THE TREASURY
Kaitohutohu Kaupapa Rawa

MINISTRY OF SOCIAL DEVELOPMENT
Te Manatū Whakahiato Ora

Inland Revenue
Te Tari Taake

POLICY ADVICE DIVISION

Joint Treasury/MSD/IRD Report: Implications of changing the tax mix and possible additional support for certain groups

Date:	11 March 2010	**Report No:**	T2010/339 REP 10/03/095 IRD 2010/042

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Agree** to recommendations	15 March 2010
Minister for Social Development and Employment (Hon Paula Bennett)	**Agree** to recommendations	15 March 2010
Minister of Revenue (Hon Peter Dunne)	**Agree** to recommendations	15 March 2010

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[deleted - privacy]	Senior Analyst, The Treasury	[deleted - privacy]	[deleted - privacy]	✓
[deleted - privacy]	Principal Analyst, MSD	[deleted - privacy]	[deleted - privacy]	
Bill Moran	Manager, Tax Strategy, The Treasury	[deleted - privacy]	[deleted - privacy]	
Chris Gillion	Senior Policy Advisor, Inland Revenue	[deleted - privacy]	[deleted - privacy]	

Minister of Finance's Office Actions (if required)

Refer copies to the Minister for Social Development and Employment and the Minister of Revenue

Enclosure: **No**

11 March 2010

Joint Treasury/MSD/IRD Report: FINAL Implications of changing the tax mix and possible additional support for certain groups

Executive Summary

This paper analyses how individuals and families could – *without compensation* – be adversely affected by a GST-income tax switch. The paper then proposes the following tailored compensation package to address this:

Group	Recommended Option	Rationale
Main benefits	Provide a payment equivalent to 2.02% of benefits from 1 October 2010	Beneficiaries would otherwise have to wait 6 months for their benefit to reflect a GST-induced price rise.
Student Allowances	Provide a payment equivalent to 2.02% of Student Allowances from 1 October 2010 Agree to change regulations to avoid rates further increasing Student Allowances as a result of the personal tax cuts	Maintain the Student Allowance rate at the same level as Unemployment Benefits (avoids incentives to switch between the benefit and student allowance system). Changing regulations will prevent Student Allowances from further increasing as a result of the tax changes (i.e. prevents double-dipping).
NZ Super + Veterans	Personal tax cuts will automatically increase rates of NZ Super by an average 2.5% Provide a further payment equivalent to 2.02% of NZ Super from 1 October 2010	The Prime Minister has announced that super-annuitants will benefit twice from the tax package.
Working for Families	Increase Family Tax Credit (FTC) and Minimum Family Tax Credit (MFTC) by 2.02% on 1 October 2010	FTC is the main source of support for children for beneficiary and low income families. Increasing the MFTC will ensure these low income working families continue to be better off working than being on a benefit.
	No change to the In-work Tax Credit (IWTC) or Parental Tax Credit (PTC)	The IWTC is designed to make work pay, rather than subsidise costs of children. Hence, this rate is not subject to CPI increases. The PTC is paid to some parents upon the birth of a child. Neither payment is adjusted for inflation, but both are considered as part of a triennial review process.
Supplementary benefits	Increase the rates of the most significant forms of supplementary assistance, but not Accommodation Supplement, by 2.02% from 1 October 2010 to 31 March 2011 (i.e. Disability Allowance, Child Disability Allowance and Childcare Assistance)	Apart from the Accommodation Supplement (see below), these are the most significant supplementary benefits. Increases in these payments are needed to help ensure that beneficiaries are not worse off from a GST-income tax switch.

Supplementary benefits (continued)	Increase on 1 April 2011 by an estimated 2.02% the rates and income thresholds of all supplementary assistance normally subject to the Annual General Adjustment	Increasing these payments will help to compensate beneficiaries and super-annuitants for a GST rise. Note you can choose to defer this decision. However, any later decision to increase payments by 2.02% would be a charge on the Budget 2010 contingency or Budget 2011.
	Direct officials to examine possible impacts of the tax package on housing affordability and wider issues relating to Government housing support	There are a range of outstanding policy issues with the benefit system, especially relating to housing assistance. Tax reform is not the place to resolve these issues. Any additional costs would be a charge on future Budgets.
Other groups	Indicate preference for whether or not to bring forward to 1 October 2010 a 2.02% cost of living increase for Government Superannuation Fund and National Provident Fund payments	These payments will, by legislation, increase in April 2011. Bringing these payments forward to October 2010 would increase payments at the same time as GST is raised, but raises fairness issues compared with the treatment of non-Government (private) pensions. Final agreement will depend on advice about the technical feasibility of making payments early.
	Agree not to bring forward indexation of the Student Loan Living Cost Component	This is not an entitlement and will increase on 1 April 2011 by CPI. There are broader issues with student support that cannot be resolved here.

The compensation package recommended in this paper is comprehensive, and compares favourably with the package that accompanied the introduction of GST. In designing a compensation package Ministers should be aware that:

- While we can design a compensation package to prevent people being worse off *on average*, we cannot guarantee this for all people in all circumstances (e.g. if they are currently spending more than they are earning or if they are beneficiaries that are spending less than 8% of their income on housing costs).
- The dynamic effects of the tax package – together with the *Future Focus* benefit reforms – will incentivise many people to earn more and thus benefit in time from the new tax system.

We recommend that a Ministerial Welfare Programme be established to make compensation payments of 2.02% from 1 October 2010 to 31 March 2011 for those receiving welfare assistance (excluding Family Tax Credit). This will ensure that people are compensated for the GST increase until the impact of the increase in prices is captured in the CPI and can be properly incorporated in rates of assistance. It will prevent negative flow-ons to supplementary support in the first six months (after which the Annual General Adjustment will resolve many, but not all, of these flow-on issues). This is similar to the mechanism used by the previous administration for its October 2008 tax cuts.

The proposed compensation package - *including the flow-on costs of personal tax cuts to NZ Super and Veterans Pension* - has the following estimated costs:

	2010/11	**2011/12**	**2012/13**	**2013/14**
Estimated cost of compensation package, including effects of tax cuts on NZ Super and Veterans Pension	$378m	$536m	$562m	$567m

Costings based on HYEFU 09 forecasts. Final costings will use preliminary BEFU 10 forecasts.

Recommended Action

We recommend that you:

General issues

a **note** that on 15 February 2010 we advised that we would report back to you with detailed advice on a GST compensation package to begin on 1 October 2010 [T2010/191 and PAD 2010/16 refers];

b **note** that compensation may warrant consideration in some or all of the following circumstances:

- where any groups would not be fully compensated for a rise in the rate of GST through the reduction of their personal income tax rates;
- where automatic adjustments to welfare payments would not happen soon enough to compensate for the price rises that will occur following a GST rise;
- where compensation to main welfare payments leads to an automatic reduction in supplementary support;
- where individuals or families have non-taxable income or are dis-saving; and
- where changes to the treatment of property taxation leads to future rent increases.

c **note** that officials estimate that increasing the rate of GST by 2.5% will increase the Consumers Price Index by 2.02%

d **agree** that the general rate of compensation to be used in the Budget 2010 tax package for payments from 1 October 2010 to 31 March 2011 be 2.02%, with the actual impact on prices reflected in the Annual General Adjustment to welfare payments from 1 April 2011 onwards;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

Main working-age benefits

e **note** that while main working-age benefits would automatically rise in April 2011 to reflect the full impact of GST-induced price rises, without earlier compensation beneficiaries would face six months of higher prices without an increase to their primary source of income;

f **note** that the costs of increasing main working-age benefits by 2.02% from 1 October 2010 and thereafter are approximately:

	2010/11	2011/12	2012/13	2013/14
Provide a payment equivalent to 2.02% of benefits from 1 October 2010	$75m	$105m	$105m	$105m

Numbers have been rounded to the nearest $5m

g **note** that officials currently recommend paying these increases (and those for student allowances and payments to super-annuitants – see recommendations m and w) through a Ministerial Welfare Programme from 1 October 2010 to 31 March 2011 rather than by an actual increase in these payments as this will prevent unintended flow-ons to supplementary assistance (see recommendations jj-vv below);

h **note** that the entire cost of providing compensation to both beneficiaries and New Zealand Super recipients through the Ministerial Welfare Programme is $6.7 million higher in the 2010/11 year than a 2.02% in increase in benefits, Student Allowance, NZ Super and Veterans Pension, due to the absence of consequential reductions in supplementary benefits;

i **agree** to introduce a Ministerial Welfare Programme to pay main benefit recipients an amount equivalent to 2.02% of main working-age benefits from 1 October 2010 to 31 March 2011 and thereafter increase benefit rates from 1 April 2011 by an amount that reflects the actual impact on CPI of the rise in GST;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

j **agree** that for the purposes of this compensation package main working-age benefits are those which Cabinet has agreed to legislate for annual CPI adjustment in the Future Focus package (i.e. Unemployment Benefit, Sickness Benefit, Invalids Benefit, Domestic Purposes Benefits, Independent Youth Benefit, Orphans Benefit, Unsupported Child Benefit, Foster Care Allowance, minimum board rates and Widow's Benefit);

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

Student Allowances

k **note** that Student Allowance rates have historically been set at the same rate as the Unemployment Benefit (to avoid incentives to switch between the benefit and student allowance system) and that Cabinet has agreed as part of the *Future Focus* reforms to put automatic increases in these payments into legislation;

l **note** that the costs of increasing Student Allowances by 2.02% from 1 October 2010 and thereafter are:

	2010/11	2011/12	2012/13	2013/14
Provide a payment equivalent to 2.02% of Student Allowances from 1 October 2010	$7m	$10m	$10m	$10m

Numbers have been rounded to the nearest $1m

m **agree** to introduce a Ministerial Welfare Programme to pay Student Allowances recipients an amount equivalent to 2.02% of Student Allowances from 1 October 2010 to 31 March 2011 and thereafter increase Student Allowances rates from 1 April 2011 by an amount that reflects the actual impact on CPI of the rise in GST;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

n **note** that because Student Allowances are legislatively set on a gross basis, across the board tax cuts would, without further action, further increase the rates of these payments and put them out of line with the Unemployment Benefit;

o **note** that changes to regulations will be needed to prevent tax cuts flowing-on to Student Allowances (this was the mechanism adopted for the October 2008 tax cuts);

p **agree** that Budget 2010 tax cuts should not further increase net Student Allowance amounts;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

q **direct** officials to report back to Joint Ministers (Minister of Finance, Minister for Tertiary Education, Minister for Social Development and Employment and the Minister of Revenue) after Budget 2010 with advice on changing regulations to prevent the tax package further increasing net Student Allowance amounts;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

New Zealand Super and Veterans Pension

r **note** that any reductions to the current 12.5% and 21% tax rates will immediately and automatically increase the rates of New Zealand Super and Veterans Pension;

s **note** that under the GST-income tax changes discussed in our previous report of 15 February, the income tax changes alone would increase the net payment on NZ Super and Veterans Pensions by on average 2.5% on 1 October 2010;

t **note** that the rate of New Zealand Super and Veterans Pension would also automatically be increased on 1 April 2011 by the rate of inflation, which would fully incorporate the estimated GST-induced rise of 2.02% to the Consumer Price Index (CPI), along with changes to the net average ordinary time weekly wage;

u **note** that while it may seem inequitable for older people to benefit from both the tax changes and the CPI indexation (in a way that ordinary wage earners cannot) retired people may be dis-saving, effectively using up savings earned from earlier income at a higher rate of tax and then spent when the GST rate is higher;

v **note** that the costs of increasing NZ Super and Veterans Pension, including the effect of the flow-on increase to these payments as a result of the personal tax cuts, from 1 October 2010 and thereafter are:

	2010/11	2011/12	2012/13	2013/14
Effect of tax change flow-ons to NZ Super and Veterans Pension	$140m	$235m	$265m	$275m
Provide a payment equivalent to 2.02% of NZ Super and Veterans Pension from 1 October 2010	$80m	$75m	$65m	$60m
Total	**$220m**	**$310m**	**$330m**	**$335m**

Numbers have been rounded to the nearest $5m.

w **agree** to introduce a Ministerial Welfare Programme to pay recipients of NZ Super and Veterans Pensions an amount equivalent to 2.02% of their post-tax payment rates from 1 October 2010 to 31 March 2011 (from 1 April 2011 the full effect of GST induced price rises will, through existing legislation, be reflected in the Annual General Adjustment to these rates);

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

Working for Families

x **note** that the Family Tax Credit is the primary source of income to pay for the cost of children for beneficiaries and is an important source of income for many low to middle income families;

y **note** that officials also recommend increasing the rate of the Minimum Family Tax Credit on 1 October 2010 to ensure that these low income families receive an increase in their net income, and to maintain the positive work incentive created by this payment;

z **note** the fiscal costs of increasing the amount of the Family Tax Credit and Minimum Family Tax Credit by 2.02% from 1 October 2010 are:

	2010/11	2011/12	2012/13	2013/14
Increase FTC and MFTC by 2.02% on 1 October 2010	$45m	$60m	$65m	$65m

Numbers rounded to the nearest $5m

aa **note** that the administrative costs of implementing the mid-year adjustment of 2.02% to the Family Tax Credit and the Minimum Family Tax Credit are approximately $0.75 million;

bb **agree** to enact as part of Budget night legislation an increase in the amount of the Family Tax Credit and Minimum Family Tax Credit by 2.02% from 1 October 2010;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

cc **note** that increasing the amount of the FTC mid-year will, because of the way this payment is administered, lead to an increase in the number of families who receive an over-payment of their Working for Families tax credits;

dd **agree** to amend legislation to provide that Inland Revenue will automatically write-off a capped amount of all Working for Families overpayments for the 2010/11 tax year;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

ee **note** that an automatic write-off of $30 has an estimated fiscal cost of $2.1 million and an administrative cost of $50,000 and should ensure that 96% of overpaid Working for Families recipients who received an overpayment as a result of Budget 2010 will not have to repay any of that overpayment;

ff **agree** to enact as part of Budget night legislation a write-off cap of $30 per family if recommendation (dd) is agreed to;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

gg **note** that other Working for Families tax credits – the In-work Tax Credit and Parental Tax Credit – are legislatively subject to periodic review and that these payments are not designed to reflect changes in prices;

hh **agree** that the amounts of other Working for Families tax credits – the In-work Tax Credit and Parental Tax Credit – ***not*** be increased at this time;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

ii **note** that any future increases in the amounts of the Family Tax Credit and the Minimum Family Tax Credit will be adjusted by the 2.02% change that occurs on 1 October 2010 to ensure that these tax credits are not increased twice to compensate for an increase in GST;

Supplementary Benefits

jj **note** that there are three matters relating to flow-ons to supplementary assistance that Ministers will need to decide upon as part of the Budget 2010 tax package:

1) C*ompensating beneficiaries' and low income earners' supplementary support*: many beneficiaries receive a significant proportion of their income from supplementary assistance (e.g. Disability Assistance) – to provide full compensation would require increases to supplementary support in addition to the 2.02% increase to main benefits;
2) *General flow-ons*: increases to main benefits, NZ Super and the Family Tax Credit would, without further action, reduce people's eligibility – and amounts of payments received – for a range of supplementary benefits;
3) *Flow-ons to the Accommodation Supplement (and other payments that historically are not annually increased by CPI)*: some supplementary support will reduce as an effect of the tax package, but these payments are historically not annually increased – there are broader policy issues associated with these payments that should be considered as part of broader benefit reform;

1) Compensating beneficiaries' and low income earners' supplementary support

kk **note** that around 245,000 beneficiaries, New Zealand Superannuitants and others would have an increase of less than 2% of their total income as a result of the tax package (and so would not be fully compensated by a rise in benefits of 2.02%), because a significant proportion of their income comes from (non-taxable) supplementary support;

ll **note** that officials do not recommend increasing the amount of the Accommodation Supplement (the largest supplementary benefit), because rent does not attract GST and there are broader policy issues with this payment that should be dealt with as part of a separate review (see recommendation vv below);

mm **note** that increasing the rates of the Disability Allowance, Child Disability Allowance and Childcare Assistance (the most significant forms of supplementary assistance after the Accommodation Supplement) by 2.02% from 1 October 2010 to 31 March 2011 would help to ensure that recipients of these payments are fully compensated;

nn **note** that the cost of increasing the rates of the Disability Allowance, Child Disability Allowance and Childcare Assistance by 2.02% from 1 October 2010 to 31 March 2011 is:

	2010/11	2011/12	2012/13	2013/14
Increase Disability Allowance, Child Disability Allowance and Childcare Assistance by 2.02% from 1 October 2010 to 31 March 2011	$6m			

Number rounded to the nearest $1m

oo **agree** to increase Disability Allowance, Child Disability Allowance and Childcare Assistance by 2.02% from 1 October 2010 to 31 March 2011;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

2) General flow-ons

pp **note** that making compensation payments to benefits and NZ Super through a Ministerial Welfare Programme (recommendations g to i refer) will stop unintended flow-ons to supplementary support until 1 April 2011, by which time we will have information on the actual CPI increase;

qq **note** that historically most supplementary payments have been increased by CPI as part of the Annual General Adjustment process (refer to Tables B and C in the Annex of this report);

rr **note** the costs of increasing the supplementary assistance in Tables B and C of the Annex of this report by 2.02% in April 2011 are:

	2010/11	2011/12	2012/13	2013/14
Increase supplementary assistance by 2.02% on 1 April 2011	$3m	$14m	$15m	$15m

Numbers rounded to the nearest $1m

ss **agree** to increase the full range of supplementary assistance that is normally subject to CPI adjustment on 1 April (details are included in Tables B and C in the Annex) by an estimated 2.02% from April 2011 with costs included in the Budget 2010 tax package;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

3) Flow-ons to the Accommodation Supplement and Income Related Rents

tt **note** that there are flow-ons to the Accommodation Supplement and Income Related Rents, which will result in a reduction in these entitlements for some people from 1 April 2011, but that there are also broader issues, including their adequacy and targeting parameters and the impact of proposed changes to property taxation, that may need to be addressed;

uu **note** that Treasury estimates that the proposed changes to property taxation may result in a modest increase in rents over time;

vv **direct** officials (led by the Ministry of Social Development) to report back to the Ministers of Finance, Social Development and Employment and Housing on the impacts of changes in the tax package on housing affordability, and wider considerations relating to the Accommodation Supplement and Income Related Rents, before Budget 2011;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

Government Superannuation Fund and the National Provident Fund

ww **note** that increasing the rate of GST will, under the Government Superannuation Fund Amendment Act 2008, increase cost of living payments to recipients of the Government Superannuation Fund and the National Provident Fund from 1 April 2011 at an estimated annual cost of $20 million per annum from 2011/12;

xx **note** that our preliminary estimate for bringing forward this cost of living increase to 1 October 2010 – which would ensure that these recipients receive an immediate compensatory increase in their payments – is around $10 million in 2010/11;

yy **note** that bringing forward this payment to 1 October 2010 could raise fairness issues with non-Government (private) superannuation schemes, which would not receive such favourable treatment;

zz **indicate** whether your preference is to bring forward the Government Superannuation Fund and the National Provident Fund cost of living increase forward to 1 October 2010;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

aaa **note** that if you agree to recommendation zz above we will report back to you with more accurate costings, including impact on the Crown balance sheet, and further advice about whether or not it is feasible to increase Government Superannuation Fund and the National Provident Fund payments mid-year;

Student Loans Living Cost Component

bbb **note** that higher prices as a result of raising GST will flow through to an increase in the Student Loan Living Cost Component from 1 April 2011 with a preliminary estimated cost of $20m per annum from 2011/12;

ccc **note** that our preliminary estimate for bringing forward this cost of living increase to 1 October 2010 is around $7 million in 2010/11;

ddd **note** that the Student Loan Living Cost Component is not an entitlement and that there are broader issues with student support that cannot be resolved in this tax package

eee **agree** ***not*** to bring forward this living cost component increase forward to 1 October 2010;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

fff **note** that if you do wish to bring forward the Student Loan Living Cost Component we will need to consult with the Ministry of Education to prepare more accurate costings, including any impact on the Crown balance sheet;

Other matters

ggg **note** that all costings referred to in this report, and the policy decisions decided in this paper, are provisional and will change depending on the final income tax and GST settings that Ministers choose, as well as the preliminary BEFU 2010 forecasts that will be used to cost the final tax package;

hhh **note** that while we have sought to identify all possible compensation matters in this paper, the complexity of the welfare system means that other issues could arise (before or after the Budget);

iii **agree** that the Budget 2010 tax package include a contingency fund of up to $10 million per annum to deal with any other compensation matters that may arise after the Budget;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

jjj **direct** officials to develop options for a special payment mechanism, to be funded from the contingency in recommendation iii above, which ensures that any low income individuals in receipt of welfare payments who see an overall reduction in their net income from 1 October 2010 as a result of the tax package, are compensated;

Agree/Disagree *Agree/Disagree* *Agree/Disagree*

kkk **note** that we will report to you separately on any significant operational or legal matters that arise from decisions you take on providing a compensation package.

Bill Moran
for Secretary to the Treasury

Sue Mackwell
Deputy Chief Executive
Ministry of Social Development

Chris Gillion
Senior Policy Advisor
Inland Revenue

Hon Bill English
Minister of Finance

Hon Paula Bennett
Minister for Social Development and Employment

Hon Peter Dunne
Minister of Revenue

Treasury/MSD/Inland Revenue Report: [Unedited Release Version] Joint Treasury/Inland Revenue/MSD Report - Implications of Changing the Tax Mix and Possible Additional Support for Certain Groups (12 March 2010)

Purpose of Report

1. Part One of this report explains the potential ways by which individuals and families could – *without compensation* – be adversely affected by a GST-income tax switch. Part Two seeks your agreement to a specific tailored compensation package.

Background

2. The 15 February joint Treasury/IRD report *Personal tax rate reductions and an increase in the GST rate* (T2010/191 and PAD2010/16 refers) noted that officials would report back to you with further detailed advice on a possible compensation package.

Part One: Potential Implications of the 2010 Tax Package

3. This part of the paper identifies five issues for you to consider when determining a GST compensation package:

   Issue 1: whether all groups will be fully compensated for a rise in the rate of GST through the reduction of their personal income tax rates;
   Issue 2: the timing of any compensation package;
   Issue 3: potential implications for supplementary welfare support, e.g. rates of Accommodation Supplement and Disability Allowance;
   Issue 4: where individuals or families have non-taxable income or are dis-saving;
   Issue 5: where changes to the treatment of property taxation lead to future rent increases.

General background and important caveats

4. In our report to you on 15 February 2010, we modelled the impact that one possible new income and GST tax mix would have on different household income bands. The modelling used in this paper is based on the same assumptions. Table 1 shows the scenario tax mix that was modelled.

5. We have also added an additional end column to Table 1 to show the set of income tax rates needed to exactly compensate taxpayers for a 15% GST rate[1]. This last column assumes that all after-tax income is spent on goods subject to GST, and that all the GST increase flows through to higher prices (i.e. none is absorbed by businesses).

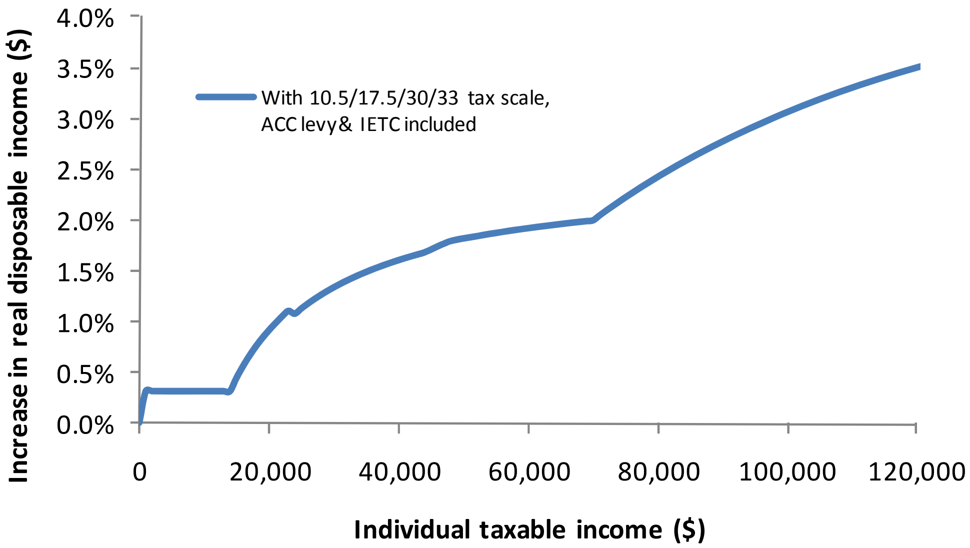
[1] Note that if bottom tax rates are lower than specified in the last column of Table 1, the upper tax rates can be reduced by a lesser amount and still ensure people are better off. While in this Table the neutral rates are higher for the top two tax rates than the scenario tax rates, there are other parts of the tax package, e.g. around the treatment of property, that will help offset a reduction in the top tax rates.

Table 1: a possible new income and GST tax mix

Income bracket	Existing tax rate	Scenario tax rate	Neutral Rate
$0–$14,000	12.5%	10.5%	10.7%
$14,001–$48,000	21%	17.5%	19.4%
$48,001–$70,000	33%	30%	31.6%
Over $70,001	38%	33%	36.7%
GST	12.5%	15%	

6. Any tax package that delivers a 15% GST and income tax rates at or below the "neutral" rates shown here will leave taxpayers better off, in terms of their annual taxable income and expenditure flows.

Figure 1: Increase in real disposable income (adjusted for CPI impact from GST increase)



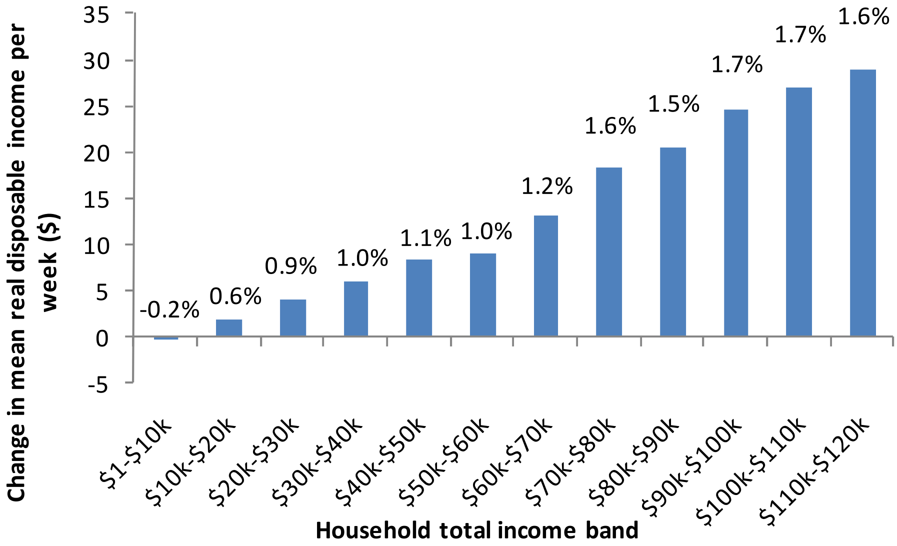
7. Figure 1 shows that people at every income should be better off *on average* following a GST-income tax switch. However, *we cannot guarantee this for all people in all circumstances*. Where people in particular income bands are spending significantly more than they are earning, an increase in a consumption tax may leave them worse off, at least in the short term. For example, any person receiving trustee income (taxed at the trust tax rate) will not benefit from a tax reduction on that income if the trust tax rate remains unchanged. They are, however, likely to have other sources of income (e.g. salary and wages) that will be taxed at lower rates.

8. On the other hand, you should also note the dynamic effects of the proposed tax changes, especially when seen in conjunction with the *Future Focus* benefit reforms. The tax reforms will incentivise work by allowing people to keep more money from their earnings. They can then choose whether to spend this additional revenue on consumption or savings. *Future Focus* will further support these incentive changes by increasing the amount that beneficiaries can earn before their payments start abating. It will also increase the requirements on beneficiaries to actively look for work.

9. The potential new tax mix used in both the 15 February report and this report had significant fiscal costs. As we work through different scenarios to reflect your preferences for a final tax package we will need to update the analysis included in this paper to ensure you are comfortable with the level of compensation required. We will also update the figures using the preliminary Budget forecasts when they become available (costing in this paper are based on HYEFU 09 forecasts). In other words, you should view the analysis presented in this paper – and the recommended compensation package – as not final. The different 'pieces of the jigsaw' (including a complete analysis of winners and losers) can only come together with the final tax package chosen for Budget 2010.

Issue 1: Whether all groups will be fully compensated for a rise in the rate of GST through the reduction of their personal income tax rates

Figure 2: Average change in disposable income by household total income band with basic compensation and new GST/income tax rates



10. Figure 2 shows the impact of GST-income tax switch on households (based on Taxwell modelling of Household Economic Survey data) using the scenario tax rates shown in Table 1. It shows that, *on average*, all households with total income greater than $10,000 per annum would have an increase in real disposable income under this particular tax package. For households with incomes less than $10,000, the average reduction is just 21c per week[2].

11. Figure 2 includes a 2.02% rise on 1 October 2010 of main benefits, NZ Super and Working for Families. This is predicated on the assumption that there will be an immediate increase of 2.02% in the CPI due to a change in the rate of GST from 12.5% to 15%. The 2.02% figure is based on the fact that while goods that attract GST may increase by around 2.22%, around 9% of components in the CPI (mostly rent) do not attract GST.[3]

2 Supplementary assistance is not modelled in Taxwell: this estimated reduction will be overstated in this analysis because we have not modelled an increase to supplementary assistance, which is generally non-taxable.

3 If all consumption goods and services attracted GST and we assumed retailers passed on the full amount of the increase to their customers, lifting GST to 15% from its current level would result in a 2.22% lift in prices (1.15/1.125)-1 = 2.22%. However, three components in the benchmark CPI do not attract GST, meaning the price of these goods and services would be expected to remain unchanged as a direct result of a higher GST rate, immediately following the increase. The sum of the three components accounts for 9% of the weight of the CPI basket, with residential rents being the largest at almost 8%. Using 91% of

12. A compensation payment of 2.02% will, in general, be appropriate where welfare recipients are spending at least 9% of their income on rent or other goods and services that do not attract GST. Beneficiaries typically spend far more than 8% of their income on rent. Indeed, the Accommodation Supplement formula assumes that beneficiaries must spend the first 25% of their income (including the first child rate of Family Tax Credit) on rent and thereafter the Government will provide 70% of rental costs up to a maximum limit.

13. While the majority of beneficiaries spend substantially more than 8% of their income on accommodation, for the minority that have very low accommodation costs a package based on increasing payments by 2.02% may not provide full compensation for price increases. The worst case for a Domestic Purposes Beneficiary would see prices rise by 56 cents per week ($14.56 from 1 October 2010 to 31 March 2011) more than their compensation payments. The issue for these beneficiaries relates not to the adequacy of the 2.02% compensation payment, but more that in their circumstances the CPI does not relate to their particular living costs (the CPI factors in price changes for an *average* basket of goods).

14. Many super-annuitants will be spending little or no money on rent, for example where they fully own their property. However, the full compensation package (where recipients will benefit twice from the personal tax cuts and the 2.02% rise) will more than offset this issue. Moreover, the actual impact on the CPI of the GST increases will be reflected in the 1 April Annual General Adjustment of welfare payments.

15. As discussed in Treasury's Aide Memoire to the Minister of Finance on 8 March 2010, Ministers could consider compensating people using a higher figure than 2.02% on the basis that it would be preferable to over-compensate for additional expenses. However, using a higher rate may lift inflation expectations, given the immediate impact on consumer prices is only expected to be 2.02%. Higher inflation expectations would be an unwelcome development given the strong relationship of expectations with future inflation.

16. Households may not be better off as a result of the GST-income tax switch for two other main reasons:

    a) More than 100% of disposable income is consumed; and
    b) Non-taxable income forms a sizable proportion of income.

17. Our analysis of HES data indicates that, on average, all households spend around 100% of their disposable income, but this varies greatly across households. Super-annuitant and beneficiary households are not statistically significantly different from other households in this regard. Average expenditure on GST items is around 90% for super-annuitant households and around 75% for other households – but again the variance around these figures is large and the difference between these household types is not statistically meaningful. We therefore have no basis to assume that a super-annuitant or beneficiary household selected at random would spend a different proportion of their disposable income compared to other households from this analysis.

18. Around 38% of households have some form of non-taxable income. Non-taxable income (as reported in HES) can come from a variety of sources: welfare assistance, retirement schemes, maintenance, lump-sum payments from various sources like lottery or horse-race winnings, life insurance policies, educational bursaries to name a few. Non-taxable income of $10,000 per annum would decline in real value by around

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the assumed price change in consumption goods and services is the most appropriate measure for determining the immediate impact on prices. As a result, the impact on prices is estimated at 2.02% as opposed to 2.22%.

$200 per annum (or $3.80 per week). In net terms this effect would be reduced to the extent that non-taxable income is from sources that are to be adjusted for inflation (e.g. welfare assistance described in this report) and where tax reductions and compensatory measures more than compensate taxable income (refer Figure 1).

Issue 2: The timing of any compensation package

19. A second issue to consider is *when* to provide any compensation package. The current welfare system contains the following mechanisms to ensure that payments are protected from CPI increases:

- Main benefits are, by convention (and after *Future Focus*, will be through legislation), increased on 1 April every year by the annual CPI.
- NZ Super and Veterans Pensions are, according to legislation, increased on 1 April by CPI *and* any payments further increased if the married couple rate would otherwise fall below the current 66% wage floor.
- The amount of Family Tax Credit is increased when cumulative quarterly CPI changes are more than 5% from the last time the amount was increased[4].

20. In the case of main benefits and the Family Tax Credit, the case for bringing forward compensation to 1 October 2010 is clear. If this does not happen then beneficiaries will have six months where the price they pay for goods will be higher, but their benefit would not yet have increased. We are currently forecasting that the Family Tax Credit would not otherwise be increased until 1 April 2012. Given that the Family Tax Credit is the main source of income to provide support for children of beneficiaries, there is a clear rationale for increasing this payment earlier. Note that while this will assist beneficiary and low income families, it will increase the incomes of many higher income families too (currently families with three children can have household incomes greater than $100,000 and still qualify for Working for Families).

21. There is a less clear case for immediately increasing payments for NZ Super and Veterans Pension by 2.02%. This is because these payments will automatically increase on 1 October 2010 by virtue of changes to the bottom two tax rates. Indeed under the tax-GST scenario used in this paper, average NZ Super payments would increase by 2.5% due to the tax changes alone.

22. On the one hand, providing a further immediate increase on 1 October 2010 of 2.02% for recipients of NZ Super and Veterans Pension could be seen as inequitable for working-age tax payers who would only receive the benefit of the personal income tax cuts. On the other hand, some retirees will be dis-saving. There is some rationale for providing additional compensation to older people on these grounds, although this policy may raise issues of discrimination under Human Rights legislation.

23. When GST of 10% was introduced in 1986, the Government provided an immediate increase of 5% to the rate of benefits and superannuation. The actual impact of price rises was then reflected in rates when payments were next adjusted for CPI effects.

24. Ministers also need to decide whether to increase certain supplementary payments from 1 October 2010 to reduce the number of beneficiaries who would otherwise be worse off by the proposed tax changes. This issue is discussed below.

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4 Currently, the income abatement threshold (the point after which Family Tax Credit payments start to abate by 20 cents for every additional dollar of earned income) is also increased when the cumulative quarterly inflation reaches 5%. As was discussed in our report to you on 26 February 2010 (T2010/300 and PAD 2010/36 refers), Budget 2010 is intending to remove this provision.

Issue 3: Potential implications for supplementary welfare support

25. There are three matters relating to flow-ons to supplementary assistance that Ministers will need to decide upon as part of the Budget 2010 tax package:

1) *Compensating beneficiaries' and other low income earners' supplementary assistance;*
2) *General flow-ons*; and
3) *Flow-ons to the Accommodation Supplement and Income Related Rents*

Compensating beneficiaries' and other low income earners' supplementary assistance

26. Many beneficiaries receive a significant proportion of their total income from supplementary welfare payments, including the Accommodation Supplement (AS), Disability Allowance and Childcare Assistance. If main benefits only are increased by 2.02% on 1 October 2010 then the total income of many beneficiaries would increase by a lesser amount (because their supplementary payments would not increase by CPI until 1 April 2011).

27. Table 2 shows the percentage increase that NZ Super recipients, beneficiaries and non-beneficiaries receiving supplementary payments would receive from both the tax changes and a compensation package that included main benefits, Student Allowances, NZ Super and Veterans Pension only (i.e. excluding any additional increase to supplementary payments).

28. Table 2 (columns 2 and 3 refer) shows there are around 210,000 beneficiaries and around 35,000 non-beneficiaries whose total compensation would be less than 2% as a percentage of their total income on 1 October 2010 (i.e. a lesser amount than the expected increase in prices due to the GST changes).

Table 2: Percentage increase in total net income from tax changes and 2.02% compensation to NZ Super, main benefits and Family Tax Credit only from 1 October 2010

	% increase in total net taxable income from tax changes and 2.02% compensation to NZ Super, main benefits and Family Tax Credit only from 1 October 2010 (number of recipients)					
	<0%	0-2%	2-2.5%	2.5-3.5%	3.5-4%	4%+
NZ Super and Veterans Pension	215	581	1,306	43,644	408,336	111,312
Beneficiaries	2,272	207,149	97,918	16,567	4,372	37,747
Non-beneficiaries receiving supplementary benefits	3,628	31,473	1,147	1,911	1,162	35,267
Total	**6,116**	**239,203**	**100,370**	**62,122**	**413,870**	**184,326**

29. As discussed below, the Annual General Adjustment to main and supplementary benefits will increase rates and thresholds for most forms of assistance. Most assistance will also automatically adjust in response to an increase in prices. However, Ministers may wish to consider increasing the payment amounts for some of the larger supplementary benefits from 1 October 2010.

30. The four most significant supplementary benefits both in terms of government expenditure and the composition of low income households' income are: AS, Disability

Allowance, Temporary Additional Support, Special Benefit, Childcare Assistance and Child Disability Allowance.

31. We do not recommend any increases to the AS on 1 October 2010. This is because housing costs do not attract GST and there are broader policy issues with the AS that cannot be resolved in this tax package (see below).

32. We do not recommend making adjustments to Temporary Additional Support and Special Benefit from 1 October 2010. These benefits are last-resort hardship assistance, and provide additional income for people whose allowable costs exceed their income. Accommodation costs (which do not attract GST) are a major cost driver for these payments, and this assistance will automatically adjust if the prices of individual commodities included in the assessment rise.

33. We do, however, recommend increasing the Disability Allowance, Childcare Assistance and Child Disability Allowance by 2.02% on 1 October 2010. Doing this, and removing payments of AS, Temporary Additional Support and Special Benefit from the equation, would significantly reduce the number of beneficiaries who would not be fully compensated.

34. The table below shows that the vast majority of people in the target groups have an increase of more than 2%. The 15,573 non-beneficiaries remaining who receive an increase in net income less than 2% are individuals with very low income from work, or no reported earned income at all. These people will receive a very small or no benefit from the proposed tax changes.

Table 3: Percentage increase in total net income, excluding payments for items that are GST-exempt, from tax changes and 2.02% compensation package, including increases to Disability Allowance, Childcare Assistance and Child Disability Allowance, on 1 October 2010

	% increase in total net income from tax changes and 2.02% compensation, including increases to Disability Allowance, Childcare Assistance and Child Disability Allowance					
	<0%	0-2%	2-2.5%	2.5-3.5%	3.5-4%	4%+
NZ Super	-	-	-	189	435,550	129,654
Beneficiaries	-	-	290,409	22,355	6,795	45,898
Non-beneficiaries receiving supplementary benefits	-	15,573	123	371	258	58,263
Total	**-**	**15,573**	**290,531**	**22,915**	**442,603**	**233,815**

General Flow-ons

35. The impact of the increase in GST will feed through into the CPI measure used to adjust rates and income thresholds for benefits and supplementary assistance for the 1 April 2011 general adjustment. We are currently estimating an increase of 4.5% in the CPI index used for the Annual General Adjustment, including the estimated 2.02% impact from increased GST.

36. Ongoing compensation for the GST rate increase can be provided through this CPI adjustment, and we propose that the Ministerial Welfare Programme therefore cease from 1 April 2011.

37. On 1 April 2011, the interconnections between forms of social assistance will mean that the normal full range of consequential impacts on supplementary assistance will apply. These issues arise at every Annual General Adjustment. The fact that the majority of rates and thresholds for assistance are all adjusted simultaneously helps to mitigate any negative impacts, and Ministers have a range of options for dealing with situations where people suffer an overall reduction in income, if required.

38. Officials will report on the impact of the GST increase on the CPI and general flow on implications as part of the 2011 Annual General Adjustment process.

39. Ministers can choose now to increase supplementary rates in April 2011 by the full rate of CPI, including the estimated 2.02% rise caused by the rise in GST. The additional cost of the 2.02% rise would be a cost on the tax package for Budget 2010. Alternatively, you can defer a decision on this matter, in which case the costs would either be a call on the 2010 Between Budget Contingency or a charge on Budget 2011. We recommend making a decision on this issue now so the full costs of the tax package are incorporated in Budget 2010.

Flow-ons to the Accommodation Supplement and Income Related Rents

40. While the Annual General Adjustment can relatively straight-forwardly deal with many of the flow-on issues, it cannot deal with them all. In particular, significant components of the AS, which is the primary form of financial assistance provided to low income earners, beneficiaries and super-annuitants for their accommodation costs are not adjusted. The maximum rates of AS were last adjusted in 2005, based on 2003 market data, and have eroded significantly in value since that time. Changes made in 2004 and 2005 also increased abatement thresholds for AS, loosening the targeting parameters for AS and making it available to families on higher incomes.

41. The proposed changes to property taxation will result in an increase in rents, although, as outlined below, Treasury estimates that the impact is likely to be modest.

42. While there may be a rationale for targeted changes to the AS as part of a compensation package, the wider issues with this benefit and the uncertainties about the impact of changes to property taxation, mean that a broader review of housing assistance may be warranted.

43. Changes to AS generally carry significant fiscal costs, but there may be opportunities to offset some of these costs by retargeting the payment. We propose that officials be tasked with reporting back to the Ministers of Finance, Social Development and Employment and Housing on the impacts of changes in the tax package on housing affordability and wider considerations with Accommodation Supplement and Income Related Rents, before Budget 2011.

44. It should be noted that the previous Government reviewed the AS, but decided that increases were not affordable at that time. Given the pressure on future Budget operating allowances, any review would benefit from clear parameters on funding availability. In particular, the Treasury recommends that any changes only be considered if they can be funded out of a reprioritisation of current benefit entitlements.

Issue 4: Where individuals or families have non-taxable income or are dis-saving

45. As noted by the Tax Working Group, raising the rate of GST increases the tax on existing wealth because past accumulated savings would now face a higher tax rate when spent. This can potentially affect older age groups who have accumulated savings from past income but now have limited income-earning ability.

46. More generally, savers benefit from the income tax cuts on their interest income, but face higher GST rates when they spend their income or capital. Therefore the effect of

the change on individual savers depends on the particular intentions of the saver. For instance retirees running down savings will be disadvantaged by the higher GST rate, while retirees with longer planning horizons may be net beneficiaries of the lower income tax rate.

47. In addition, the total income of some households comes from both taxable and non-taxable income. For example, individuals may receive income from private pensions. These income sources do not benefit from any reduction in income tax, meaning an individual with the same income but from solely taxable-income sources would be relatively better off under the new tax mix. Non-taxable was, however. included in the analysis presented in Figure 2.

48. Note that a super-annuitant couple receiving NZ Super could receive just over $30,250 of non-taxable income before they experience a decline in real disposable income (based on the scenario in Table 1 with compensation as described in this report, and assuming the non-taxable income is not received through an inflation-adjusted payment). If they also earn taxable income, this amount will increase to the extent that tax cuts more than offset the GST rise for taxable income (refer Figure 1).

49. Individuals receiving (non-taxable) income from the Government Superannuation Fund or National Provident Fund will be compensated by the automatic cost of living increase in April 2011. As discussed in Part Two of this report, Ministers may also wish to consider bringing this payment forward to 1 October 2010.

Issue 5: Where changes to the treatment of property taxation leads to future rent increases

50. The proposed changes to property taxation, whereby investment houses were no longer able to claim depreciation as a tax deduction, may result in an increase in rents. As outlined in the joint report of 15 February 2010, the impact on rents is likely to be modest. Treasury estimates that, over time, the most extreme impact would be approximately a one-off increase of 2.2%. This would be experienced by all households that pay rent, but not those individuals that are in state housing (unless the price for this housing stock adjusts accordingly).

Part Two: A Tailored Compensation Package

Mechanism for making payments from 1 October 2010 to 31 March 2011

51. This part of the report draws on the issues identified in Part One to recommend a specific compensation package for certain groups. We currently recommend that compensation for main benefits, Student Allowances, NZ Super and Veterans Pension from 1 October 2010 to 30 March 2011 be paid through a Ministerial Welfare Programme. The Ministerial Welfare Programme would provide for a payment equivalent to 2.02% of the main benefit rate, or the net rate of NZ Super payable to an individual. It would be paid on a weekly basis, alongside the benefit or NZ Super payment.

52. The payment would be non-taxable, and would not be treated as income for the purposes of any other government financial assistance. The cost of providing compensation through the Ministerial Welfare Programme is $6.7 million higher in the 2010/11 year than a 2.02% in increase in benefits, Student Allowance, NZ Super and Veterans Pension, due to the absence of consequential reductions in supplementary benefits.

53. From 1 April 2011 the Ministerial Welfare Programme would cease and the normal flow-on changes to supplementary benefits would occur through the Annual General Adjustment. The cost *savings* from these Annual General Adjustment flow-ons (associated with increasing the CPI by 2.02%) for beneficiaries, super-annuitants and non-beneficiaries receiving supplementary benefits are:

	2010/11	2011/12	2012/13	2013/14
Flow-on **savings** to supplementary assistance from 1 April 2011	$3m	$13m	$13m	$13m

Numbers have been rounded to the nearest $1m

54. Making payments via a Ministerial Welfare Programme will prevent the compensation payments from resulting in reductions in other financial assistance, and either eroding the value of the compensation, or resulting in people being financially worse off as a result of the package in the first six months. It is also possible to use this mechanism to ensure that increases in the FTC amounts proposed in this paper do not result in withdrawal of other assistance. The full amount of compensation would therefore be received by every person entitled.

55. Note that the Income Tax Act 2007 will need to be amended on Budget night to ensure that the 2.02% increase in the FTC is not double counted the next time the amounts of these tax credits are automatically indexed. In other words, we need to 'back out' the 2.02% increase to the FTC the next time it is increased.

Beneficiaries

56. We recommend that a 2.02% compensatory payment is made in addition to main benefits from 1 October 2010. This will have the following fiscal costs:

	2010/11	2011/12	2012/13	2013/14
2.02% compensatory payment for main working-age benefits from 1 October 2010	$75m	$105m	$105m	$105m

Numbers have been rounded to the nearest $5m

57. For the purposes of this compensation package main working-age benefits are those which Cabinet has agreed to legislate for annual CPI adjustment in the Future Focus package (i.e. Unemployment Benefit, Sickness Benefit, Invalids Benefit, Domestic Purposes Benefits, Independent Youth Benefit, Orphans Benefit, Unsupported Child Benefit, Foster Care Allowance, minimum board rates and Widow's Benefit)

Student Allowances

58. Student Allowances have historically been paid at the same rate as the Unemployment Benefit. This seeks to avoid creating incentives for people to move between these forms of assistance. *Future Focus* is intending to put automatic increases in Student Allowance assistance into legislation.

59. We recommend that a 2.02% compensatory payment is made to Student Allowances from 1 October 2010. This will have the following fiscal costs:

	2010/11	2011/12	2012/13	2013/14
2.02% compensatory payment for Student Allowances from 1 October 2010	$7m	$10m	$10m	$10m

Numbers have been rounded to the nearest $1m

60. Because Student Allowances are, similar to NZ Super, legislatively set on a gross basis, across the board tax cuts would also further increase the rates of these payments and put them out of line with the Unemployment Benefit. We recommend that Ministers agree to reduce the gross rates of Student Allowances in regulations to ensure that students do not benefit from a double increase in their payments. This was the approach used by the previous administration in the October 2008 tax cuts.

New Zealand Super and Veterans Pension

61. We recommend that a Ministerial Welfare Programme be established to pay recipients of NZ Super and Veterans Pensions an amount equivalent to 2.02% of their current payment rates from 1 October 2010 to 31 March 2011 (from 1 April 2011 the full effect of GST induced prices will, through existing legislation, be reflected in the Annual General Adjustment to these rates).

62. Providing compensation for NZ Super and Veterans Pension, including the flow-on increases due to the personal tax cuts modelled in this paper, will have the following fiscal costs:

	2010/11	2011/12	2012/13	2013/14
Effect of tax change flow-ons to NZ Super and Veterans Pension	$140m	$235m	$265m	$275m
2.02% compensatory increase for NZ Super and Veterans Pension recipients from 1 October 2010	$80m	$75m	$65m	$60m
Total	**$220m**	**$310m**	**$330m**	**$335m**

Numbers have been rounded to the nearest $5m.

Working for Families

Family Tax Credit and Minimum Family Tax Credit

63. We recommend that the Family Tax Credit (FTC) and the Minimum Family Tax Credit (MFTC) be increased by 2.02% from 1 October 2010. This MFTC will need to increase to reflect the fact that main benefit rates have increased, and hence we need to ensure that families are always better off in work than being on a benefit.[5] Increasing both these credits will have the following fiscal costs:

	2010/11	2011/12	2012/13	2013/14
Increase FTC and MFTC by 2.02% on 1 October 2010	$45m	$60m	$65m	$65m

Numbers have been rounded to the nearest $5m

64. A mid-year adjustment to the FTC and MFTC will require changes to Inland Revenue's systems. The cost of implementing a mid-year adjustment is approximately $0.75 million for the 2010/11 fiscal year.

65. Ministers should note that increasing the amount of the FTC in the middle of the tax year is likely to lead to an increase in the number of families who receive Working for Families over-payments. This will particularly be the case where families have a change in circumstances over the course of the tax year.

5 Note that this payment will also be increased under *Future Focus* due to the increase in the abatement-free zone for beneficiaries from $80 to $100.

66. Final entitlements to Working for Families tax credits are calculated at the end of the year and are based on the annual amount of the tax credit and the annual income threshold. In the 2010/11 income year the annual family tax credit will be increased to reflect a composite amount: the average between the annual amount before 1 October 2010, and the annual amount after the 1 October 2010 adjustment of 2.02%.

67. The end of year entitlement based on the composite amount will be lower than the fortnightly or weekly amount received for recipients who, for example, have a new child after 1 October 2010. These overpayments could, in turn, result in tax bills for affected families at the end of the income year. The issue is whether families should repay the extra FTC at the end of the year or whether some or all of the overpayment should be written off.

68. Based on 2008 data, we predict that 56,000 families will be overpaid as a result of the mid-year changes. Of these 56,000 families, around 41,000 will be in an overall Working for Families refund situation at the end of the year, so will not receive a bill for overpayments. The remaining 15,000 overpaid families will be in an overall debt situation. We estimate that the average amount by which their debt would be increased by the Budget 2010 changes is $10.

69. An automatic write-off could be applied to all Working for Families overpayments, up to a capped amount, before an individual's final tax assessment is calculated. If a family has overpayments totalling more than the write-off cap amount, they will receive a write-off of the cap amount and would be required to pay back the remaining debt.

70. The table below shows results from setting the write-off cap at different amounts. For example, with an automatic write-off of $20 there will be 2,250 families who will still have a debt of $10 on average as a result of the adjustment on 1 October to the FTC.

Amount of write-off	Families who do not get all of Budget-related overpayment written off	% of families in debt who do not get full amount of Budget-related overpayment written off	Average amount of Budget-related overpayment not covered by the write-off cap	Fiscal cost ($million)
Up to $20	2,250	15%	$10	1.4
Up to $30	600	4%	$15	2.1
Up to $40	300	2%	$13	2.7
Up to $50	180	1%	$11	3.4
Up to $60	70	0%	$9	4.1
Up to $70	10	0%	$4	4.7

71. If a write-off cap is implemented, we recommend that the amount be set at $30. This would incur a fiscal cost of around $2.1 million. Of this, approximately $350,000 is expected to fall in the current fiscal year, with the remaining $1.75 million occurring in the 2010/11 fiscal year. This approach would fully write off Budget-related Working for Families overpayments of around 96% of families in a debt situation, and who receive Budget overpayments. Budget-related overpayments not fully covered by the $30 would be reduced by $30. Although more families would be covered by a higher write-off cap amount, the marginal fiscal cost of doing this is high.

72. To apply a standard write-off amount requires changes to Inland Revenue's systems. The administrative costs would be approximately $50,000 for the 2010/11 fiscal year. A write-off cap of $30 would require a legislative amendment as part of Budget night legislation.

Other Working for Families Tax Credits

73. Officials do not recommend increasing the amounts of the other two Working for Families payments – the In-work Tax Credit and the Parental Tax Credit – at this time. These two payments are not designed to compensate for the prices of particular goods or the general costs of having children. Instead, the In-work Tax Credit is designed to make work pay and the Parental Tax Credit provides money to parents who would not otherwise qualify for Paid Parental Leave (the main mechanism for supporting parents with a child that has just been born) and who are not receiving a main benefit. Both these payments are legislatively subject to triennial review. Any changes to these payments can be considered under the auspices of these reviews.

74. Note that this compensation package assumes no change to the amount of the Transitional Circumstances Tax Credit as a result of any tax cuts in Budget 2010

Supplementary payments

75. We recommend that Ministers agree to the following compensatory increases to supplementary assistance (see paragraphs 25-44 for an explanation of the reasons for these payments):

	2010/11	2011/12	2012/13	2013/14
Increase Disability Allowance, Child Disability Allowance and Childcare Assistance rates by 2.02% from 1 October 2010 to 31 March 2011	$6m			
Increase supplementary assistance by 2.02% on 1 April 2011	$3m	$14m	$15m	$15m

Numbers have been rounded to the nearest $1m

Other payments

Government Superannuation Fund and National Provident Fund

76. Increasing the rate of GST will also have flow-on consequences to payment amounts of the Government Superannuation Fund (GSF) and National Provident Fund (NPF). Under the recently passed Government Superannuation Fund Act 2008, the Government agreed that all GSF and NPF annuitants' benefits should be treated consistently with regard to annual cost of living adjustments and that all benefits should be annually adjusted based on 100% of the changes in the Consumers Price Index. Our preliminary estimate is that the cost to the Crown of increasing these payments by around 2.02% in April 2011 would be in the order of $20m per annum from 2011/12.

77. Ministers may wish to consider bringing forward the date of this cost of living allowance adjustment forward to 1 October 2010. Our preliminary estimate is that this will increase costs by around $10 million in 2010/11. There may also be balance sheet consequences, which we will provide further advice on if needed. On the one hand, this would ensure that recipients of these payments receive a cost of living increase associated with the GST rise as soon as possible. On the other hand, this may be considered unfair by recipients of private pensions, who are unlikely to receive such favourable treatment from their pension providers.

78. If your preference is to bring forward these payments to 1 October 2010 we will need to check with the administrators of these funds on the practicality of increasing payments mid-year. We would also need to consult with the Government actuary to determine the exact costs to the Crown as Treasury does not hold this information.

Student Loans Living Cost Component

79. Ministers may wish to bring forward the CPI increase to the student loans living cost component from 1 April 2011 to 1 October 2010. This living cost component is the maximum amount that students entitled to a Student Loan can borrow to meet their living costs (currently $160.24 per week). In 2008 the previous administration agreed that the amount of living costs students can borrow should be adjusted by changes to the CPI.

80. Our preliminary estimate is that increasing these living cost amounts will cost around $20 million per annum from 2011/12. Indexing the Student Loans Living Cost Component is expected to have a negligible impact on the overall Student Loan impairment.

81. Bringing forward the date of this cost of living increase to 1 October 2010 would cost around $7 million in 2010/11. Bringing forward this increase would prevent recipients of these payments potentially being worse off for six months. However, this is a loan not an entitlement and there are broader issues with student support that cannot be resolved as part of this tax package. If you do wish to bring this payment forward we may need to consult with the Ministry of Education to determine more accurately the operating costs and any impact on the balance sheet.

Accident Compensation Corporation

82. People receiving weekly compensation from the ACC will benefit from reductions in income tax just like any other income earner, which will compensate them for any rise in GST (although as with income earners generally, we cannot guarantee this for all people in all circumstances). On that basis we are of the view that no other compensation for people receiving weekly compensation from the ACC is required.

Other payments and establishing a contingency

83. We have sought to identify all potential compensation issues in this paper. Because the tax-benefit interface is complex, it is difficult to provide complete surety that no-one will be adversely affected. In past major reforms, the Government has sought additional surety that if unintended consequences are identified, these can be remedied. For this reason we recommend that the Budget 2010 tax package include a compensation contingency fund of up to $10 million per annum.

84. Within the funding parameters of this contingency, officials recommend developing options for a payment mechanism that would be available from 1 October 2010 to ensure that low income individuals in receipt of welfare payments, who see an overall reduction in their net income as a result of the tax package, are compensated. A similar mechanism was implemented alongside Working for Families changes from 2004 to 2007. The transitional supplement programme paid to people who could demonstrate they were financially worse off as a result of the Working for Families changes was paid to no more than 100 people at any particular point in time.

Summary of total costs of compensation package

85. The following table summarises all the recommended compensation payments included in this paper. Note that it includes the flow-on increases to NZ Super and Veterans Pension as a result of the personal tax cuts modelled in this paper.

Compensation components	2010/11	2011/12	2012/13	2013/14
2.02% increase to main benefits	$75m	$105m	$105m	$105m
2.02% increase to Student Allowances	$7m	$10m	$10m	$10m
flow-on increase to NZ Super and Veterans Pension due to personal tax cuts	$140m	$235m	$265m	$275m
2.02% increase to NZ Super and Veterans Pensions from 1 October 2010	$80m	$75m	$65m	$60m
2.02% increase to Family Tax Credit and Minimum Family Tax Credit	$45m	$60m	$65m	$65m
Write-off of Family Tax Credit over-payments	$2m			
2.02% increase to Disability Allowance, Child Disability Allowance and Childcare Assistance from 1 October 2010 to 31 March 2010	$6m			
2.02% increase to supplementary benefits from 1 April 2011 through AGA	$3m	$14m	$15m	$15m
2.02% increase in cost of living increase for GSF and NPF from 1 April 2010	$5m	$20m	$20m	$20m
2.02% increase in Student Loan Cost of Living component from 1 April 2011	$8m	$20m	$20m	$20m
Compensation contingency fund	$10m	$10m	$10m	$10m
*Plus flow-on **savings** to supplementary assistance from 1 April 2011*	*($3m)*	*($13m)*	*($13m)*	*($13m)*
Total estimated compensation package costs	**$378m**	**$536m**	**$562m**	**$567m**

Table assumes compensation for main benefits, Student Allowances, NZ Super and Veterans Pension paid through a Ministerial Welfare Payment from 1 October 2010 to 31 March 2010. Numbers have been rounded to nearest $1m for smaller payments (below $20m) and to nearest $5m for larger payments.

Costings for GSF, NPF and Student Loan Cost of Living Components are particularly uncertain and exclude any balance sheet implications. These particular costings also assume that payments increase from 1 April 2011, not 1 October 2010 (costs of bringing GSF costs forward to 1 October 2010 are approximately $10m in 2010/11; costs of bringing Student Loan Living Cost Component costs forward to 1 October 2010 are approximately $7m in 2010/11).

Costings based on HYEFU 09 forecasts – final costings will be updated using BEFU 10 preliminary forecasts.

Annex: List of all benefits – including information on adjustment process

Table A to C show the benefits, allowances & assessment thresholds for which there is current legislation or Cabinet decisions to adjust from 1 April each year and are within the scope of the Annual General Adjustment (AGA). Table D identifies secondary support that is not adjusted as part of the AGA.

Table A

CORE PAYMENTS	
NZ Superannuation	Veteran's Pension
Unemployment Benefit	Sickness Benefit
Independent Youth Benefit	Grandparented Sickness Benefit
Invalids Benefit	Widows Benefit
Domestic Purposes Benefit-Sole Parent	Domestic Purposes Benefit –Care of Sick or Infirm
Domestic Purposes Benefit –Woman Alone	Orphans Benefit, Unsupported Childs Benefit & Foster Care Allowance board rates
Student Allowance Rates	Minimum Family Tax Credit
War Disablement Pension	

Table B

SUPPLEMENTARIES	
Child Disability Allowance	Training Incentive Allowance
Disability Allowance	Child Care Subsidy & OSCAR
Seasonal Work Assistance	New Employment Transition Grant
Civil Defence Scheme	Clothing Allowance
Funeral Grants (maximums)	Blind Subsidy
Payment on Death of a Veteran or Veteran's Spouse	Housekeeping Allowance
Personal Allowance for: • Older people receiving RCS • People with Psychiatric or Intellectual Disabilities • People with physical or sensory disabilities	Hospital rate
Student Loan Living Cost Component	Special Assistance to the Rural Sector
Special Disability Allowance	Social Rehabilitation Assistance
Income Support for Live Organ Donors	Home Help Payments
Early Learning Payment	

Table C

INCOME LIMITS & THRESHOLDS	
Income limits for Disability Allowance	Benefit Cut-out points
Income limits for: • Benefit Advances • Recoverable Assistance Payments • Special Needs Grants	Asset limits for: • Special Benefit • Benefit Advances • Recoverable Assistance Payments • Special Needs Grants • Temporary Additional Support
Accommodation Supplement: • Entry thresholds • Non-beneficiary abatement thresholds	Special transfer Allowance – Average Regional Rental
Special Benefit Standard Costs	Temporary Additional Support – maximum limits for allowable costs for essential household items, car repayments and accommodation loading
Community Service Card Income Thresholds	Income Exemption – Home based care
Student Allowance Parental Income Thresholds	
Student Allowance Personal Income Thresholds	

Table D

SUPPORT THAT IS NOT ADJUSTED
• Accommodation Benefit maxima (last adjusted with effect from 1 January 2007) • Accommodation Supplement cash asset levels (last adjusted 1988) • Maximum regional rates of Accommodation Supplement (last adjusted 2005) • Away from Home Allowance • Emergency Benefit/Hardship Benefits cash asset levels (last adjusted 1991) • Participation Allowance • Transition to Work Grant • Hardship assistance guideline limits (e.g. 6-monthly limit for food special needs grants)