, however, that a rate change may present challenges for those businesses with bespoke or out-dated software solutions.

As it is expected that any increase in GST is fully passed on to consumers, the cost of doing business will not increase, except for those businesses that supply exempt goods and services or fall below the GST threshold and are not registered. Therefore, as a means of raising revenue, increasing the rate of GST is more business-friendly and compliance cost light than the addition of new taxes, or regime changes.

GST: A principled revenue raising mechanism

An increase in the rate of GST is a sustainable and enduring partial solution to NZ's systemic fiscal deficit as it aligns with fundamental tax principles, does not create complex administrative issues or increase compliance costs, and has less of an economic impact than other tax increases would. As it is a simple rate change rather than a fundamental change to tax regimes, it will result in an immediate increase in Crown revenue, can be reversed in future if NZ is able to solve its systemic fiscal deficit or can be extended if NZ was to shift to a tax system with a greater focus on consumption taxes. Given NZ's uncertain future and ageing population, this flexibility further strengthens the case for a GST rate increase.

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28. Brook, A, O Karagedikli, and D Scrimgeour. "An Optimal Inflation Target for New Zealand: Lessons from the Literature." *Reserve Bank of New Zealand Bulletin* 65, no. 3 (2002): 5–16.
29. Inland Revenue*, 2021 study on the time and cost of doing business taxes incurred by NZ small businesses* (Wellington: Inland Revenue, 2021), 8, https://www.ird.govt.nz/-/media/project/ir/home/documents/about us/publications/research-and-evaluation-reports/small-and-medium-enterprises-compliance-costs/2021.pdf?modified=20240318003735&modified=20240318003735.

The impact of a GST rate increase on low-to-middle income New Zealanders and options for addressing this

Despite being a principled mechanism through which Crown revenue can be increased, there are equity concerns with a GST rate increase. Increasing the rate of GST will increase prices relative to incomes, impacting the spending capacity of individuals, particularly low-to-middle income individuals who have little disposable income. This impact is exacerbated by the fact that GST is regressive as low-to-middle income individuals spend proportionally more of their income on GST than higher income individuals.[30] Although it is argued that GST regimes are relatively proportional over a life-time,[31] the periods of life in which low-to-middle income individuals experience the regressivity of GST has equity implications, can push individuals into poverty and diminishes future economic positions.[32]

The above is of particular concern given the high levels of income inequality and material hardship in NZ.[33] Addressing the impact of a GST rate increase on low-to-middle income NZers may help to alleviate poverty and improve economic positions in the long-term, resulting in a decreased need for future Government spending and, thus, helping to address NZ's fiscal deficit. Specifically, introducing a mechanism to offset the impact of a GST rate increase on low-to-middle income individuals will ensure that any GST rate increase embodies distributional equity, whilst increasing the political and public acceptability of a rate increase.

These factors will ensure a 17.5% GST rate is maintained through election cycles and is able to partially address the long-term structural deficit. Such a mechanism will also partially mitigate the economic growth and price elasticity implications of increasing the rate of GST, as more money in the hands of low-to-middle income individuals results in economic stimulus.[34]

Broadly, there are three main options available to negate the impact of a GST rate increase on low-to-middle income NZers;

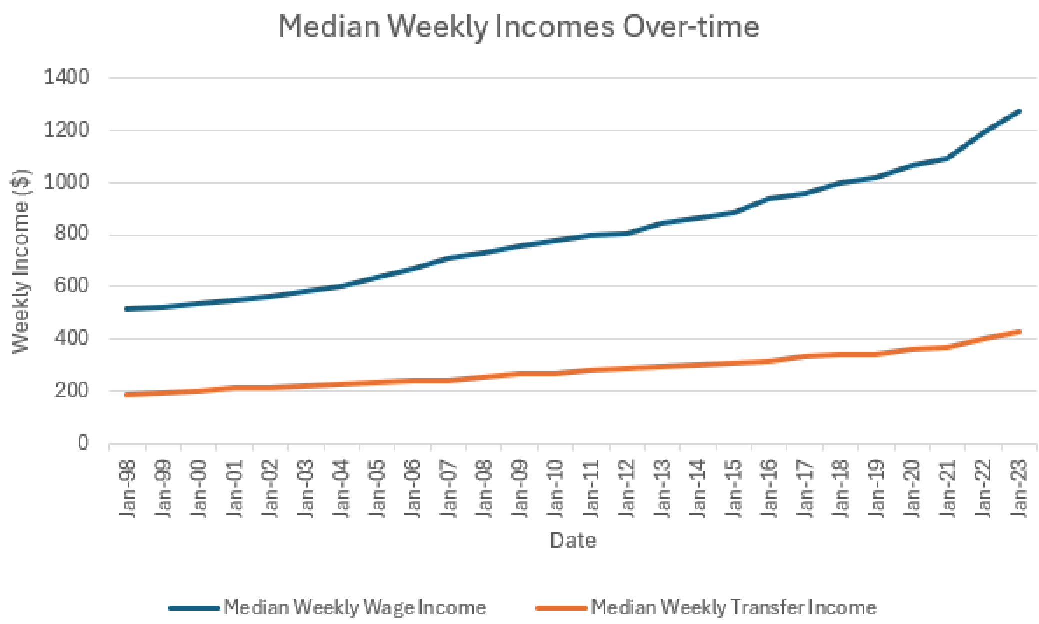
- an increase in transfer rates,

30. Varela, P, *What are progressive and regressive taxes?* (Canberra: Tax and Transfer Policy Institute, 2016), https://taxpolicy.crawford.anu.edu.au/files/uploads/taxstudies_crawford_anu_edu_au/2016-11/progressive_varela_feb_2016_complete.pdf.
31. Tax Working Group, *Note on effect of decreasing GST rate* (Wellington: Tax Working Group, 2018), 2, https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-bg-3996822-note-on-effect-of-decreasing-the-rate-of-gst.pdf.
32. Thomas, A, "Reassessing the regressivity of the VAT", *OECD Taxation Working Papers,* No. 49 (2020): https://doi.org/10.1787/b76ced82-en.
33. Ministry of Social Development, *The Social Report 2016 – Te Pūrongo Oranga Tangata*, 133.
34. New Zealand Institute of Economic Research, *Literature scan on economic effects of social protection expenditure* (Wellington: New Zealand Institute of Economic Research, 2020), https://drive.google.com/file/d/1HRlH1NHj6dfVhURyNEUlB4J2PiAdLkZ/view.

- zero-rating essential products such as food,
- introducing a GST refund tax credit.

When the rate of GST was last increased in 2010, transfer payment rates and personal income tax changes were made to ensure most individuals would be better off.[35] Increasing transfer rates is not optimal however, as transfer payments have become more targeted over time, not all low-to-middle income individuals are eligible for payments, current payments have numerous design issues, and there has been a decrease in the real value of transfers over time (Figure 1 refers).

Figure 1: Median Weekly Income Over-time



Data sourced from the Household Labour Force Survey conducted by Statistics New Zealand

Alternatively, zero-rating products is poorly targeted and disproportionately benefits higher income earners on a nominal basis (Table 1 refers). Not only will this result in an expensive policy that fails to meet its objectives, but it will also introduce complexities and compliance costs to the GST regime whilst irreversibly damaging its broad base, undermining the principles that underpin a GST rate increase in the first place.

35. "Fact sheet - GST and compensation", Beehive, Published 21 May 2010, https://www.beehive.govt.nz/release/fact-sheet-gst-and-compensation.

Table 1: Average Benefit Gained by the Zero-Rating of GST on Food by Income Group			
Income Group	Average Amount Spent on Food Per Week	Average Benefit from the Zero-Rating of Food	
		Weekly Benefit	Yearly Benefit
Under $23,700	$167.76	$25.16	$1,308.53
$23,700 - $35,599	$169.91	$25.49	$1,325.30
$35,600 - $44,999	$188.60	$28.29	$1,471.08
$45,000 - $60,799	$231.30	$34.70	$1,804.14
$60,800 - $77,199	$266.04	$39.91	$2,075.11
$77,200 - $96,499	$294.97	$44.25	$2,300.77
$96,500 - $118,399	$322.38	$48.36	$2,514.56
$118,400 - $147,799	$340.95	$51.14	$2,659.41
$147,800 - $199,399	$440.75	$66.11	$3,437.85
$199,400 and Over	$527.79	$79.17	$4,116.76

Data sourced from the Statistics New Zealand 2019 Household Economic Survey. The data has been adjusted for inflation using the Reserve Bank's food price inflation calculator.

The introduction of a GST refund tax credit

The introduction of a GST refund tax credit provides a mechanism through which the impact of a GST rate increase on low-to-middle income NZers can be off-set in an enduring way. Although international examples provide NZ with possible design parameters for such a credit, it is important that the parameters selected suit NZ's tax and transfer system. This is particularly important given countries such as Canada have complex tax and Governmental systems, meaning the design of their credits reflect these systemic complexities. [36]

Proposed design features: A targeted, individualised credit with a 'cliff-face'

A GST refund tax credit could be introduced as a nominal amount paid to all, or a targeted credit paid to those who meet specified eligibility criterion. I propose to target the credit, as it ensures better distributional equity and fiscal stewardship, both of which are vital given the future fiscal context, the regressivity of GST and the amount of revenue a GST rate increase would generate.

Although international examples of such a credit,[37] as well as other transfer payments in New Zealand, have both an individual and a couple rate, I propose that this credit is individualised. Individualising the credit aligns with the individualised nature of NZ's income tax system and will ensure that there is no requirement for income information of an applicant's partner, simplifying both administration and take-up. Furthermore, according to Statistics NZ the average two-person household consumes almost twice as much as the average one-person household meaning individual consumption levels do not vary due to partnership.[38]

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36. Centre for the Study of Living Standards, *New Directions for Intelligent Government in Canada* (Ottawa: Centre for the Study of Living Standards, 2011), https://www.csls.ca/festschrift/StewartFestschrift.pdf#page=171, and "GST/HST Credit", Government of Canada, last modified 2 July 2024, https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4210/gst-hst-credit.html.
37. Ibid.
38. Data is adjusted for inflation and is sourced from: "Household Economic Survey", Statistics New Zealand, 2019, https://nzdotstat.stats.govt.nz/wbos/Index.aspx?DataSetCode=TABLECODE7553.

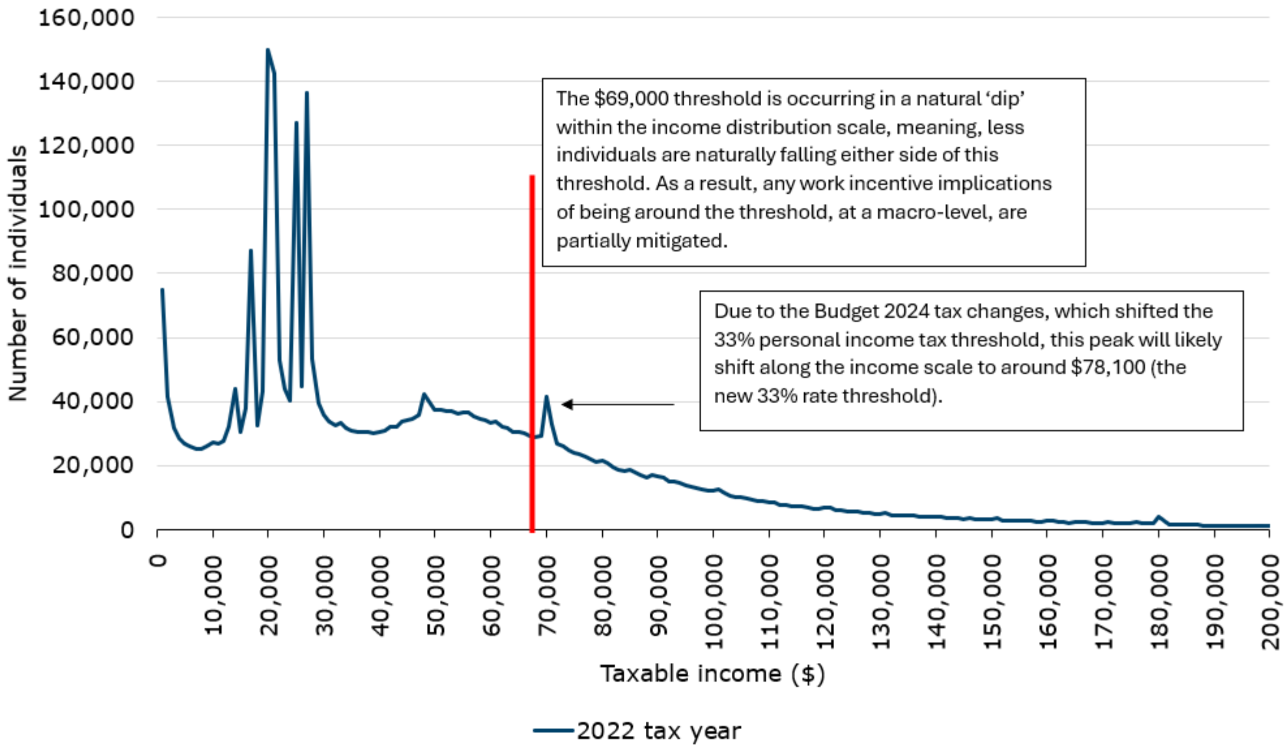
The GST refund tax credit equivalent in Canada provides those with children an additional top up to their credit.[39] Given that this would complicate administration, the application process, and create complex care-related issues, if it was deemed that additional support should be provided to those with children to address the impact a GST rate increase has on child related costs, this could be addressed via increases to child-specific transfers, such as the Family Tax Credit.

To be eligible for the credit individuals would need to be 19 or older, which aligns with when an individual is no longer considered a dependent child within the NZ transfer system and is no longer in secondary education, signalling a transition to greater self-reliance. Individuals would also need to be ordinarily resident, which can be defined as an individual who is present in, has ties to, and has the intention of living in, NZ.[40] Utilising this definition of residency will ensure that the credit is paid to those who are contributing to NZ, intending to continue to contribute, and who are consuming (that is, experiencing the impact of a GST rate increase).

The credit should be paid at a rate that takes into consideration the impact of a 2.5% increase in the rate of GST on the average individual. In 2024 this impact on a one-person household would be approximately $707 for the year.[41] This provides an approximation for the rate of the credit. The credit should be paid to those earning under $69,000 (gross) a year, the median income from salary and wages.[42] This threshold aligns with a 'dip' in income distribution data (Figure 2 refers),[43] meaning less individuals naturally fall either side of this threshold. As a result, the disincentives to work that are associated with entitlement thresholds will impact a smaller number of individuals. This threshold should be based on a definition of taxable income, rather than economic income.[44]

39. Centre for the Study of Living Standards, *New Directions for Intelligent Government in Canada*.
40. Greenfield v Chief Executive of the Ministry of Social Development – SC 10/2015, https://www.courtsofnz.govt.nz/cases/dawn-lorraine-greenfield-v-chief-executive-of-the-ministry-of-social-development-1.
41. Data has been filtered to ensure that non-taxable supplies such as rents and financial services are not included. The data has also been adjusted for inflation. The data was sourced from: "Household Economic Survey", Statistics New Zealand, 2019, https://nzdotstat.stats.govt.nz/wbos/Index.aspx?DataSetCode=TABLECODE7553.
42. "Labour market statistics (income): June 2024 quarter", Statistics New Zealand, 2024, https://www.stats.govt.nz/information-releases/labour-market-statistics-income-june-2024-quarter#:~:text=Median%20weekly%20earnings%20from%20wages,percent)%2C%20to%20reach%20%241%2C197.
43. "Tax on taxable income datasets", Inland Revenue, 2024, https://www.ird.govt.nz/about-us/tax-statistics/revenue-refunds/income-distribution/tax-on-taxable-income-datasets.
44. Welfare Expert Advisory Group, *A brief history of family support payments in New Zealand* (Wellington: 2018), 15, https://www.weag.govt.nz/assets/documents/WEAG-report/background-documents/133db2ad05/History-of-family-support-payments-010419.pdf.

Figure 2: Taxable Income Distribution



The proposed GST refund tax credit should utilise a cliff-face approach rather than an abatement regime. A cliff-face denotes where a credit goes from full entitlement to no entitlement once an income threshold is passed, whilst abatement is when an entitlement is reduced by a specified percentage for each dollar over an income threshold that an individual earns. Abatement extends the period of the income scale for which an individual is receiving an entitlement and contributes to an individual's effective marginal tax rate (EMTR). High EMTRs heavily impact work incentives.[45] As low-to-middle income individuals in NZ receive numerous, often simultaneously abating transfer payments, EMTRs are already high. Introducing an additional abating credit will exacerbate this.

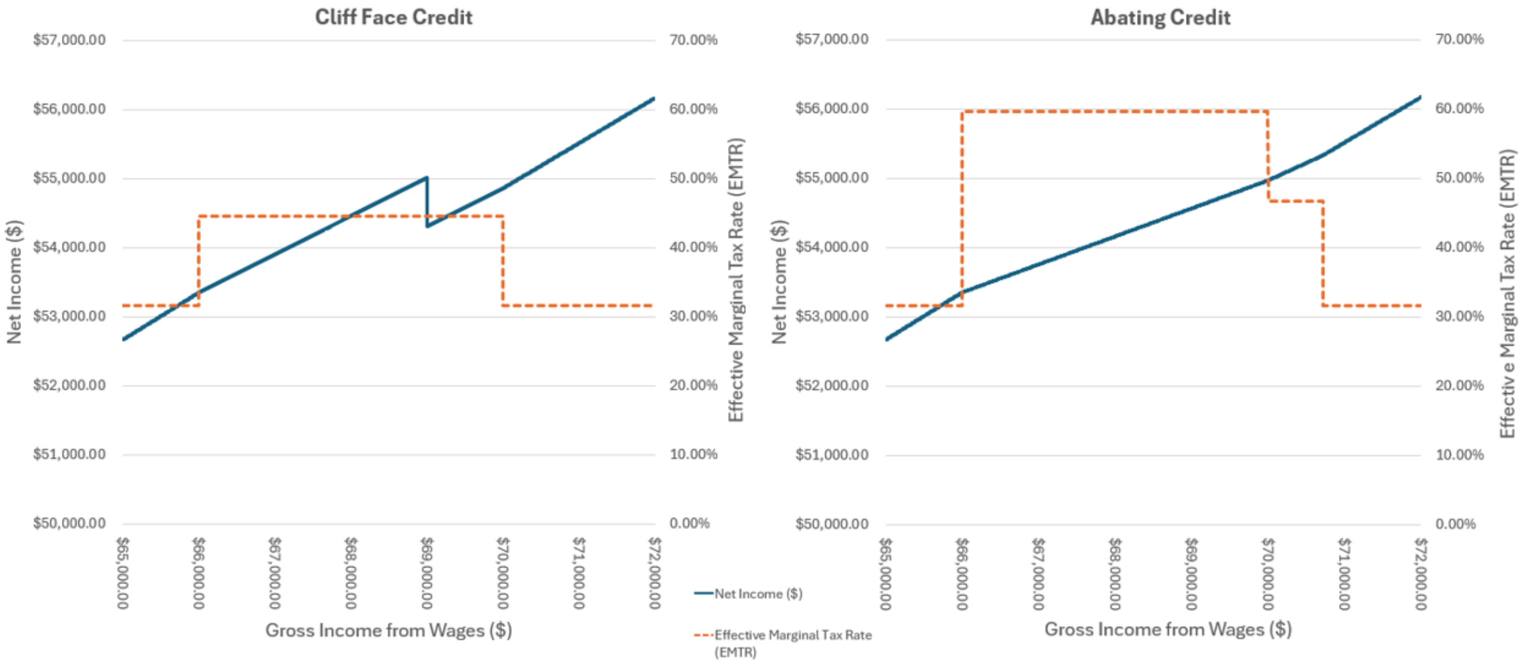
Instead, utilising a cliff-face approach impacts work incentives over a shorter number of hours-worked, partially mitigating the personal and economic implications associated with introducing a new credit. A cliff-face does have an impact on the net income of those who are just over the income threshold. This is because once an individual is over the threshold and no longer receives any entitlement their net income needs to increase by more than the amount of the credit to be better off again (in this case their net income would need to increase $707 a year

45. Binh T., C. Evans, and B. Andrew. "Effective Marginal Tax Rates and Work Disincentives." Australian Tax Forum 22, no. 3 (2007): 117–135.

after going over the $69,000 threshold in order to be better-off than they were when receiving the credit at $68,999).

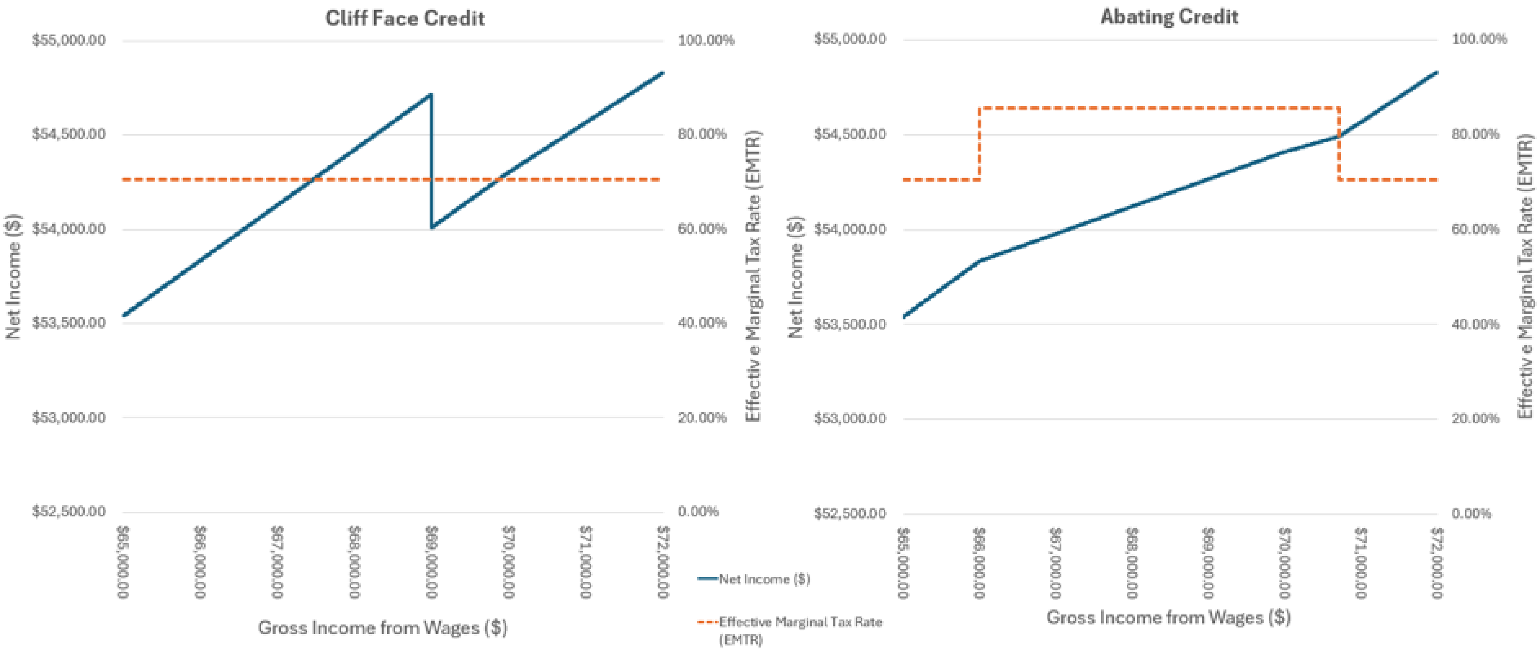
A cliff-face allows the credit to either be paid at a higher rate, or for the full rate to be paid to a larger group of individuals. As abatement extends the amount of income for which an individual is receiving an entitlement, in order to maintain the fiscal cost of the credit it would either need to begin abating at a lower income threshold or be paid at a lower rate. Both of these would partially undermine the credit's purpose of reimbursing low-to-middle income individuals for the impact of a GST rate increase. Figure 3 and Figure 4 highlight the work incentive and net-income impacts of utilising a cliff-face approach and an abatement regime of 15% for individuals with differing circumstances.[46]

Figure 3: Comparison of an Abating and Cliff Face Approach to a GST Refund Tax Credit for an Individual in New Zealand



46. Figure 3 is an individual with no children. This individual receives the Independent Earner Tax Credit. Figure 4 is an individual with one child and a student loan. The individual receives Working for Families. For simplicity, both figures have assumed that the measures introduced as part of the Budget Measures (Taxation 2024) Act have applied from 1 April 2024, rather than 31 July 2024.

Figure 4: Comparison of an Abating and Cliff Face Approach to a GST Refund Tax Credit for an Individual with a Child and a Student Loan



Fiscal cost and maintaining value over time

Using the above parameters, the maximum cost of the credit would be $2.4 billion.[47] However, the true cost of the credit would be significantly less as not all individuals with taxable income in NZ under the threshold will meet the eligibility criteria. For example, many will be under the age of 19, or will not be ordinarily resident. Design decisions, such as whether to pay the credit to super-annuitants, or to introduce a cap on income from passive means (this approach is used by the Earned Income Tax Credit in the United States),[48] could decrease fiscal cost whilst maintaining policy intent.

In order to protect the credit's real value over time, both the rate of the credit, and the income threshold should be indexed. The credit should be indexed to a CPI metric that carves out increases to the price of exempt supplies such as rents, due to their more inelastic response to GST changes.[49] This indexation will ensure the credit's value remains proportional to the

47. This cost was generated using Inland Revenue's Taxable Income Distribution database, which states for the 2022 tax year that 3,423,390 people had a taxable income under $69,000. It is important to note that there is no way to know the circumstances, including age, of those in this database, meaning the actual fiscal cost will likely be much less than this calculated amount.
48. "Earned Income and Earned Income Tax Credit (EITC) Tables", Inland Revenue Service, 2024, https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-and-earned-income-tax-credit-eitc-tables.
49. Tax Working Group, *Changing the Rate of GST: Fiscal, Efficiency and Equity Considerations*, 8.

increases in costs that individuals experience over time due to a 2.5% GST rate increase. The income threshold should be indexed to median wage growth to ensure that it remains relative over time. Although indexation comes with an increased fiscal cost, due to the innate relationship between GST and CPI, any increases in fiscal cost will be relatively proportional to the additional revenue raised through the increased GST rate.

Administration, implementation and customer experience

The above design parameters ensure ease of administration, and positive low compliance customer experiences. Administrative and implementation parameters can further support these objectives.

In order to balance the timeliness of payments received, equity, and system capability concerns, the credit should be paid quarterly, based on lagged income and be full and final. This will ensure that recipients do not need to prospectively estimate their income, prevent debt, and eliminate demand for reassessments, whilst also ensuring recipients receive payments close to the period in which they incurred a GST cost. This does mean, however, that individuals such as seasonal workers who have low income in a quarter but high income in another, may receive the credit in some quarters despite their yearly income exceeding the income threshold.

The above model does not suit the nature of income returned by those who are self-employed or receive non-salary and wage income. Utilising a provisional tax approach, Inland Revenue could take the previous tax year(s) income and add a percentage uplift, then divide the number by 4, to determine quarterly income. Recipients who experience income shocks would have the ability to request a more up-to-date calculation. This approach attempts to balance the credit's objectives for those who are not salary and wage earners whilst maintaining administrative feasibility, low customer compliance and integrity.

Developing, implementing and administering a targeted GST refund tax credit is feasible for Inland Revenue. Inland Revenue has the system capability needed, particularly after Business Transformation, to administer such a payment and already administers other, more complex transfer payments.[50] Inland Revenue holds individual taxable income information. Given the credit is proposed to be both individualised, and based on a definition of taxable income, the assessment and payment process would be heavily automated. Not only is this important from an administration perspective, but it is advantageous from a recipient perspective as

50. Inland Revenue, *Inland Revenue's Final Transformation Update* (Wellington: Inland Revenue, 2022), https://www.ird.govt.nz/-/media/project/ir/home/documents/about-us/business-transformation/publications/six-monthly-transformation-updates/2022-march-final-transformation-update.pdf?modified=20220901030433&modified=20220901030433.

compliance costs would be extremely low. If the eligibility criteria were to be kept broad (groups such as super-annuitants were not carved-out) most recipients would not have to apply for the credit or provide Inland Revenue with additional information. It is important to note that this automation may impact the visibility of the tax credit, which may be a political concern given recipients may not understand why they are receiving payments. Figure 5 highlights the administration and application process using the above parameters, compared to the process if the credit was paid based on income estimations (not lagged income), a broader definition of income and there was a couples rate.

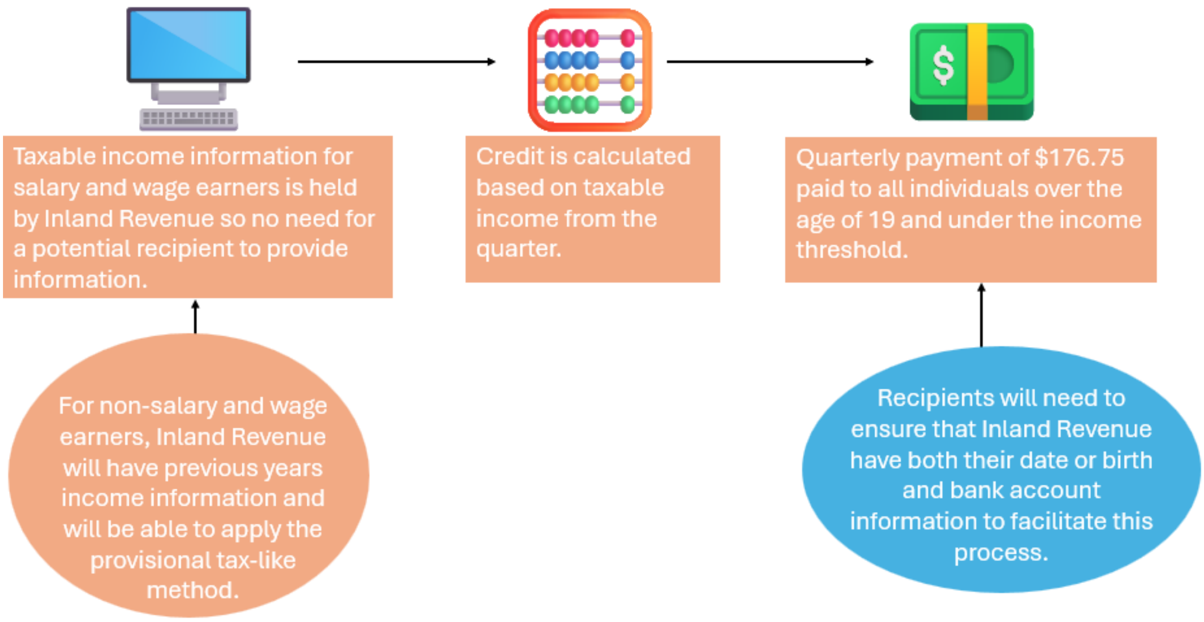
Figure 5: Comparison of application and payment process between different administrative settings

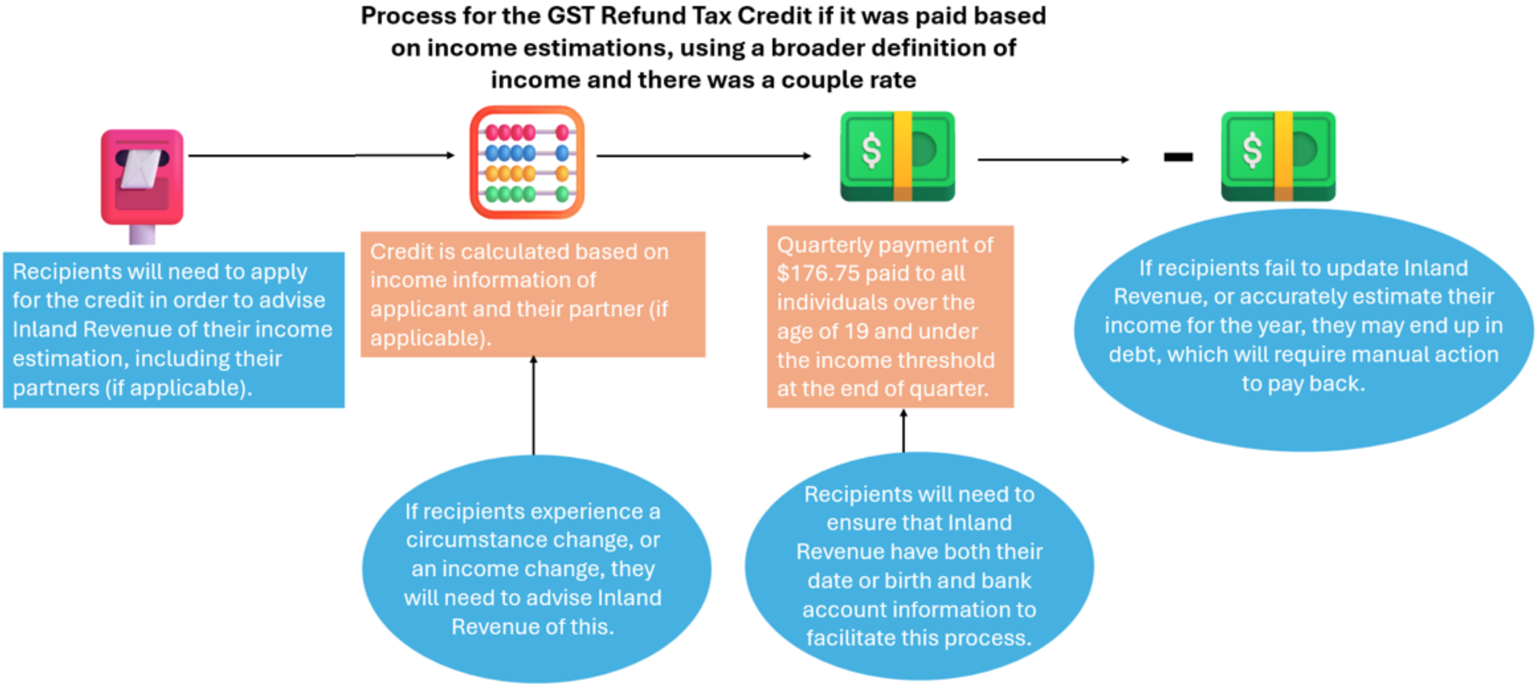
Key

Certain Action — Blue **Recipient Action**

Possible Action — Orange **Inland Revenue Action**

Process for receiving the GST Refund Tax Credit under the proposal in this document





Timing of implementation: Preventing dual compensation

The implementation of both the GST rate increase and the GST refund tax credit should occur on the 1st of April. Not only does this ensure simplicity by aligning with the tax year, but it also ensures the any interaction issues with the transfer system can be easily mitigated. Some transfers, such as main benefits and superannuation, are indexed to CPI on the 1st of April each year. A GST rate increase will result in increases to CPI, which will then flow through to CPI-indexed transfer payments. Given the GST refund tax credit is being introduced to address the impacts of a GST rate increase, it is important to ensure that individuals do not receive dual compensation. Implementing the GST rate increase, and the GST refund tax credit, on the 1st of April will allow for the CPI indexation of transfer payments in the following year to ignore the quarter directly proceeding the implementation of a GST rate increase. As per NZ's last GST increase experience, the change in CPI is predominantly reflected after a quarter.[51]

The possibility of further action

Despite the above, there are limitations to a GST refund tax credit which cannot be fully mitigated through design decisions. Introducing a new tax credit will create greater complexities for low-to-middle income individuals and families who may already be receiving numerous, overlapping payments. This has recently been exacerbated by the introduction of FamilyBoost and the extension of the Independent Earner Tax Credit.[52]

51. The New Zealand Treasury, *Aide Memoire: Impact on CPI from Raising the GST Rate to 15%*.
52. "Tax at a Glance, Budget 2024," The Treasury, 2024, https://budget.govt.nz/budget/2024/tax-at-a-glance/extending-ietc.htm.

A broader review of the tax and transfer system and the design and purpose of various payments could identify ways to simplify the system, improve work incentives and reduce interaction issues. Furthermore, potential tax switches which seek to decrease marginal rates, particularly the 30% personal income tax rate, could also address complexity, and improve work incentives by decreasing EMTRs.

Raising revenue and ensuring equity

In order to partially address NZ's future fiscal deficit, as well as to ensure that low-to-middle income individuals are not disproportionately impacted by revenue raising measures, I have proposed that the rate of GST be increased 2.5% and a targeted GST refund tax credit be introduced. This proposal embodies the principles of BBLR and distributional equity, is feasible to implement, seeks to leverage future shifts in the tax base, would likely have public and political support, does not increase compliance costs, and is designed to mitigate the economic and GDP implications that are typical with tax increases. This proposal could be strengthened by further considerations into simplifying the transfer system, as well as possible changes to personal income tax settings.