



**Inland Revenue**  
Te Tari Taake



POLICY ADVICE DIVISION

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To: Minister of Finance and Minister of Revenue

cc: Minister for Social Development

## **WORKING FOR FAMILIES INTEGRITY – OPTIONS FOR BUDGET NIGHT LEGISLATION**

The purpose of this note is to provide you with further information on options for Budget 2010 to address the integrity of Working for Families (WFF) tax credits and other forms of social assistance. The two options outlined in this note are:

Option 1 – legislate on Budget night to exclude investment losses for WFF tax credit purposes (effective from 1 April 2011). Announce a review that would result in further amendments that would take effect from 1 April 2011.

Option 2 - legislate on Budget night to exclude investment losses from income for WFF tax credit purposes (effective from 1 April 2011) and **a basic rule to include distributions of trustee income** and income from non-locked in PIEs for WFF purposes, effective from enactment on Budget night. Announce a review that would result in further amendments that would take effect from 1 April 2011.

### **Option 1 Budget night legislation for investment losses followed by a review**

A Budget night amendment would exclude investment losses (including rental property losses) for the purposes of determining WFF tax credits. The investment loss amendment would take effect from 1 April 2011. An announcement would also be made that a subsequent review would be conducted regarding the breadth of the definition of income for determining WFF tax credit entitlements as well as other forms of social assistance that use the tax definition of income (covering student allowances and health entitlement cards). The announcement could specifically state that trustee income and income from non-locked in PIEs would be taken into account when determining a family's entitlement to WFF tax credits (and other types of social assistance listed above) and that legislation will be introduced later in 2010 to ensure this policy is effective from 1 April 2011. In addition, the review would include addressing the following types of income that undermine the integrity of WFF tax credits:

- Contributions to non-locked in superannuation schemes;

- Income from non-resident spouses; and
- Certain types of fringe benefits.

This relies on legislation being introduced and passed under urgency late in 2010 so that peoples' entitlements can be adjusted by February 2011 when letters stating families entitlements are sent out.

The intention is to have these integrity-enhancing amendments to the definition of income for social assistance purposes completed and implemented in a robust form by 1 April 2011.

A preliminary estimate of the revenue gain from including trustee income for WFF purposes (based on a 2% sample of trustee taxpayers), puts the potential reduction in WFF payments at approximately \$10 million per annum. This is in addition to the \$15m that is estimated from excluding rental losses. At this stage we do not have revenue estimates for the other types of income (although trustee income is expected to be a large proportion of total potential revenue gains).

### **Option 2 Budget night legislation for investment losses and a basic amendment for trustee income and income from non-locked in PIEs**

A Budget night amendment would exclude investment losses (including rental property losses) and have a very basic rule for including distributions of trustee income and income from non-locked in PIEs for the purposes of determining WFF tax credits. This basic rule would be in place for the 2010/11 tax year until a more comprehensive rule (which would also cover other forms of social assistance) could be developed and implemented for the 2011/12 tax year. The basic amendment to include trustee income and income from non-locked in PIEs would take effect from enactment on Budget night. The review of all other types of income (listed above) would still proceed and it would cover other forms of social assistance such as student allowances and health entitlement cards. All other measures (investment losses legislated for on Budget night and amendments arising from the review) would still take effect from 1 April 2011.

There are some concerns with enacting a basic rule for distributions of trustee income on Budget night.

#### *Policy effectiveness*

Introducing a very basic rule that simply includes all distributions from trusts is unlikely to be properly targeted. For example, without proper ordering rules for trust distributions, corpus of the trust might be unintentionally included as income (e.g. income from property sold by the trust). Similarly, a basic rule may not include loans from trusts (which is an alternative way to distribute income from a trust) when arguably it should be. Legislation that addressed all the complexities of distributions from trusts could not be prepared in time for introduction on Budget night.

#### *Implementation*

An amendment to the definition of income effective from Budget night would mean the first seven weeks of the income year would have a different basis for entitlement to WFF tax credits than for the remainder of the year. A family with trustee income would need two calculations for entitlement for each period. This would involve considerable administrative complexity from IRD's perspective. It is most likely the entitlements for those families receiving distributions from trusts would have to be calculated manually.

IRD does not match distributions of trustee income with individuals. If trustee income distributions were to be included for the 2010/11 income year effective from Budget night, IRD would have to rely on families to contact the department to inform them of their distributions of income from a trust. However, this would be similar to what would need to occur under current rules should the circumstances of a recipient change during the year. A final assessment would not be made until the 2011/12 income year once the trust returns had been received by IRD. If families did not contact IRD, they would receive too much in WFF tax credits and they would be put into debt.

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