

# 2010 Tax Expenditure Statement

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## Introduction

This statement provides a first step towards providing additional transparency around policy-motivated 'expenditures' made through the tax system. Tax expenditures take the form of an exemption, allowance, preferential tax rate, deferral or offset that reduce a tax obligation to achieve a specific policy objective.

This is the first time New Zealand has released tax expenditure data since 1984. This voluntary disclosure fills an obvious weakness in our current transparency arrangements by bringing New Zealand's financial reporting closer to OECD best practice standards. As with other disclosures, additional tax expenditure transparency is not intended to be a statement of policy effectiveness or desirability.

## What Is a Tax Expenditure?

Governments can spend in a variety of direct and indirect ways. International public sector accounting standards (IPSAS 23) divide spending into three different categories: direct spending; spending through the tax system; and tax expenditures. The Treasury has not released tax expenditure information in recent years, although information on the first two categories of spending has been routinely released as part of our annual accountability data.

**Table 1:** Classification of Crown spending under public sector accounting standards

	Definition	Reporting
<b>Direct spending</b>	Traditional spending made as a direct transfer between the Crown and different entities or individuals.	Disclosed in the <i>Crown Financial Statements</i> and annual Budget.
<b>Spending through the tax system</b>	Hybrid transfers that can be taken as a cash payment or via a reduction in tax.	A predictable cash value allows these transfers to be formally appropriated and disclosed in the <i>Crown Financial Statements</i> and annual Budget.
<b>Tax expenditures</b>	Individual features of the tax system that reduce an entities' tax obligation in a way that is designed to give effect to policy other than to raise revenue in the most efficient and economically neutral way.	Tax expenditures are defined in tax legislation, but have not previously been disclosed.  This document is the first disclosure since 1984.

Tax systems differ from country to country. Thus, there is no current international consensus as to how tax expenditures should be categorised. Treasury released a

discussion of how tax expenditure reporting could be categorised to meet New Zealand's objectives in Treasury *Policy Perspectives Paper 09/01*.

Some countries define tax expenditures indirectly relative to a normative benchmark. This approach allows countries to report a wider set of structural tax expenditures that are generally applicable<sup>1</sup>. This document has focused, in the first instance, on a narrow subset of tax expenditures that bear a distinct fiscal cost and represent a clear policy-motivated exemption<sup>2</sup> to current tax practice. A summary of the guiding criteria is included in figure 1.

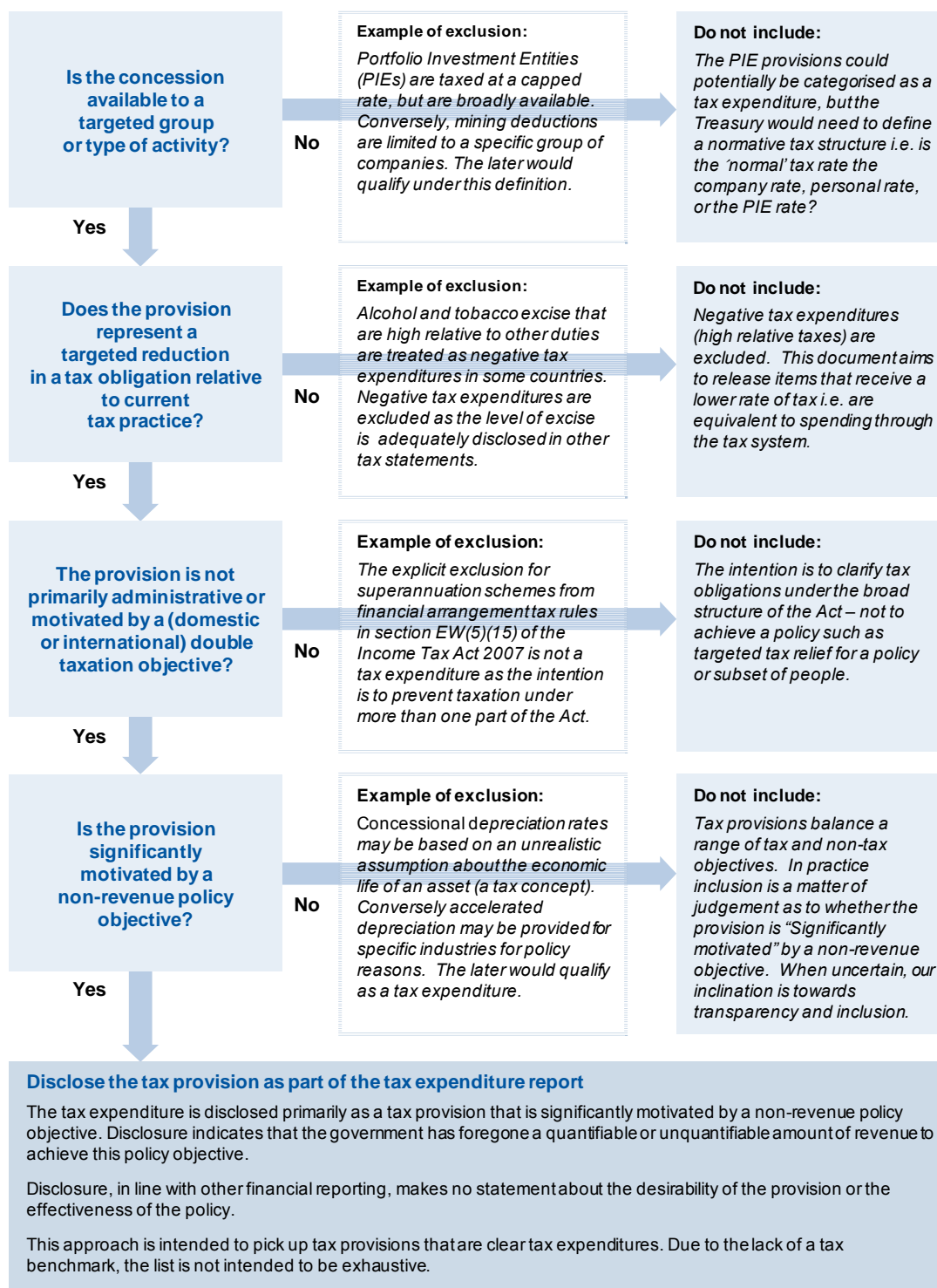
This document is a first step towards improved transparency in this area. No attempt has been made to identify a normative tax benchmark or to comprehensively analyse tax legislation. Work on identification has begun and is expected to continue as part of a multi-year work programme. For this reason, this preliminary list should not be taken as exhaustive or complete list of all current tax expenditures.

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<sup>1</sup> For example, Portfolio Investment Entities (PIEs) offer all tax payers the option of relatively 'concessional' tax treatment as a mechanism to encourage portfolio investment. While a non-revenue policy objective suggests that PIEs could be categorised as a tax expenditure, PIEs are excluded from the tax expenditure definition used in this document as PIEs are available to all taxpayers. A benchmark tax system would allow the Treasury to categorise structural features of the tax system such as PIEs, trusts, or progressive personal tax rates. A benchmark tax structure is useful where no clear exemption exists as it would define what constitutes the 'standard' tax treatment. For instance, is the 'standard rate' the company rate, PIE rate, trust rate, or one of the personal tax rates.

<sup>2</sup> The stated purpose of the Income Tax Act 2007 is to "define and, impose tax on, net income". Tax expenditures are not motivated by a desire to raise revenue in the most efficient manner possible, but instead are significantly motivated by non-revenue policy objective.

**Figure 1:** Guiding criteria for inclusion in this disclosure document



## Current Tax Expenditures

The following sections list tax expenditures drawn from both the *Income Tax Act 2007* and the *Good and Services Act 1985*. Appropriated cash payments (spending) made through the tax system, e.g. working for family tax credits, have also been included in the final part of the list. Cash payments made through the tax system do not formally meet a tax expenditure definition, but have been included for transparency purposes.

A small sub-section of tax expenditures with readily accessible data has been quantified (refer table 2). The government does not collect data on all tax expenditures as the compliance cost of collecting additional data is, in some instances, considered prohibitive. While work quantifying tax expenditures will continue, many tax expenditures may not be able to be quantified.

**Table 2:** Quantified tax expenditures and spending through the tax system

Quantified tax expenditures	Value of expenditure 2008/09 (actual)	Value of expenditure 2009/10 (forecast)
Housekeeping tax credit	\$13 million	\$13 million
Child tax credit	\$25 million	\$25 million
Juror's and witnesses' fees -- exemption	\$2 million	\$2 million
Charitable or other public benefits: tax credit	\$184 million	\$184 million
Transitional tax allowance	\$9 million	\$9 million

Note: measured in March tax years

Appropriated spending through the tax system	Value of expenditure 2008/09 (actual)	Value of expenditure 2009/10 (forecast)
Child tax credit	\$6 million	\$4 million
Family tax credits	\$2,053 million	\$2,191 million
In-work tax credits	\$584 million	\$604 million
KiwiSaver tax credits	\$857 million	\$656 million
Parental tax credits	\$20 million	\$21 million
Minimum Family tax credit	\$9 million	\$9 million

Note: These credits are appropriated and are measured over the financial year.

## Tax Expenditures Included in the Income Tax Act 2007<sup>3</sup>

### **Accelerated depreciation: deferral**

*Sections DO 4-5, 12, DP 3, DZ 17-18, EE31 of the Income Tax Act 2007*

The ability to depreciate capital items faster than their economic life reduces income by a greater amount in earlier years (deferring tax payments).

### **Bodies promoting amateur games and sports: exempt income**

*Section CW 46 of the Income Tax Act 2007*

Income derived by a club, society or association is exempt income, providing it is established to promote an amateur game or sport and no funds are used for private pecuniary profit.

### **Bodies promoting scientific or industrial research: exempt income**

*Section CW 49 of the Income Tax Act 2007*

Income derived by a society or association established mainly to promote or encourage scientific or industrial research is exempt income, providing the society or association is approved by the Royal Society of New Zealand and no funds are used for private pecuniary profit.

### **Certain income derived by transitional residents: exempt income**

*Sections CW 27 and HR 8 of the Income Tax Act 2007*

New tax residents in New Zealand can gain a temporary tax exemption for up to four years on most foreign-sourced income.

### **Charitable or other public benefit gifts by a company: deduction**

*Section DB 41 of the Income Tax Act 2007*

A company is allowed a deduction for a charitable donation or other gift that produces a public benefit when made to a society, institution, association, organisation, trust, or fund set out in schedule 32 of the *Income Tax Act 2007*.

### **Charitable or other public benefits: tax credit**

*Section LD 1-3 of the Income Tax Act 2007*

A person who makes a charitable or other public benefit gift may under certain conditions is allowed a refundable tax credit. Payroll donations are allowed under sections LD 4-8.

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<sup>3</sup> This list has mainly been sourced from the following sections of the Act: Section D (Deductions); Section C (Income); Section L (Tax credits and other credits); and Section M (Tax credits paid in cash).

**Charities: exempt income**

*Sections CW 41-43 of the Income Tax Act 2007*

Business, non-business and charitable bequests are exempt income for registered charitable entities.

**Child tax credit**

*Section LC 3 of the Income Tax Act 2007*

A tax credit of up to \$292.50 is available to children, as defined in the Act, for each tax year.

**Community trusts: exempt income**

*Section CW 52 of the Income Tax Act 2007*

Income derived by the trustee of a community trust is exempt income.

**Farming and aquaculture business expenditure**

*Section DO 1-13 of the Income Tax Act 2007*

Deductions granted for improvements and enhancements to land for farming and aquaculture can be expensed rather than treated as capital.

**Film industry expenditure: deduction**

*Section DS 1-4 of the Income Tax Act 2007*

Expenditure incurred acquiring film rights can be expensed over a specified time frame.

**Forestry expenditure: deduction**

*Section DP 1 & DP 5 of the Income Tax Act 2007*

Expenditures associated with forestry (ie, improvements or planting costs) can be expensed rather than treated as capital improvements.

**Friendly societies: exempt income**

*Section CW 44 of the Income Tax Act 2007*

Specified income derived by a friendly society is treated as exempt income.

**Funeral Trusts: exempt income**

*Section CW 45 of the Income Tax Act 2007*

Interest or a dividend derived by a trustee in a funeral trust is exempt income.

**Herd improvement bodies: exempt income**

*Section CW 51 of the Income Tax Act 2007*

Specified income derived by a herd improvement association, or society established mainly to promote an improvement in New Zealand dairy cattle, is exempt income.

### **Housekeeping/carer: tax credit**

*Section LC 6 of the Income Tax Act 2007*

A tax credit of up to \$310 is granted for a person who makes specified housekeeping/carer payments in a tax year.

### **Income equalisation schemes**

*Section EI 1 of the Income Tax Act 2007*

Persons working in forestry, fishing, or farming entities may reduce their taxable income in a year by depositing taxable income with the IRD. The schemes allow taxable income to be transferred between years.

### **Income for military or police service in operational area: exempt income**

*Section CW 23-24 of the Income Tax Act 2007*

Specified income derived by members of the New Zealand Defence Force (or the police) serving in an operational area can be treated as exempt income.

### **Income from conducting gaming-machine gambling: exempt income**

*Section CW 48 of the Income Tax Act 2007*

Gross gambling proceeds from gaming-machine gambling are exempt income if the person complies with the *Gambling Act 2003*.

### **Income of the Governor-General: exempt income**

*Section CW 16 of the Income Tax Act 2007*

The salary of the Governor-General is exempt income under the *Civil List Act 1979*.

### **Independent earner tax credit**

*Section LC13 of the Income Tax Act 2007*

Individuals whose income is between \$24,000 and \$44,000 are entitled to a tax credit of \$520. This credit abates once annual income rises above \$44,000.

### **Interest on home vendor mortgages: tax credit**

*Section LZ 6-8 of the Income Tax Act 2007*

A tax credit may be available for interest from a home vendor mortgage.

### **Jurors' and witnesses' fees: exempt income**

*Section CW 26 of the Income Tax Act 2007*

Fees paid by the Crown to jurors and its witnesses, other than expert witnesses, are exempt income.

### **KiwiSaver superannuation contribution tax exemption**

*Section RD 65 of the Income Tax Act 2007*

Employers are provided a limited exemption from paying employer superannuation contribution tax (ESCT) for KiwiSaver contributions.

### **Local and regional promotional bodies: exempt income**

*Section CW 40 of the Income Tax Act 2007*

The income derived by a charitable association or society is exempt income, if it is primarily established for beautification purposes.

### **Maori Authorities: deduction**

*Section DV 12 of the Income Tax Act 2007*

A Māori authority is allowed a deduction for a donation that it makes to a Māori association as defined in the *Māori Community Development Act 1962*.

### **Mineral mining expenditure: deduction**

*Section DU 1 of the Income Tax Act 2007*

A mining company can deduct all exploration and development expenditure in the year it is incurred.

### **New Zealand companies operating in Niue**

*Section CW 59 of the Income Tax Act 2007*

Dividends derived from or by a company incorporated in New Zealand that derives its income wholly or mainly from Niue are exempt income.

### **Non-profit organisations: deduction**

*Section DV 8 of the Income Tax Act 2007*

Non-profit organisations are allowed deductions for the lesser of \$1,000 and the amount that would be the organisation's net income in the absence of any deductions.

### **Payments of interest post-war credits: exempt income**

*Section CW 5 of the Income Tax Act 2007*

Interest derived by a person under section two of the *Income Tax (Repayment of Post-War Credits) Act 1959* of the United Kingdom Parliament is exempt income.

### **Payments of interest on farm mortgages: exempt income**

*Section CW 6 of the Income Tax Act 2007*

50 percent of the interest that a person derives from a mortgage securing a loan made by a seller of a farm is exempt income, if the Rural Banking and Finance Corporation of New Zealand approves the mortgage.

### **Petroleum mining expenditure: deduction**

*Sections DT 1, DT 5, and EJ 12 of the Income Tax Act 2007*

Petroleum exploration expenditure can be deducted where it generates an asset. Development expenditure is written off over an accelerated seven-year period.



**Scholarships and bursaries: exempt income**

*Section CW 36 of the Income Tax Act 2007*

Any scholarship or bursary payment for attendance at an educational institution is exempt income, except for a basic grant or an independent circumstances grant under the *Education Act 1989*.

**TAB and racing clubs: exempt income**

*Section CW 47 of the Income Tax Act 2007*

Income derived by the New Zealand Racing Board, New Zealand Thoroughbred Racing, Harness Racing New Zealand and the New Zealand Greyhound Racing Association is exempt income.

**Transitional tax allowance**

*Section LC 4 of the Income Tax Act*

The means-tested transitional tax allowance (credit) is available to full-time earners working more than 20 hours without dependent children.

**Veterinary services bodies: exempt income**

*Section CW 50 of the Income Tax Act 2007*

Income derived by a veterinary association, club or society established mainly to promote efficient veterinary services in New Zealand is exempt income.

## **Tax Expenditures Included in the Goods and Services Act 1985<sup>4</sup>**

### **Duty free goods: zero weighting**

*Section 11 of the Goods and Services Act 1985*

Approved retailers are allowed a zero GST weighting on goods that will be taken out of the country.

### **Financial services general: exemption**

*Section 14(1) of the Goods and Services Act 1985*

The supply of financial services and any goods and services incidental to the provision of those services are exempt from GST.

### **Leases or leasehold land: exemption**

*Section 14(1) of the Goods and Services Act 1985*

Leases or the supply of leasehold land by way of rental is exempt from GST, to the extent that the land is used for the principal purpose of accommodation in a dwelling.

### **Residential land and property sales: exemption**

*Section 14(1) & 14(1) of the Goods and Services Act 1985*

The sale of any dwelling is exempt from GST.

### **Supply of fine metal: exemption**

*Section 14(1) of the Goods and Services Act 1985*

The supply of fine metal is either exempted (domestic sales) or subject to a zero-rated rate of GST.

### **The sale or supply of accommodation: exemption**

*Section 14(1) of the Goods and Services Act 1985*

The supply or sale of accommodation in a dwelling by way of hire, service, or occupancy agreement is exempt from GST.

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<sup>4</sup> The GST Act 1985 provides two types of exemption: a pure exemption; and a zero weighting. A zero weighting is potentially more concessionary as the business retains the ability to claim GST on inputs.

# Approved Appropriated Spending Made through the Tax System

## Child tax credit

*Section MZ 2 of the Income Tax Act 2007*

Families with a pre-existing entitlement dating from before 31 March 2006 are able to claim a tax credit for dependent children. Additional access to this tax credit is no longer available.

## Family tax credits

*Section MD 3 of the Income Tax Act 2007*

Families are entitled to an income tested tax credit or cash payment for children aged 18 years or younger.

## In-work tax credits

*Section MD 10 of the Income Tax Act 2007*

Families with children 18 years or younger that work the required number of hours per week are entitled to a means-tested in-work tax credit.

## KiwiSaver tax credits

*Section MK 1-16 of the Income Tax Act 2007*

The savings and contributions of participants in the KiwiSaver scheme are entitled to a series of tax credits.

## Parental tax credits

*Section MD 12 of the Income Tax Act 2007*

A tax credit may, under certain conditions, be paid to families with a newborn baby for the first 56 days (eight weeks) after the baby is born.

## Minimum family tax credit

*Section ME 1 of the Income Tax Act 2007*

A tax credit may be available to ensure that the annual income (after tax) of a family with dependent children 18 or younger does not fall below \$20,800.