Inland Revenue
Te Tari Taake

THE TREASURY
Kaitohutohu Kaupapa Rawa

Briefing note

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To: Tax Advisor, Minister of Finance – Kieran Kennedy
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s9(2)(a)
Government & Executive Services (Ministerial Services)
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From: Phil Whittington, Senior Policy Advisor, Inland Revenue

Subject: **High-level comparisons of Australia and New Zealand tax system**

Purpose

1. This note responds to your request to compare the New Zealand and Australian tax systems along a number of dimensions, particularly in light of the Tax Working Group's recommendations for extending the taxation of capital gains.

2. For simplicity we have not modelled or commented on the Australian or New Zealand welfare and transfer system or its interactions with the tax system. In the context of taxes on those who are earning capital gains, the welfare and transfer systems are less likely to be relevant given capital gains tend to be earned by those on higher incomes.

3. Because of the scale and importance of the tax concessions in the Australian superannuation system, these are commented on and modelled in the discussion below. Kiwisaver tax concessions have also been modelled.

4. In general, the examples show that for high labour income earners, taxes are likely to be higher in Australia. For those with very high capital gains, or retirees, taxes are likely to be higher in New Zealand under the Tax Working Group proposals.

Main features of the New Zealand and Australian systems

5. Australia has a tax to GDP ratio of 27.8%, while New Zealand's is 32%. These figures include state-level payroll taxes and stamp duties in Australia, and local body taxation in New Zealand.

6. Aside from the current non-taxation of most capital gains, New Zealand's tax system taxes income at much more even rates, regardless of how it is earned. There is a modest 5 percentage point difference between the top personal rate and the PIE and company rate.

7. New Zealand's top tax rate (33%, or 34.39% with the ACC earner's levy) is also significantly lower than Australia's top tax rate (45%, or 47% with the Medicare levy).

8. In contrast, in Australia income is taxed very differently depending on how it is earned. There is a 17 percentage point difference between the top personal rate and the company rate (30%), although when dividends are paid, the income is taxed at the personal rate with credits for tax at the company level (as in New Zealand). However, the deferral benefit for earning income in a company in Australia is significantly greater than in New Zealand.

9. More significantly, for those in the payout phase (over the age of 60), the tax rate on income in an Australian super fund is 0%. Thus, for high income people, the differential treatment of how income is taxed can be very large: either 47% if earned personally, or 0% if put in a super fund.

10. As previously explained (T2019/297, IR2019/081 refers), the very low taxation of retirement savings in Australia influences the treatment of capital gains in a small business, which are often used to fund retirement. The non-taxation of income of high income earners has obvious fairness implications, but also efficiency implications. By requiring income to be in a locked in superfund, and noting the relatively high fees charged on these superfunds (see for example the Australian Productivity Commission's conclusion that "Evidence abounds of excessive and unwarranted fees in the super system"[1]), the Australian system indirectly subsidises the financial industry.

11. By providing very concessionary retirement concessions, the Government has to have higher taxes on other income to fund these concessions.

12. If the concern is that taxing capital gains on retirement will cause people to move to Australia, we note that the current exemption for capital gains means that, for any given level of revenue, we must have higher taxes on other forms of income. Those higher taxes must have their own incentive effects that will (to a greater or lesser extent) discourage people from moving to New Zealand or encourage them to move offshore.

13. Further, those New Zealanders moving to Australia for retirement will lose eligibility for NZ Superannuation payments if their assets are above the Australian means tested threshold for the Australian Aged Pension. This is likely to be the case if they are moving due to concerns about paying a large capital gains tax obligation. Finally, if the small business is in New Zealand, the TWG proposals would mean that the gain in the value of the business is taxed on emigration in any event.

14. Looking at the personal income tax (including the Medicare levy in Australia and the ACC earners levy in New Zealand), New Zealand has a much flatter structure than

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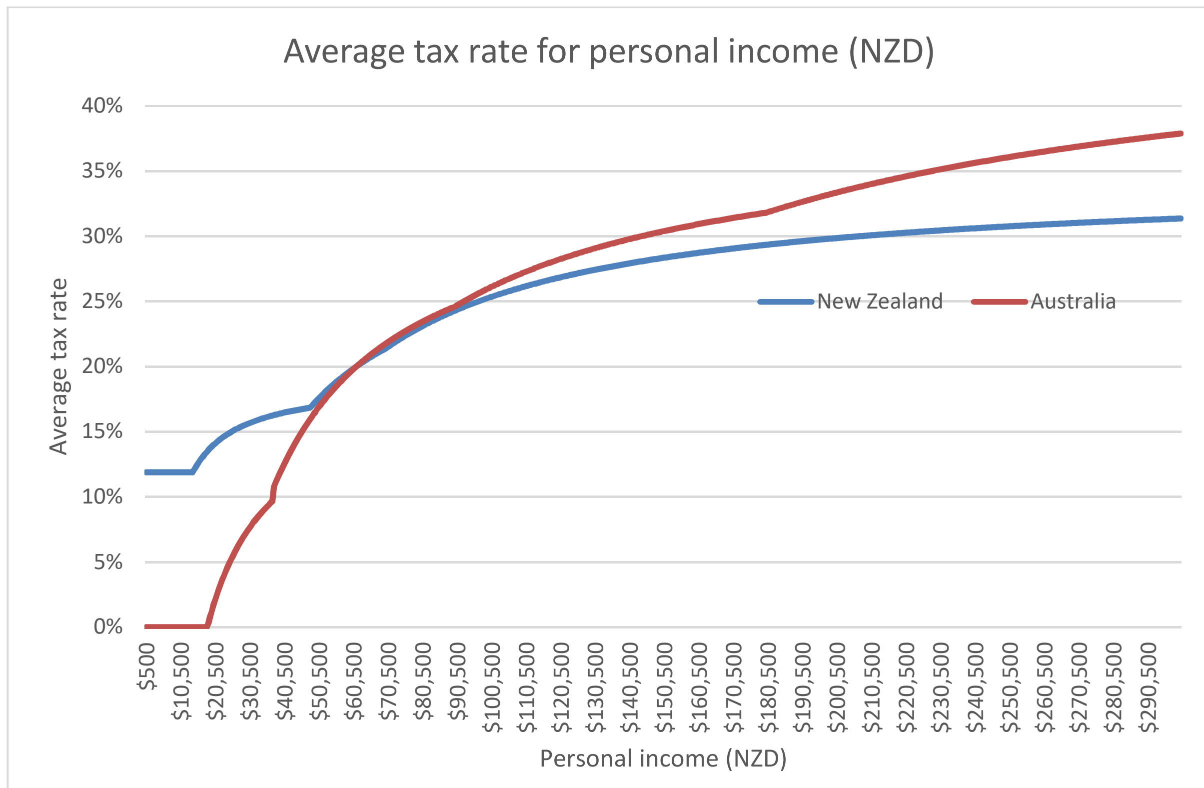
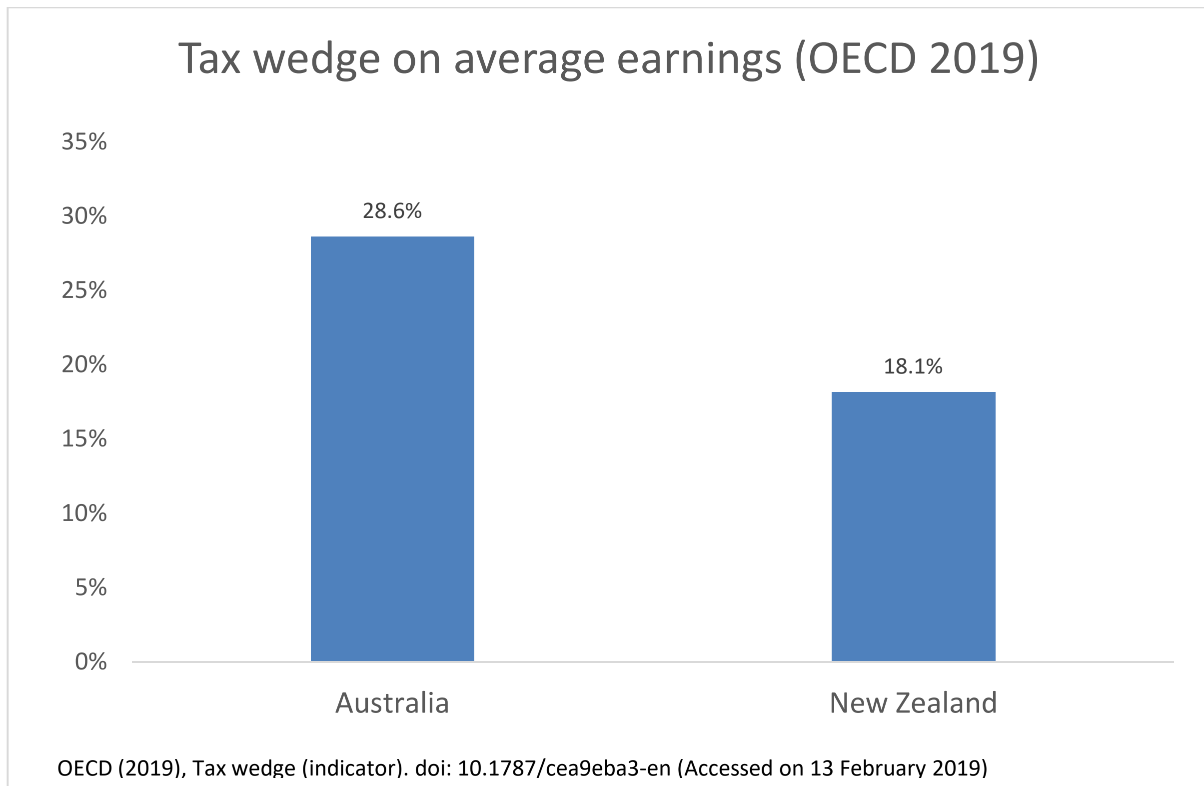
[1] Australian Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness, Overview*, 21 December 2018, p 2.
https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment-overview.pdf

Australia. The following chart shows the average tax rate on different levels of earnings.



15. Another way of looking at the tax on personal income is with the OECD's tax wedge measure. The tax wedge is defined as the ratio between the amount of taxes paid by an average single worker (a single person at 100% of average earnings) without children and the corresponding total labour cost for the employer[2]. The average tax wedge measures the extent to which tax on labour income discourages employment. This indicator is measured in percentage of labour cost.

[2] The tax wedge is the sum of personal income tax, employee plus employer social security contributions together with any payroll tax, minus benefits as a percentage of labour costs.



16. Australia's tax wedge is materially higher than New Zealand's because Australia's average incomes are higher (resulting in an average tax rate that is higher due to the progressive Australian tax schedule), and Australia also has state-level payroll taxes which add to the tax wedge.

Specific examples

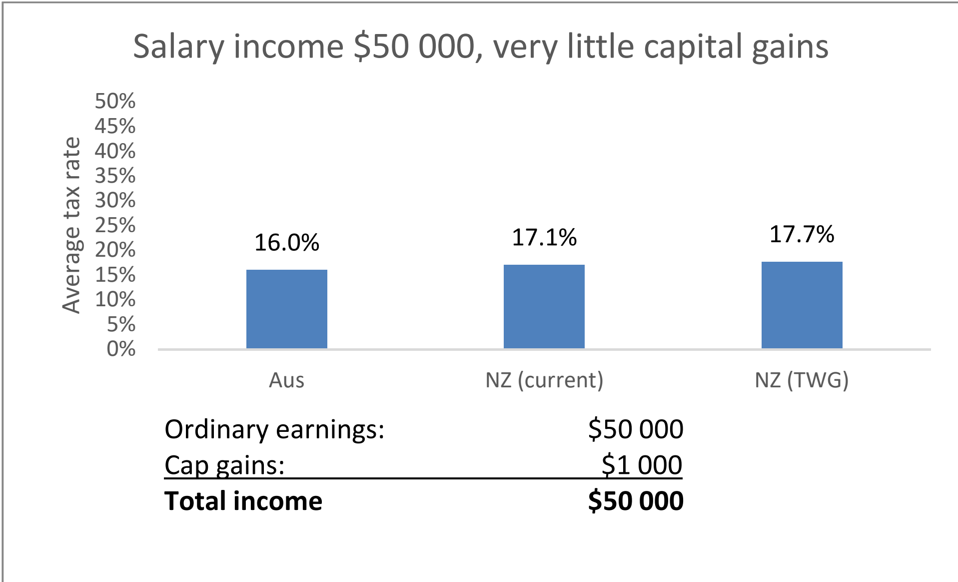
17. In the following examples, the dollar figures quoted are New Zealand dollars, but for modelling Australian results they have been converted to Australian dollars[3]. We have not modelled any transfer or welfare payments (e.g Working for Families Tax Credits or any Australian equivalents), or any state payroll taxes in Australia. This is for three reasons:

- Transfer and welfare payments are likely to be less important for those who make capital gains (as their incomes tend to be higher), and it requires further assumptions about family situations.
- State payroll taxes in Australia vary by state.
- It would be difficult to establish whether we had correctly modelled the Australian transfer payment systems as we do not have access to experts in the Australian transfer payment system.

18. In all of these examples, the capital gains are the gains realised during that year.

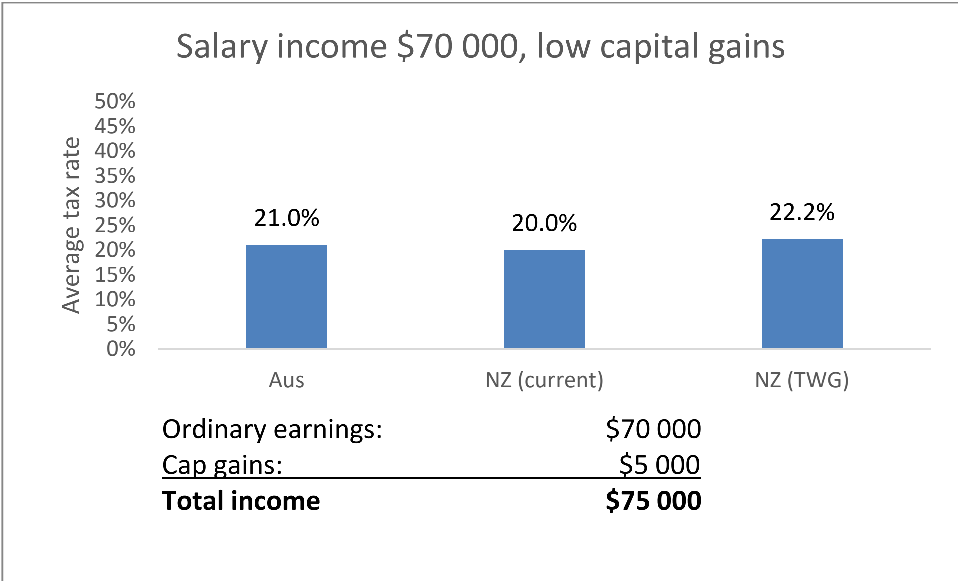
[3] As an example, in the first scenario the $50 000 NZD ordinary earnings is modelled in the Australian system as $48 123 AUD, using an exchange rate of $1 AUD for $1.039 NZD (as at 15 February 2019)

Example 1: Salary income $50 000, very little capital gains



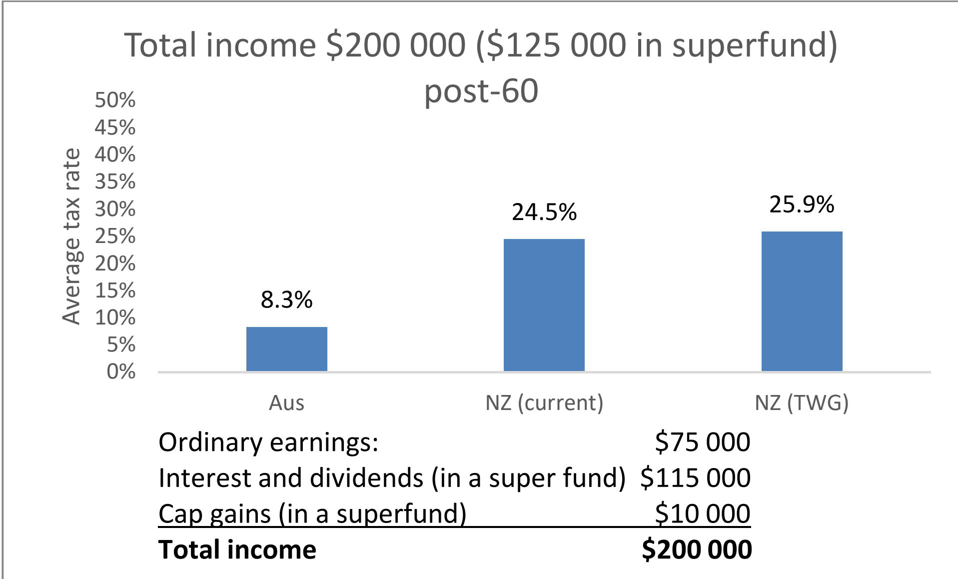
19. In this example there would be a 0.6 percentage point increase in the average tax rate for the income in New Zealand. Because of Australia's tax-free threshold, the average tax rate in New Zealand is currently slightly higher than it would be in Australia with the same income.

Example 2: Salary income $70 000, low capital gains



20. In this example the person would be taxed slightly less in New Zealand than in Australia currently, but this would increase by 2.2 percentage points if capital gains were taxed, bringing it slightly higher than in Australia.

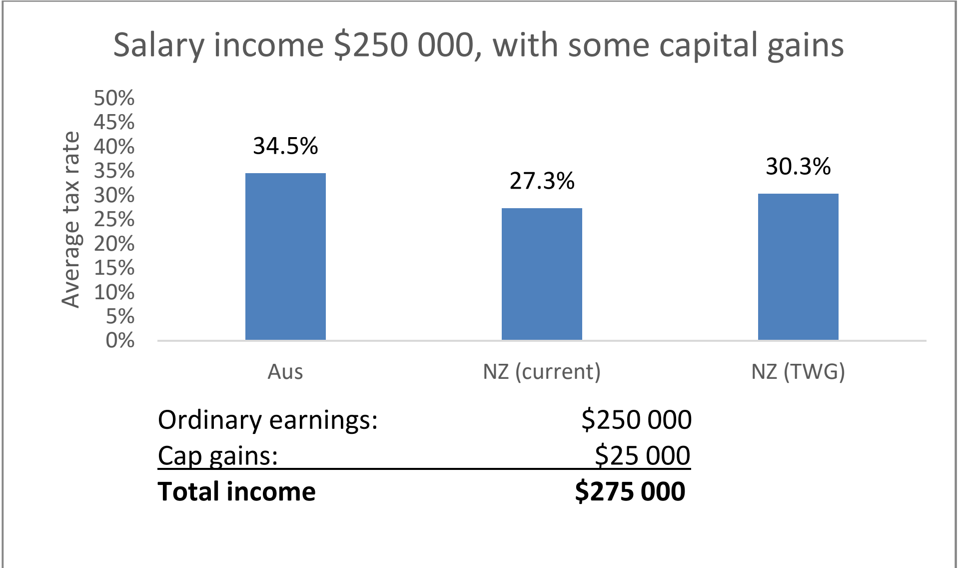
Example 3: Total income of $200 000, with $125 000 income from a superfund, after age 60



21. In this example we can see the scale of Australia's retirement tax concessions. Despite having a significantly higher income than any of the previous examples (including ordinary earnings that are higher than any of the previous examples and still taxed at ordinary rates), the Australian average tax rate is the lowest of any effective tax rate yet. This is because $125 000 of income is untaxed in Australia as it is in a superfund in the payout phase. If the ordinary earnings (of $75 000) were passive earnings and were able to be earned through a superfund, the average tax rate in Australia would be 0%.

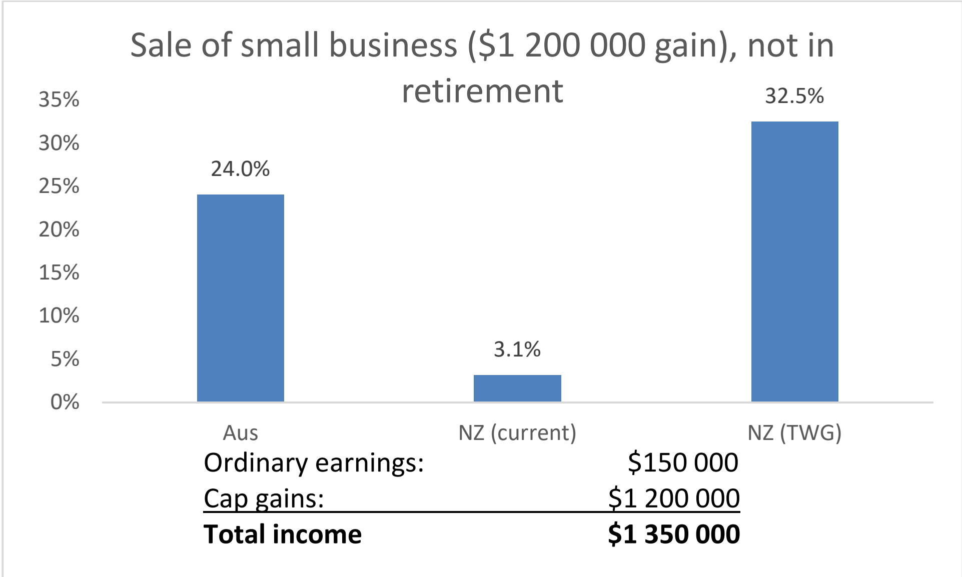
22. The New Zealand effective tax rate is 24.5%, rising to 25.9% if the $10 000 of capital gains are taxed at the Kiwisaver PIE rate of 28%.

Example 4: Salary income $250 000, with some capital gains



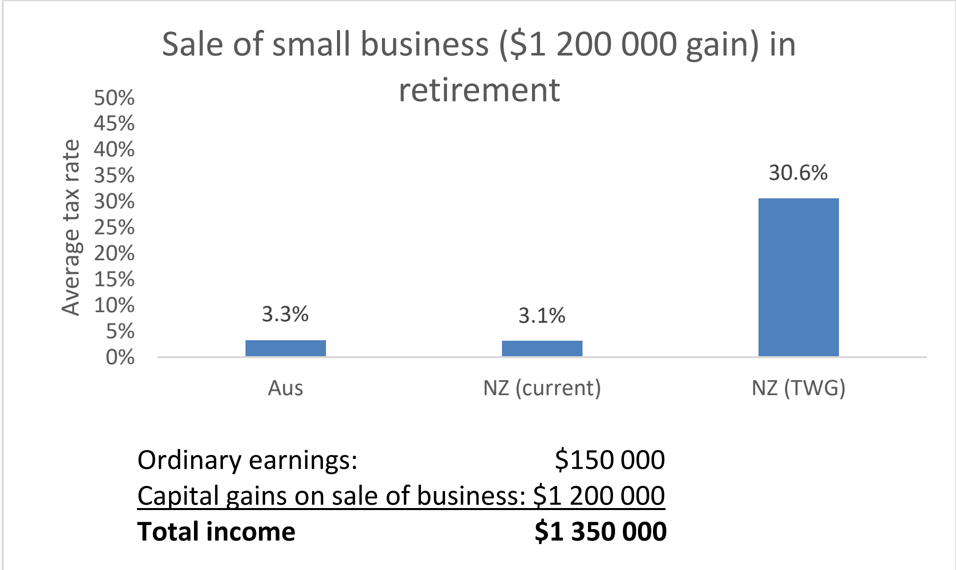
23. In this example, despite the 50% discount received in Australia, the average tax rate on all the person's income would still be lower in New Zealand under the Tax Working Group's proposal than in Australia.

Example 5: Sale of a small business, no retirement concessions available



24. This example looks at the effective tax rate if none of the Australian retirement concessions are available (but it does allow the 50% capital gains tax discount in Australia). This would be the case if the person was aged under 55 and not permanently incapacitated. In this case, the average tax rate in Australia is 24%. In New Zealand currently it is 3.1% due to the exemption of capital gains from taxation. Under the Tax Working Group proposal that effective tax rate would rise to 32.5%.

Example 6: Sale of small business ($1 200 000 gain) in retirement



25. The Australian retirement concessions and New Zealand's current exemption of capital gains result in very low average tax rates – lower than any other example, despite total income being the highest equal (with example 5). The Tax Working Group proposals would significantly increase the average tax rate on this substantial amount of income.

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Country	Tax/GDP[4]	Top personal rate	Top personal threshold	Other labour taxes	Capital gains discount	Small business CGT concessions	Company rate
Australia	27.8%	45% (47% with Medicare Levy)	$180 000	State payroll taxes: NSW: 5.45% Victoria: 3.65% - 4.85% Queensland: 4.75% SA: 2.5% - 4.95% WA: 5.5% Tasmania: 6.1% ACT: 6.85% NT: 5.5%	50% inclusion rate for individuals (i.e. 50% of the capital gain is taxed at person's marginal rate). No discount for general companies. See small business CGT concessions for discount for small businesses.	4 types of small business concession: Exemption if owner is aged over 55 and has owned asset for at least 15 years and is retiring. Exemption if funds put into the owner's super scheme ($500k AUD lifetime cap) 50% discount for small business assets owned for 1 year (can be combined with individual discount so taxed on only 25% of gain) Rollover for small businesses that reinvest in active assets within two years.	30%. 27.5% for small businesses
NZ	32.0%	33% (34.39% with ACC earner's levy)	$70 000		No tax at all currently. No discount under TWG proposal.	No CGT currently. TWG propose retirement concession: lower Kiwisaver tax rates apply to the first $500,000 of capital ains made by business owners who sell a closely held active business they have owned for a certain period of time (e.g. 15 years) in order to retire once they reach retirement age (e.g. 60 years or older) or younger business owners if the capital gain is reinvested into a Kiwisaver scheme. TWG propose rollover for small businesses (less than $5m of turnover) that reinvest in active assets.	28%

[4] Source: *OECD Revenue Statistics*, https://stats.oecd.org/index.aspx?DataSetCode=REV, accessed 20 February 2019.