Date: 3 December 2008 SH-13-3-0

NOTES FOR CBC – PERSONAL TAX AND KIWISAVER

Personal Tax

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

Independent Earner Rebate

An independent earner rebate as announced by the National Party in October will be enacted. This is:

- From 1 April 2009, a $10 per week credit ($520 per year) for individuals earning between $24,000 and $44,000 per year;
- From 1 April 2010, a $15 per week ($780 per year) for individuals earning between $24,000 and $44,000 per year;
- From $44,000 per year, the rebate will be abated at 13 cents per dollar of income until fully abated.

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;
- Foreign social security benefits or pensions paid by other governments;
- Working for Families tax credits.

The taxpayer also must be a New Zealand resident for tax purposes. If a taxpayer receives a disqualifying payment or is not a New Zealand resident for part of the year, the rebate will pro-rated over the period the taxpayer qualifies.

I 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 I 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.

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).
I have decided not to reduce the member tax credit to $15 per week, as this would be too much of a reduction in benefits for members and it may be viewed as inconsistent with statements made before the election.

To manage the fiscal cost, I have decided to repeal the $40 annual fee subsidy. The $40 annual fee subsidy is a fairly small subsidy that was part of the original KiwiSaver design that did not include the $1040 member tax credit. With the member tax credit, there is still a significant incentive for an employee to join and save so the annual fee subsidy is not needed. With the annual fee subsidy removed, the total fiscal savings from our changes to KiwiSaver are:

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)	-83	-794	-972	-1100	-1178	-4127
CTU proposal - $1040 maximum	-83	-619	-777	-893	-964	-3336
CTU proposal and fee subsidy removal	-92	-664	-828	-947	-1021	-3552

(Negative numbers are fiscal savings).

KiwiSaver fiscal costings are very sensitive to assumptions, eg, takeup projections. If experience indicates that these assumptions should change, the costings could be revised.

Employee / Employer Bargaining

The amendment made to the Employment Relations Act prohibiting wage negotiations to be on a "total remuneration" basis will be repealed. However, the amendment will have to be made in a different bill because the Clerk of the House has determined that the amendment is out of the scope of the tax bill.

However, the tax bill will amend the KiwiSaver Act to provide that an employer cannot reduce an employee's take home pay because they join KiwiSaver. Notwithstanding this, an employer can negotiate with employees to account equitably between members and non-members their total remuneration.

Research and Development Tax Credit

I have decided to repeal the R&D tax credit effective from the 2009/10 income year. We have 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 mid-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.

Fiscal Effect

The fiscal effect of the package 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	(92)	(664)	(828)	(947)	(1,021)	(3,552)
Net reduction in operating balance	**109**	**151**	**(60)**	**(299)**	**(322)**	**(421)**

The above table does not take into account recycling 1/3 of the R&D savings into new R&D spending. Taking this into account, the net cost of the tax package is shown in the table 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 (2/3 savings)	(36)	(162)	(193)	(221)	(249)	(861)
KiwiSaver changes	(92)	(664)	(828)	(947)	(1,021)	(3,552)
Net reduction in operating balance	**127**	**231**	**37**	**(188)**	**(197)**	**9**

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. There will also be administrative savings from the repeal of the R&D tax credit.

ANNEX

PROPOSED PERSONAL TAX RATES

From 1 April 2009

$0 - $14,000	12.5%
$14,001 - $48,000	21%
$48,001 - $70,000	33%
$70,001 +	38%

From 1 April 2010

$0 - $14,000	12.5%
$14,001 - $50,000	21%
$50,001 - $70,000	33%
$70,001 +	37%

From 1 April 2011

$0 - $14,000	12.5%
$14,001 - $50,000	20%
$50,001 - $70,000	33%
$70,001 +	37%