Iain Middleton
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To tax or not?

If a Basic Income were paid to everyone, should it be taxable or tax-free? The Basic Income Earth Network (BIEN) defines a Basic Income as "a periodic cash payment unconditionally delivered to all on an individual basis, without means-test or work requirement". It does not answer the tax question. Was this deliberate, leaving it to those who establish a Basic Income scheme to decide what best fits their country or their proposal? Which is best?

To some, the answer seems obvious. But two people who think the answer is obvious may disagree as to which is best! Some argue, erroneously, that as a Basic Income is a government payment, it makes no difference to the government if the payments are taxable or not. This is incorrect – it does. Some believe that a Basic Income is always or must be tax-free. This is a persistent myth.

New Zealand has a long-standing Basic Income, New Zealand Super. It is taxable. The government pays the same gross amount to all in the same living circumstances: single and living alone, single and sharing, or a couple sharing accommodation. For a person receiving Super, it is additional income. If you have no other income, New Zealand Super is taxed at the minimum rates: 10.5% for income less than $15,600 and 17.5% for income between $15,600 and $53,500. If you have high income from other sources, say over $180,000, your income from New Zealand Super is additional income and is taxed at the highest marginal rate, currently 39%.

A person with other income over $180,000 pays 39% on their additional income from New Zealand Super, while a person with income less than $53,500, including the Super payment, will pay no more than 17.5% in tax. The high-income person pays an additional 21.5%.

With taxable payments, high-income earners pay more tax on their super payments than low-income earners. This lowers the net cost to the government of the scheme while ensuring that those with the lowest incomes and the greatest need receive the greatest support. A taxable Basic Income with a progressive tax achieves a significant clawback of the payments from higher-income earners, lowering the overall cost of the scheme.

New Zealand also has a long-standing practice of taxing all personal income but not expense payments. This ensures that those with the greatest ability to pay do so and that those with the greatest need will benefit the most.

As a general rule, cash transfers should always be from those with the greatest ability to pay to those with the greatest need. A good test for any cash transfer scheme is: does it have a net result of transferring money from those who have wealth to those who do not? A good Basic Income scheme achieves this by taxing those who have the means to pay while paying the same gross amount to everyone. A Basic Income should enhance, not reduce, the incomes of low-income individuals or households. Governments should never tax the poor to pay the rich.

So why then do some people want to make Basic Income payments tax-free? Is it so that the wealthy will get larger income increases from a Basic Income than they might with a taxable scheme? This may be exactly why some people support tax-free payments.

Let us consider other possibilities. With a Basic Income, there are two ways to achieve the same after-tax results: pay a Basic Income as a taxable amount with a progressive tax, or pay it as a tax-free amount with higher tax rates to give the same net income after tax. The first option is preferable. The second option would be fine, but tax rates on higher incomes must be increased, and there is opposition from some people to increasing tax rates, often from the same people who argue for a tax-free Basic Income! Is this self-interest?

Looking back in history, New Zealand Superannuation, originally called National Superannuation, was introduced in its present non-contributory, universal form by Robert Muldoon's National Government in 1977 with a maximum tax rate of 60%. The same government increased the maximum tax rate to 66% in 1982. With a 66% maximum rate, high-income recipients lost 66% of their Super payments to taxation. A progressive tax scheme, increasing tax rates as income increases, provides broad targeting of the Super payments to those with low incomes.

Looking further afield, in 1962 in the USA, Milton Friedman proposed a flat tax paid in combination with a Negative Income Tax. The flat tax reduced taxation rates for higher incomes, a move Friedman argued was necessary to avoid tax evasion, while the Negative Income Tax boosted the incomes of those with lower incomes. Richard Nixon introduced a tax reform in 1969 that included a form of Negative Income Tax, designed to entirely replace the existing bureaucratic welfare program (Aid to Families with Dependent Children). It passed the House of Representatives twice, but failed to pass the Senate**.**

In New Zealand, in 1989, Roger Douglas, minister of finance under David Lange and a fan of Milton Friedman’s proposals, particularly the flat tax, lowered the maximum tax rate from 66% to 33% and introduced taxation from the first dollar. Goods and Services Tax (GST) was introduced to compensate for the loss of Income tax revenue. The higher tax rates on lower incomes and the GST increased total taxes and hardship for those with low to mid incomes. When told that the changes would increase hardship for those on low incomes and increase the number of beneficiaries, he simply responded that this was good.

Any effective reduction in the minimum wage, average incomes, or the incomes of those on low incomes is of concern. Policies that cause hardship for those on low incomes, forcing them to take any possible employment, are seen by many as a form of modern slavery. If Douglas had paid more heed to Friedman, he would have introduced a Negative Income Tax with his tax changes. Today, we would suggest a Basic Income, as it is simpler and reaches more people than a Negative Income Tax.

One impact of lowering the maximum tax rate was a reduction in the clawback of New Zealand Super from high-income earners, increasing the net cost of the NZ Super scheme, eventually leading to calls to raise the age of eligibility that we hear today. Now, if we were to increase tax rates on high incomes for those who receive Super, we would improve targeting of the Super payments to those who need them and achieve the savings without raising the age of eligibility.

Subsequent changes to the top tax rate include an increase to 39% under Helen Clark in 2000, a cut to 33% under John Key by October 2010, and an increase again to 39% for income over $180,000 under Jacinda Ardern in April 2021.

In 2009, John Key introduced the Independent Earner Tax Credit (IETC), which is in some ways like a Basic Income, but only available to people in work with no income other than their employment income. However, successive governments, including the present coalition, have failed to increase the IETC in value or shift the thresholds sufficiently to match inflation, leading to a progressive erosion of the effective incomes of those on low to middle incomes.

In England, early Basic Income advocates argued for a tax-free Basic Income funded in part by increasing the taxes on lower incomes. England currently has a tax-free personal income allowance of £12,570. If a minimum tax rate of 30% to 33% were applied to lower incomes, the additional taxes raised would go a long way toward paying for a Basic Income. Those with low to mid incomes would receive more from the Basic Income than they would pay in additional taxes. The additional net amount received would taper off as other income increased.

While New Zealand has an initial tax rate of 10.5% from the first dollar, the same principle will apply. New Zealand proposals usually advocate partially funding a Basic Income by increasing the initial tax rates to either 30% or 33%, with higher rates on higher incomes. A common proposal in New Zealand is a two-stage tax with an initial rate of 33% and 39% on incomes over $180,000, effectively retaining the two highest tax rates. Opportunity is currently proposing a three-tiered tax scale with 28% on the first $50,000, 34% from $50,000 to $200,000, and 39% over $200,000.

Essentially, there is no real difference between England and New Zealand. We would both increase tax rates on initial incomes to pay (or partly pay) the cost of a Basic Income. England would achieve more in doing so, as it has no current tax on the first £12,570. Increasing the tax rates on the lower tax bands also increases the tax on the wealthy, as they must pay this tax increase on their income as well. With a Basic Income, people on low to mid incomes will benefit, as they will receive more from the Basic Income than they will pay in increased taxes. With a well-designed system, people on higher incomes will pay more in increased taxes than they receive from the Basic Income.

In New Zealand, some advocates have suggested converting New Zealand Super to a tax-free Basic Income with increased tax rates. Investigating the reasons, it was found that in some cases the authors had mistakenly believed the myth that a “true” Basic Income must be tax-free. It does not. Others saw it as an advertising gimmick: offering a tax-free Basic Income payment they thought would appeal to voters who would then agree to higher tax rates on their high income from other sources. Sometimes the authors had not realised that making a Basic Income tax-free rather than taxable would increase the cost of a scheme, give money to multi-millionaires, and would require higher taxes on other income to fund it.

Many earlier Basic Income advocates were idealists who believed that a Basic Income should be unconditional, and not subject to taxation. Idealists often favour a tax-free Basic Income while pragmatists or realists who have checked the figures favour a taxable Basic Income.

While earlier European advocates supported a tax-free Basic Income, it is now found that both individuals and organisations in Europe are as likely to support a taxable Basic Income, because it improves targeting and lowers the cost of the scheme, while making it easier for a government to introduce. American advocates, familiar with the Negative Income Tax proposals, were more likely to be supporters of a taxable Basic Income.

Today, it is pleasing to see that Opportunity proposes a Citizens' Dividend (Basic Income) as a cornerstone policy of their election platform. The proposed Citizens' Dividend is of the right size, will replace welfare payments of the same or smaller size, and will be topped up as necessary to match existing welfare payments. New Zealand Super recipients will receive the Citizens Dividend with a top-up to the level of New Zealand Super.

However, Opportunity proposes that their Citizens' Dividend is tax-free. Because it is tax-free, multimillionaires will receive the same as a person with no other income, and the overall net cost of the scheme is higher than for a taxable scheme. Their proposed income tax changes, which increase taxes on lower tax bands, claw back some of the money as other income increases, but are insufficient to fully fund it and still leave people with million-dollar incomes with an effective tax cut!. Consequently, they need to find more money from other sources. They propose a Land Value Tax (LVT).

Opportunity also justifies a LVT as a means of controlling house price inflation and speculation, and it is likely to have some impact. However, house price inflation has multiple causes that LVT does not address. Others have pointed out that, as a means of funding a Basic Income, LVT is not without issues. House prices, including land prices, tend to fluctuate. If the LVT succeeds in controlling house price inflation, and house prices stabilise at a lower level as expected, the government must increase the LVT rate to maintain tax revenue. If the population expands, as it continues to do, more money is required to fund a Basic Income, but the amount of land does not increase. Again, LVT tax rates must be increased. Other problems arise with difficulties in establishing valuations.

For most homeowning couples, the Land Value Tax will be less than the Citizens Income they receive. The LVT will, however, cause hardship for some low-income retirees who have saved all their lives to own a home for their retirement. Unlike low-income working people who receive additional income from the Citizens Dividend that exceeds the extra LVT they must pay, retirees over 65 receiving Super will not receive additional income. Consequently, with LVT, they will be worse off.

The scheme results in retirees paying extra tax to provide additional money to multimillionaires. Asset stripping low-income retirees to subsidise the wealthy! This breaks the principle that a Basic Income Scheme, or any cash transfer scheme, must not lower the net incomes of low-income people.

While Opportunity indicates that they may either offer exemptions or deferments for retirees, the indications are that they only intend to offer deferments. With a deferment, LVT is still charged, but payment may be deferred and charged against the estate of the people involved. Meanwhile, wealthy retirees with similar homes will be able to pass on a much larger proportion of their estate to their descendants. A deferment still breaches the principle of no one worse off. A land tax exemption on, say, the first $500,000 per person for a family home for retirees may offer a better solution than deferment.

Opportunity has signalled a longer-term intention to eliminate the top-up to New Zealand Super levels for those over 65, as KiwiSaver levels rise. This will also reduce the incomes of retirees with low incomes who are paying LVT, again breaching the principle of no one worse off.

The current level of New Zealand Super is considered necessary for those who depend on it. During all or part of their working age lives, some people are unable to work or earn income. With high housing prices and rentals, some are unable to contribute to a KiwiSaver fund. Others must retire early for health reasons.

KiwiSaver rewards those who are lucky enough to earn higher incomes during their full working lives. Eliminating the top-up to New Zealand Super levels will harm those who are less fortunate and have smaller KiwiSaver balances.

The Opportunity Citizens Income proposal could be improved by making the Citizens Dividend a taxable payment, which improves targeting, reduces the need for additional taxation, and by ensuring the incomes of retirees by exempting, say, the first $500,000 of land value from LVT per individual, or $1,000,000 for couples.

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