To: The Prime Minister
Hon Simon Power
Hon Steven Joyce
Hon Paula Bennett

From: Minister of Finance and Minister of Revenue

Re: Ministers' Sub-Group on Tax Meeting One (22 February 2010)

Date: 19 February 2010

Attached for the first meeting of Ministers' Sub-Group on Tax is:

- An agenda; and
- A briefing note on the matters to be discussed.

Ministers' Sub-Group on Tax

Agenda for meeting of 22 February 2010

---

1. Timetable to develop a tax reform package for Budget 2010

2. Outline of tax reform package being developed and initial costings

3. Key decisions on tax rate alignment issues (tax system integrity), personal income tax reductions and an increase in the GST rate

4. Other matters

Timetable for Ministers' Sub-Group on Tax to develop a tax reform package for Budget 2010

Four meetings of the Budget 2010 Ministers' Sub-Group on Tax (the Tax Sub-Group) have been scheduled leading up to the cabinet decision on the tax reform package on 12 April 2010. Given the likely scope of the Budget 2010 tax reform, it is envisaged that the Tax Sub-Group will use meetings 1-3 to make in-principle decisions on specific components of the Budget package. The Tax Sub-Group would then use meeting 4 to make recommendations on the package as a whole after taking into account the overall revenue implications. Cabinet would consider the Tax Sub-Group's recommendations on 12 April and make final decisions on the tax package for Budget 2010.

The Ministers of Finance and Revenue will provide advice to the Tax Sub-Group on the issues due for consideration at each meeting in advance of that meeting. In addition, the Tax Sub-Group will be provided at each meeting with a table containing the estimated fiscal costs of a potential overall tax package (see appendix 1). These costs are likely to change as in-principle decisions on various components of the package are made.

- **Meeting 1, 22 February 2010 –** consideration of tax rate alignment issues, personal tax rate reductions and an increase in the GST rate.
- **Meeting 2, 8 March 2010 –** consideration of:
    - thin capitalisation;
    - property issues (LAQCs, loss ringfencing, and the capital/revenue boundary);
    - depreciation issues (buildings, loading);
    - PIEs and other savings vehicles;
    - Working for Families indexation and integrity issues; and
    - compensation for any increase in GST.
- **Meeting 3, 22 March 2010 –** consideration of:
    - company tax rates;
    - company tax consequential issues (including provisional tax); and
    - composition of the final tax package.
- **Meeting 4, 29 March 2010 –** final recommendations on the final tax package.

Key decisions to be made by the Tax Sub-Group on tax system integrity, personal income tax rate reductions and an increase in the GST rate

Overall aims of the tax reform package:

- To increase growth by a shift in the tax mix - reducing the reliance on income taxes while increasing tax revenues through GST.

- To broaden the income tax base to reduce behavioural distortions in the current tax system, and to allow further income tax rate reductions.

Benefits of a shift in the tax mix:

- Shifting the tax mix encourages economic growth by reducing reliance on income taxes that are particularly harmful for growth and efficiency.

- Taxing consumption does not discourage savings to the same extent as personal income taxes.

- It improves integrity of the tax system by allowing alignment of the trustee rate and the top personal income tax rate. This is particularly important because non-alignment of these rates can confer permanent benefits to taxpayers due to the tax on trustee income being a final tax. Non-alignment of the company rate and the top personal income tax rate, on the other hand, only confer a deferral benefit (a timing difference) – it is a matter of judgement as to what level of difference between these rates is sustainable without further integrity measures being required.

- It allows for across the board reductions in personal income tax rates which, in turn, helps support the progressivity of the tax system.

Potential criticisms of a shift in the tax mix:

- An increase in GST could adversely affect those on lower incomes who, on average, pay a higher percentage of their disposable income in GST. This concern is addressed by proposals to:

    - reduce lower personal income tax rates in order to offset any negative effects for taxpayers from increased prices of goods and services; and

    - provide immediate support to certain groups particularly affected by an increase in GST.

Recommendations on personal tax rate reductions and an increase in the GST rate:

- **Agree** there is a preference for the tax reform package to increase the GST rate to 15%.

- **Agree** there is a preference for the tax reform package to make reductions to the lower personal income tax rates.

- **Agree** there is a preference for the tax reform package to align the top personal income tax rate and the tax rate applied to trustee income at 33%.

- **Agree** there is a preference that, if the GST rate is to increase on 1 October 2010, immediate support for certain groups (e.g. beneficiaries, superannuitants, and Working for Families recipients) should also be given. **Note**, further advice will be provided by officials on how this can be achieved, and will be considered by the Tax Sub-Group on 8 March 2010.

Budget 2010 tax package – base scenarios (as at 19 February 2010)

Scenario outline:

Tax changes	Existing	Option	From	Notes
Personal tax rates				
0 – 14,000	12.5%	10.5%	1 October 2010	Costings include consequential changes to FBT and ESCT.
14,001 – 48,000	21%	17.5%		
48,000 – 70,000	33%	30%		
70,000 +	38%	33%		
GST	12.5%	15%	1 October 2010	Costings assume no change to the consumption base.
GST compensation for NZS/benefits/WfF				Costings assume indexation (including bring-forward) based on 2.22% assumed price increase (excludes adjustments to WFF abatement threshold and other welfare assistance). Initial draft costings may be revised after comparison with MSD modelling.
Deny building depreciation			2011/12 income year	Costings assume no losses on sale allowed and no grandparenting.
Remove 20% depreciation loading			20 May 2010	Costings assume removal of depreciation loading for purchases on or after budget day. (Short-term revenues would increase if measure also applied to existing assets, i.e., without grandparenting).
Reduce thin capitalisation threshold	75%	60%	2011/12 income year	
PIE rates				Costings assume no change at this time.
Company tax rate	30%	30% or 28%	2011/12 income year	Costings will vary depending on policy decisions taken on this matter (see initial draft costings alongside
WFF de-indexation of abatement threshold only			Next indexation	Next indexation currently forecast 1 April 2012

Black text indicates potential changes already discussed by the Tax Group, with preliminary preferences made.
Red text indicates potential changes currently being considered by the Tax Sub-Group.
Blue text indicates potential changes still to be considered by the Tax Sub-Group at a future date.

Other potential measures:

$ million	2010/11	2011/12	2012/13	2013/14
Tobacco excise	170	170	165	165
Dep. Loading on <u>existing</u> assets	0	600	330	150
Gains & losses on depreciation	0	239	257	288
Loss ring-fencing	indicative revenue figures not yet available			
LAQCs				
Capital revenue boundary				
WFF integrity measures				
Thin cap threshold to 50%				

*Preliminary costings based on a 28% company tax rate, excluding clawback effects. For excise figures: revenue estimates are highly sensitive to the behavioural responses of consumers and producers, and estimates will be reduced substantially by automatic inflation compensation for beneficiaries and superannuitants.

All costings are <u>provisional only</u> are based on HYEFU 2009 macroeconomic forecasts.

No change to company tax rate

$ million	2010/11	2011/12	2012/13	2013/14
Personal tax	-2,325	-3,535	-3,865	-4,055
Net NZS	-235	-330	-350	-370
Net Benefits	-80	-110	-110	-110
WFF compensation	-50	-70	-75	-70
GST	1,495	2,090	2,175	2,260
Building dep.	0	720	725	730
Dep. loading	140	260	330	370
Thin cap 60%	0	210	210	210
WFF de-indexation	0	25	95	95
Clawback	440	525	560	590
Net	**-615**	**-215**	**-305**	**-350**

*Flow-on compensation measures to supplementary assistance not included

Reduction of company tax rate to 28%

$ million	2010/11	2011/12	2012/13	2013/14
Personal tax	-2,325	-3,535	-3,865	-4,055
Net NZS	-235	-330	-350	-370
Net Benefits	-80	-110	-110	-110
WFF compensation	-50	-70	-75	-70
Company tax	-30	-410	-375	-395
GST	1,495	2,090	2,175	2,260
Building dep.	0	685	690	695
Dep. loading	135	245	315	355
Thin cap 60%	0	195	195	195
WFF de-indexation	0	25	95	95
Clawback	440	530	570	595
Net	**-650**	**-685**	**-735**	**-805**

*Flow-on compensation measures to supplementary assistance not included

Indicative costs on marginal changes

	Base scenario	Change	$million (2011/12)
Personal tax rates			
0 – 14,000	10.5%	± 1%	± 400
14,001 – 48,000	17.5%	± 1%	± 510
48,000 – 70,000	30%	± 1%	± 135
70,000 +	33%	± 1%	± 170
Personal tax thresholds	$ 14,000	+ 1,000	-170
	$ 48,000	+ 1,000	-110
	$ 70,000	+ 1,000	-50

Note no interaction with NZS and benefits accounted for in these rough marginal estimates