THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 26 November 2008 SH-13-3-0

AIDE MEMOIRE: PERSONAL TAX DECISIONS

Chris:

The following describes decisions on personal tax, KiwiSaver, and the R&D credit and issues the Prime Minister may need to consider. All of these changes will be included in a tax bill to be enacted by Christmas unless otherwise indicated.

Personal Tax

The personal tax rates will be changed to those announced by the National Party in October.

Independent Earner Rebate

An independent earner rebate as announced by the National Party in October will be enacted. The benefits which disqualify a taxpayer from receiving the rebate will be:

- "Income-tested benefits" as defined in the Income Tax Act. These are:
    - Domestic purposes benefit;
    - Emergency benefit;
    - Independent youth benefit;
    - Invalids' benefit;
    - Sickness benefit;
    - Unemployment benefit;
    - Widows' benefit
- New Zealand superannuation;
- Veterans' pensions;
- Working for families tax credits.

If a taxpayer receives a disqualifying payment for part of the year, the rebate will pro-rated over the period the taxpayer qualifies.

Ministers have decided to deliver the credit through the PAYE (salary and wage withholding) system. An alternative end-of-year rebate was considered. This would have been simpler for IRD to administer. The PAYE system costs about $3 million more per year than the end-of-year rebate and has some manageable delivery risks, but Ministers consider the benefits of using PAYE are worth the additional cost. IRD has estimated the total cost of administering the rebate will be about $10 million per year using PAYE.

KiwiSaver

An employee contribution rate of 2% will be available from 1 April 2009. This will be the default rate for new members. Existing members will continue to contribute at their existing rate unless they ask for a change. The minimum compulsory employer matching contribution rate will be reduced from 4% to 2%, and the exemption from ESCT (withholding tax on employer contributions to a superannuation scheme) will be capped at 2% of gross wages. The Department of Labour is managing the process of the repeal of the Employment Relations Act amendment relating to KiwiSaver and this may need to be included in the December tax bill.

Member Tax Credit – Options to Manage Fiscal Cost

The current member tax credit is $20 per week (about $1040 per year). Employee contributions are currently 4%, but if this is less than $1040 per year, employees may currently pay more than that and may still obtain a matching member tax credit of up to $1040 per year. The National Party announced before the election that they would propose that the member tax credit would be $20 per week but capped at 2% of wages.

At a contribution rate of 2%, employees earning less than $52,000 per year would put in less than $1040 per year. So if the maximum member tax credit is capped at 2%, those employees could not obtain the maximum member tax credit. IRD has also indicated that making the member tax credit on income and contributions rather than just contributions would create significant delivery problems. An option to allow lower-income employees to obtain the maximum $1040 would be to allow them to voluntarily pay more and receive a matching credit of up to the maximum amount. This option was raised by the CTU with the Prime Minister. This would address the issue but would come at a substantial fiscal cost (see table below).

Another option to manage the fiscal cost would be to reduce the maximum member tax credit to $15 per week ($780 per year) and, if 2% contribution is not sufficient to obtain the maximum credit (a salary level of less than $39,000 per year) allow members to top-up their contributions to the maximum and receive the full member tax credit. This would have a broadly similar fiscal cost as leaving the member tax credit at $20 per week but capping the maximum member tax credit at 2% of wages. This would address administrative and equity issues about the ability of lower-income employees to receive the maximum credit, but it would reduce the amount of the credit for current members who are now receiving more than $780 per year of the credit (at a current contribution rate of 4%, this would be employees earning more than $19,500 per year, which would include all full-time workers who are currently members).

Total KiwiSaver Fiscal Savings compared to Current Policy

MTC Options	2008/09	2009/10	2010/11	2011/12	2012/13	5-year total
MTC capped at 2% (original proposal)	-86	-815	-958	-1046	-1084	-3989
CTU proposal - $1040 maximum	-86	-640	-763	-839	-870	-3198
MTC $15 per week	-86	-772	-911	-996	-1032	-3797

(Negative numbers are fiscal savings).

Ministers have preliminarily decided they would like to implement the $15 per week uncapped option. The Prime Minister may wish to consider the options for the member tax credit.

Research and Development Tax Credit

Ministers have decided to repeal the R&D tax credit effective from the 2009/10 income year. They have preliminarily decided that the repeal should be included in the December tax bill. Another option would be to amend the July tax bill by way of SOP at the Committee of the Whole stage (expected late April early May next year). The July tax bill is expected to be enacted about May/June next year.

The 2009/10 income year begins as early as 1 October 2008 for some early balance date taxpayers, so a repeal in the December tax bill would be retrospective for these taxpayers. However, there are very few early balance date taxpayers with a balance date before December 31, so very few would be affected and it is unlikely to be an issue in practice. If the R&D credit repeal is enacted next year, then it would be retrospective for a longer period and would be retrospective for a much larger number of taxpayers, so the retrospectivity issue would become more important. However, there could be some communication advantages for timing the introduction of the repeal legislation with the announcement of other R&D assistance. In any case, for Budget reasons a decision by Cabinet on repeal would be required by early April. This is something the Prime Minister may wish to consider.

Fiscal Effect

The fiscal effect of the package (with a $15 per week member tax credit) is reflected below.

($ million) - cost/(saving)	2008/09	2009/10	2010/11	2011/12	2012/13 & outyears	5-year total
Tax rates and threshold changes	211	818	702	616	719	3,066
Independent Earner Rebate	44	239	356	364	353	1,356
Removal of Research & Development tax credit	(54)	(243)	(290)	(332)	(373)	(1,292)
KiwiSaver changes	(86)	(772)	(911)	(996)	(1,032)	(3,797)
Net operating balance impact	**114**	**42**	**(142)**	**(348)**	**(333)**	**(666)**

We do not yet have estimates of total administrative costs, but IRD has estimated the ongoing administrative cost of implementing the IER at $10 million per year if delivered through PAYE, or $7 million per year if implemented through an end-of-year rebate.