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To: Minister of Finance

AIDE MEMOIRE: POTENTIAL IMPACTS ON ACC FROM TAX CHANGES

Overview

On 31 March 2010, you received a tax policy report on outstanding issues from the Budget tax package (T2010/515). This report noted that Treasury and Inland Revenue would further consider the impact of the tax changes on the public sector and would report back to Ministers if any issues were identified.

This note provides follow up information on the potential impacts on ACC of changing the rate of GST, and recommends that an existing specific fiscal risk covering ACC issues generally be expanded to include the impact of the tax changes.

Background

Our previous advice noted that increasing GST will not result in unintended consequences to fees set by regulation, as section 78 of the Goods and Services Tax Act will automatically increase fees for the GST increase. While this is true in most cases, where fees and/or levies are unable to adjust automatically for an increase in GST for technical or administrative purposes, Government entities may face a real decrease in funding until they are adjusted.

ACC levies

ACC has three levy accounts. Levies for the Work and Motor Vehicle Accounts are collected on a GST exclusive basis and the increase in GST will not affect the level of funding received by ACC. The Earners' Account, however, is collected on a GST-inclusive basis and will not automatically adjust to reflect the increase in GST; ACC must consult publicly before any changes to ACC levies can be made.

In addition, because Inland Revenue collects the Earners' levy through the PAYE system, the levy is rounded to the nearest tenth of a cent. Preliminary consultation indicates that there is no official rounding policy followed by ACC; rather, ACC recommends levy rates that will enable it to cover its forecast liabilities. Ministers are not bound by ACC's recommendations and may take other issues, such as broader economic impact, into consideration when setting levy rates.

Rounding effects on the Earners' Account

The current GST-exclusive rate of the Earners' levy is 1.7778 cents per dollar. Inclusive of GST, this translates into an Earners' levy of 2.000025 cents per dollar. For inclusion in PAYE tables, this has been rounded to 2.0 cents per dollar.

For ACC to continue to receive 1.7778 cents per dollar with a GST rate of 15%, the GST-inclusive Earners' levy would need to be set at 2.04447 cents per dollar before rounding. Treasury estimates that in real terms, retaining a levy of 2.0 cents per dollar could reduce ACC's levy revenue by around \$15 million between 1 October 2010 and 1 April 2011, when new levies for the 2011/12 year are implemented.

Increasing the Earners' Levy

ACC could undertake a consultation process prior to implementation of the GST increase on 1 October to raise the levy to 2.1 cents in the dollar, which would enable the projected shortfall to be recovered. (It is not possible for the levy to be raised prior to the Budget due to the consultation constraint.) We do not consider, however, that the shortfall is significantly material to warrant this action. The decrease in levy revenue in real terms is unlikely to affect ACC's ability to meet its liabilities for the 2010/11 year. ACC has sufficient reserves in the Earners' account to cover a shortfall for six months. We also understand that actuals for both levy revenue and investment returns are tracking slightly above forecast. In terms of levy stability, Ministers may not wish to alter levy settings six months into the tax year.

We consider that the Earners' levy should next be reviewed in 2011/12 as part of the annual levy setting process. This process takes into account the valuation of the outstanding claims liability as at 30 June 2010, which will incorporate the impact on Scheme costs of the GST increase, and a number of other factors which affect levies including the funding policy, investment returns and revenue.

The future of the ACC scheme

The Minister for ACC is scheduled to report to Cabinet on in May 2010 in relation to the interim report of the Steering Group for the Stocktake of ACC Accounts and the Department of Labour's report on funding options for the ACC Scheme. In July 2010 the Minister for ACC will report to cabinet on the final report of the Stocktake.

In addition to these reportbacks, Cabinet has invited the Minister for ACC to request that ACC consult with relevant government agencies on the work it is preparing on options for containing future levy increases. We consider this work is the appropriate vehicle for a consideration of the impact of the GST increase.

Impact of tax changes on other levies and fees

The Treasury is not aware of any other levies or fees that will not adjust automatically for an increase in GST for technical or administrative purposes. However, given that there is a delay of over four months between the announcement and the implementation of the GST increase, we think any such issues can be resolved before the increase takes place.

Recommendations

It is recommended that you:

- 1 **Note** that Treasury will update the specific fiscal risk covering ACC issues generally to include the impact of the tax changes, as follows:

“Changes in tax settings and ACC's financial performance affect the Crown's levy income and liability for claims. The lag between half-yearly liability valuation and annual decisions on levies means that future levy rates may differ from current levels, with either a positive or negative impact on revenue.”

[deleted – privacy], Analyst, Tax Strategy, [deleted - privacy]

Simon MacPherson, Manager, Workforce Attachment and Skills, [deleted - privacy]