

Tax Indexation – Q and A

What is tax indexation?

Indexing tax thresholds would mean that every three years the tax thresholds would increase automatically to keep them in line with inflation (CPI).

Incomes only rise in real terms when wage growth is higher than inflation. Tax indexation addresses what is known as 'bracket creep' where people move into higher tax brackets without a 'real' rise in incomes.

Would the adjustment be automatic?

Effectively yes, unless there was a strong reason not to.

Under National's plan, every three years (within 12 months of every election) Treasury would advise the Government on what the tax thresholds would need to move to in order to keep them in line with the rising cost of living.

There would be a veto clause for the Minister of Finance to decide not to pass the tax threshold adjustments if they wished, however they would have to explain that decision to New Zealanders. The strong presumption would be that the thresholds would change unless there was an exceptional reason not to.

Why is there a veto clause?

There is a veto clause to enable a Government to opt out of adjusting brackets in exceptional circumstances without removing the provision entirely and hence removing future adjustments.

An example of an exceptional circumstance may be that there is deflation over the period – which would require a lowering of the thresholds – or another global financial crisis.

How much would tax indexation save New Zealanders?

People earning more than \$52,000 a year would save at least \$430 a year after the first adjustment (assuming 2 per cent annual inflation).

Somebody on the average wage would save \$430 after the first adjustment, \$900 after the second adjustment and \$1,400 after the third. Over 10 years, somebody on the average wage would be likely to save approximately \$10,000.

In proportion to income, the largest benefits of the first threshold adjustment would be to those earning between \$50,000 and \$75,000 a year.

What would be the effect on the Government's tax revenue?

On today's estimates it is expected the first tax threshold adjustment (assuming 2 per cent annual inflation) would result in approximately \$650m a year less tax collected by the Crown (or less than 1 per cent of total tax revenue).

How many people would benefit?

There are approximately 580,000 New Zealanders in the 30 per cent tax bracket who are likely to benefit by about \$430 a year after the first adjustment.

There are also more than 600,000 New Zealanders in the top income tax bracket of 33 per cent who would be likely to benefit by about \$550 a year after the first adjustment.

We expect about 84,000 people would be protected from moving into the top tax threshold after the first adjustment and 95,000 people would be protected from moving into the 30 per cent tax threshold after the first adjustment.