POLICY ADVICE DIVISION

Tax policy report: Cabinet Paper – Tax reform package for Budget 2010

Date:	8 April 2010	**Priority:**	Critical
Security Level:		**Report No:**	T2010/503 PAD2010/55

Action sought

	Action Sought	Deadline
Minister of Finance	**Sign** and **refer** the attached paper to the Cabinet Office	As soon as possible
Minister of Revenue	**Sign** and **refer** the attached paper to the Cabinet Office	As soon as possible

Contact for telephone discussion (if required)

Name	Position	Telephone	
David Carrigan	Policy Manager, Inland Revenue	[deleted- privacy]	[deleted - privacy]
Bill Moran	Manager, Tax Strategy, The Treasury	[deleted - privacy]	[deleted - privacy]

8 April 2010

Minister of Finance
Minister of Revenue

Cabinet Paper – Tax reform package for Budget 2010

Executive summary

The attached paper is for you to sign and refer to Cabinet to consider at its meeting on 12 April 2010. This paper needs to be referred to Cabinet Office as soon as possible.

The paper reflects your agreement to proposals discussed by the tax sub-group on Monday 29 March 2010. It includes the key changes recommended for inclusion in the tax reform package for Budget 2010.

It should be noted that the attached Cabinet paper recommends that changes to resident withholding tax (RWT) rates on interest to reflect the new personal tax rate structure should be made from 1 October 2010 – the same time as personal tax rates are changed. This is different to the advice in the report entitled *Personal tax rate reductions and an increase in the GST rate* (T2010/191; PAD2010/16 refers) which advised a 1 April 2011 start date for RWT changes. Officials now consider a 1 October 2010 start date is appropriate as the number of tax rate bands or thresholds at which each tax rate applies are not changing – making the systems changes easier for banks.

In addition, in the report discussing transitional measures (T2010/473; PAD2010/52) Inland Revenue recommended reducing provisional tax by a factor of 10% (last year basis) or 15% (year before last basis). This was in the context of all tax changes being effective from 1 October 2010. If the top personal tax rate is changed in two adjustments, officials recommend a smaller provisional tax adjustment (5% last year basis, or 10% year before last basis) in the 2010/11 year. The fiscal implications of agreeing to this basis for the two-step rate change scenario are (the difference between the revenues earned under the two-step rate change with no provisional tax adjustment, and the revenues earned under the two-step rate change with the provisional tax adjustment as recommended by officials):

$ million	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**
Provisional tax reduction	-	(5)	(10)	20	(5)

Also, on 31 March 2010, the Cabinet Economic Growth and Infrastructure Committee (EGI) recommended that Cabinet agree to increase the excise and excise-equivalent duties on all tobacco products (EGI Min (10) 6/7 refers). In addition, EGI recommended that Cabinet direct officials to assess the desirability of excluding the price impact of tobacco excise increases from CPI-based adjustments for New Zealand Superannuation, benefits, and Working for Families tax credits. This Cabinet paper includes recommendations to exclude the price impact of tobacco excise increases from the above payments as well as student allowance entitlements.

Recommended action

We recommend that you:

- **Agree** that RWT rates on interest be changed from 1 October 2010 to align with the proposed personal tax rate structure;

Agree/Not agree Agree/Not agree

- **Sign** and refer the attached paper to the Cabinet Office as soon as possible.

Signed and referred Signed and referred

Bill Moran
Manager, Tax Strategy
for Secretary to the Treasury

David Carrigan
Policy Manager
Inland Revenue

Hon Bill English
Minister of Finance

Hon Peter Dunne
Minister of Revenue

OFFICE OF THE MINISTER OF FINANCE
OFFICE OF THE MINISTER OF REVENUE

The Chair
CABINET

TAX REFORM PACKAGE FOR BUDGET 2010

PROPOSALS

1. We seek the agreement of Cabinet to a tax reform package to be included in Budget 2010.

2. The following <u>key</u> changes are recommended for inclusion in this tax reform package:

Change in the tax mix: increase in GST and new personal tax rate structure

- The rate of GST to be increased to 15% (from 1 October 2010).
- Personal income tax rates (at existing income thresholds) to be either:
  – reduced to 10.5%, 17.5%, 30% and 33% from 1 October 2010; or
  – reduced initially to 10.5%, 17.5%, 30% and 36% from 1 October 2010, with the top personal rate reducing further to 33% on 1 April 2011.

Compensation measures for a rise in GST

- A Ministerial Welfare Programme to be established that provides immediate compensation from 1 October 2010 to 31 March 2011 equivalent to a 2.02% increase for main working age benefits, student allowances, New Zealand Superannuation and Veterans Pensions.
- Working for Families (Family Tax Credit and Minimum Family Tax Credit), the main important forms of supplementary assistance (except Accommodation Support and Student Loan Living Costs), and the Government Superannuation Fund (GSF) and National Provident Fund (NPF) annuities which are subject to CPI adjustments, also be increased by 2.02% from 1 October 2010.
- A 'GST Compensation Contingency' of $10 million per annum to be established to deal with any other compensation matters directly related to the Budget 2010 tax reforms, and in particular where beneficiaries, New Zealand Superannuitants or low income earners would not be adequately compensated for the GST increase.
- The price impact of tobacco excise increases to be excluded from CPI-based adjustments for various benefits and entitlements.

Relief for companies, portfolio investment entities and other savings vehicles

- The company tax rate to be reduced to 28% (from the 2011/12 income year).
- The top Portfolio Investment Entity (PIE) tax rate and the tax rate for savings vehicles such as superannuation funds to be reduced to 28% (from 1 October 2010 for PIEs that

pay tax at investors' marginal tax rates and from the 2011/12 income year for other savings vehicles).

- The lower PIE rates to be reduced to match the lower personal tax rates from 1 October 2010.
- A two year transitional period to be introduced during which pre-existing imputation credits can be attached to dividends at the current maximum 30:70 imputation ratio.
- Provisional tax to be reduced for taxpayers who pay provisional tax on the earlier year basis, to reflect reductions in the personal income tax rates and the company tax rate.

Base-broadening and integrity measures

- Tax depreciation to be set to 0% for all buildings with an estimated useful life of 50 years or more (from the 2011/12 income year).
- The 20% depreciation loading to be removed on new assets (from the current income year for purchases made after Budget day).
- The 75% safe harbour in the inbound thin capitalisation (interest allocation) rules applying to the New Zealand operations of foreign multinationals to be reduced to 60% (from the 2011/12 income year).
- The replacement of the current qualifying company and loss attributing qualifying companies (LAQCs) rules with full flow-through treatment for income tax purposes (similar to the rules currently applying to limited partnerships) from 1 April 2011 through legislation introduced in late 2010, and announcement of this change as part of Budget 2010.
- The cost of a depreciable asset to be reduced by an amount that is funded by a capital contribution, so that taxpayers are not able to claim depreciation for costs that they have not in fact incurred (from the current income year for contributions made after Budget day).
- GST base changes, including measures addressing certain risks to the tax base such as phoenix scheme fraud, to be introduced from 1 April 2011, and announcement of this change as part of Budget 2010.
- Indexation of the Working for Families (WFF) tax credits abatement threshold to be removed (from the date of enactment).
- Changes to be introduced to prevent people offsetting investment losses (such as losses from rental properties) from their taxable income for the purposes of increasing their Working for Families entitlements (from 1 April 2011).
- Integrity concerns in relation to eligibility or abatement of social assistance programmes, including trust distributions, income from non-locked PIEs, income from non-resident spouses and fringe benefits, be addressed with effect from 1 April 2011. Officials will report back to the Minister of Finance, the Minister of Revenue, and the Minister for Social Development and Employment after the Budget on the precise legal mechanisms to achieve this.
- The redundancy tax credit to be removed (from 1 October 2010).
- Additional funding to be provided to Inland Revenue for compliance and enforcement purposes.

EXECUTIVE SUMMARY

3. The principal aim of taxation is to raise the revenue necessary to fund government expenditure at least economic cost. Making changes to the tax mix to tax less growth-damaging bases, reducing income tax rates and removing significant tax preferences, all assist in attaining this goal.

4. The overall objectives of Budget 2010 tax reform are to:

- achieve a step up in economic growth by improving incentives to work, save and invest;
- improve the fairness, coherence and integrity of the tax system by reducing opportunities to avoid tax (and/or unduly gain access to social assistance); and
- have a tax system that supports New Zealand's competitiveness globally in a sustainable manner.

5. This paper seeks decisions on a tax package based on the above proposals. In particular, it seeks decisions on a new personal income tax rate structure, increasing GST and reducing the tax rate for companies and various savings vehicles from 30% to 28%. There are two options for initial implementation of the planned reduction in the personal income tax rates – to reduce all personal income tax rates on 1 October 2010, or alternatively, to reduce the bottom three rates on 1 October 2010 whilst phasing in the reduction to the top personal tax rate on 1 October 2010 and 1 April 2011.

BACKGROUND

6. The current fundamental features of the New Zealand tax system were designed in the 1980s. Since that time various individual changes have been introduced in order to deal with taxation and social policy issues that have arisen over time. Some of these changes, whilst necessary or desirable in their own right, have undermined the overall integrity and coherence of the tax system.

7. This has led to various calls for significant tax reform to be considered. Most recently, potential tax reform issues have been extensively considered by the Tax Working Group (TWG). This Group, established by Victoria University of Wellington in conjunction with Treasury and Inland Revenue, set out its findings in a report entitled *A Tax System for New Zealand's Future.*

8. It is generally felt that retaining the current tax system will, over time, further exacerbate erosion in the efficiency, coherence, integrity and fairness of the tax system, raising significant sustainability risks. Without tax reform, therefore, it is unlikely New Zealand will be able to continue to deliver a tax system that is fair and supportive of economic growth.

9. The tax reform package proposed in this paper has been informed by the work of the TWG and has been developed within a framework consistent with decisions made on the Cabinet paper *Options for tax reform in Budget 2010* (Cabinet Minute (10) 3/2 refers).

COMMENT

Broader economic priorities

10. Tax is one of the Government's six key drivers of economic growth. The principal aim of taxation is to raise the revenue necessary to fund government expenditure at least economic cost. Making changes to the tax mix to tax less growth-damaging bases, reducing income tax rates and removing significant tax preferences, all assist in attaining this goal.

11. The overall objectives of Budget 2010 tax reform are to:

- achieve a step up in economic growth by improving incentives to work, save and invest;
- improve the fairness, coherence and integrity of the tax system by reducing opportunities to avoid tax (and/or unduly gain access to social assistance); and
- have a tax system that supports New Zealand's competitiveness globally in a sustainable manner.

12. Tax policy is one pervasive instrument available to the Government that has the ability to support a step up in economic growth by improving incentives to work, save and invest. We need a tax system that helps us shift away from borrowing and consumption towards saving and productive investment.

13. Personal taxes affect incentives to work and upskill. They also affect the decision to stay and work in New Zealand or work abroad, and the incentives for skilled foreigners to come to New Zealand. Given our highly mobile and skilled labour force, their importance to New Zealand's longer term growth path, and the need to compete internationally for skilled labour, reducing personal tax rates are important for growth.

14. Around 17% of skilled New Zealanders now live abroad, the third highest percentage in the OECD after Ireland and Luxembourg.[1] A more competitive tax structure will help New Zealand maintain its tax base, enhancing our skills and knowledge bases (and therefore productivity potential), and more generally, maintain or improve our living standards.

15. In addition, company tax rates have been declining globally. A reduced company tax rate will make it more attractive for businesses to locate and invest in New Zealand. Avoiding tax preferences (such as on housing) will encourage investment to flow to its most productive uses.

The Proposed Package

16. The cornerstone of the tax reform package proposed in this paper is a shift in the balance of government tax revenues from income taxes to GST. This shift is expected to increase the growth potential of the New Zealand economy by improving the overall efficiency of the tax system.

17. However, increasing consumption taxes and lowering income taxes raises concerns about fairness. The proposed tax reform package therefore contains measures to compensate vulnerable individuals for the increase in GST as well as across the board reductions in personal income tax rates.

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[1] *A profile of immigrant populations in the 21st Century*: Data from OECD countries, OECD, 2008.

18. In addition, there is evidence that the current tax system creates coherence and integrity problems through the application of different tax rates and diverse tax rules to different forms of income and different types of business entity. In particular, the current tax system can effectively subsidise investment in the non-tradables sector by providing tax preferences in respect of housing. This means it creates unintended biases against investment in areas where we must be internationally competitive if we are going to achieve our goal of sustainable growth.

19. There are also widespread concerns about some households structuring their affairs to minimise their taxable income to increase their eligibility for social assistance programmes. As a consequence some households receive more WFF tax credits than they would in the absence of these arrangements and beyond what their true economic circumstances justify. This has a fiscal cost and reduces equity because families in similar economic circumstances are treated differently. It also undermines confidence in the tax system. Changes will be made to prevent the minimisation of taxable income through the inclusion of investment losses from property investments and potentially the exclusion of trust payments, fringe benefit payments, and portfolio investment entity (PIE) distributions, in particular from non locked-in PIEs.

20. A key goal in the formulation of the Budget 2010 tax reform package is that it should be broadly revenue neutral and consistent with the fiscal strategy. Therefore, developing a sustainable tax package means that other base-broadening measures are required to fund the personal tax rate reductions and other compensatory measures. Base-broadening can be efficiency enhancing in its own right to the extent that it brings taxation of particular activities more in line with their underlying economic returns. To the extent possible, this approach has been adopted – for example, measures to increase taxation of income from property, through reductions in depreciation, are intended to reduce existing tax preferences and improve the allocation of investment capital.

21. Two of the most significant base broadening measures proposed are the removal of building depreciation and the removal of depreciation loading. It is proposed that depreciation provisions on existing buildings not be grandfathered. While grandfathering existing assets for new depreciation changes has been common past practice, this would tend to lock current property owners into holding onto their properties and also reduce revenue available to fund personal income tax rate reductions. It is proposed, on the other hand, to grandfather depreciation loading. Loading was provided as an explicit incentive to encourage investment in plant and equipment and removing this after taxpayers had invested could be seen as unfair – also, it would only provide a temporary revenue gain for the government but would impose a very high short-term cost on businesses.

A lower tax rate for companies and savings vehicles

22. The GST-personal tax switch sees significant personal tax rate cuts that encourage a shift from consumption to saving. However, the personal tax rate reductions are funded in part by base-broadening measures that apply to property and business. In broad terms, the package increases GST and taxes on property and businesses to fund the reductions in personal taxes.

23. These base-broadening measures support broader economic policy goals, including helping address investment imbalances in the economy. However, in the absence of further steps they do markedly increase the burden on business. Therefore a reduction in the company tax rate to 28% is proposed, as:

- high corporate rates discourage investment and productivity improvements.

- economies are increasingly open and average tax rates can influence global investment decisions; statutory tax rates can influence where profits are declared, and statutory company tax rates have been declining globally.
- a tax reform package that increased the tax burden on business without partially offsetting tax rate reductions would not be consistent with the Budget theme of savings, investment and growth.

24. A lower company tax rate will also reduce the tax rates on "economic rents" (i.e. returns over and above those required to induce investment in New Zealand) and to that extent can provide a windfall to those investing in New Zealand. However as the thin capitalisation changes only affect foreign investors and by themselves fund over half the cost of the reduction in company tax rates, and foreign investors also bear a significant share of the other base broadening measures, overall the package does not unduly favour foreign investors. On balance we consider the benefits of cutting the company tax rate outweigh the costs.

25. In addition, the tax rate for a number of other savings vehicles, including the top tax rate for PIEs, superannuation funds and life insurance policyholder income, is currently aligned with the company tax rate. It is proposed to continue this approach, therefore the tax rate for affected savings vehicles will also reduce to 28%. Although there are arguments for considering increasing taxes on these entities to match the top personal tax rate, on balance we prefer to maintain the current policy choice of aligning these rates with the company tax rate.

Distributional analysis

26. The distributional analysis that follows shows the effect of the personal income tax and GST switch on:

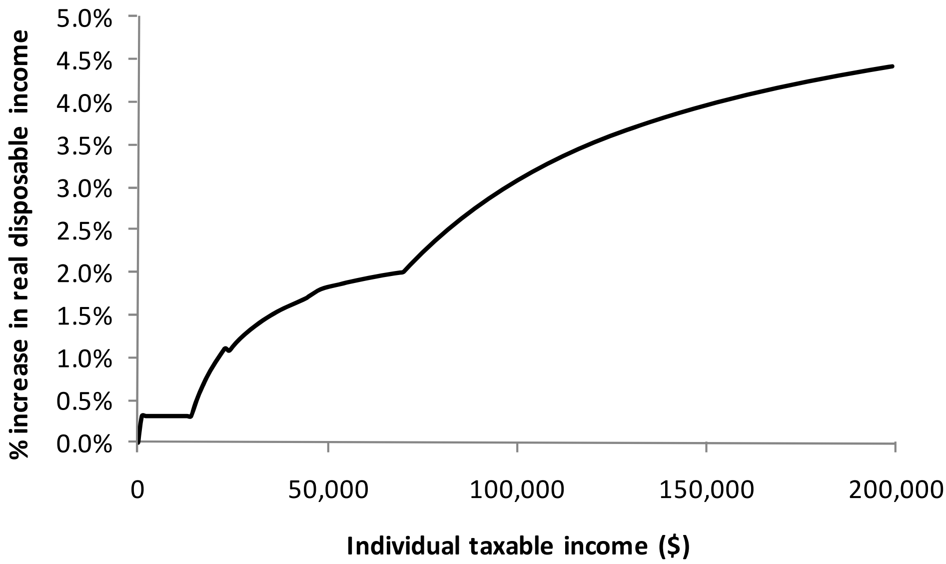
a. individuals' real disposable income derived from earned taxable income; and
b. households' real disposable income derived from total income.[2]

27. The personal income tax reductions proposed are larger than required to simply offset the GST increase to 15% for income earned from taxable sources (assuming taxpayers spend the typical fraction of their after tax income on consumption that is subject to GST[3] – namely 91%). In other words, these individuals who earn their income through taxable sources will be able to afford to pay the extra GST and have money left over.

28. Figure 1 uses a mechanical calculation to illustrate the distribution of the gains, and incorporates the effect of the proposed personal income tax scale (10.5%/17.5%/30%/33%), the ACC levy, and the Independent Earner Tax Credit.

[2] Total income includes taxable and non-taxable income, excluding Working For Families tax credits (although WFF tax credits are included in the calculation of disposable income)
[3] Also assumes retailers pass through the full amount of the GST increase to goods and services that attract GST

Figure 1: Increase in real disposable income for taxable income earners with new GST and personal income tax rates

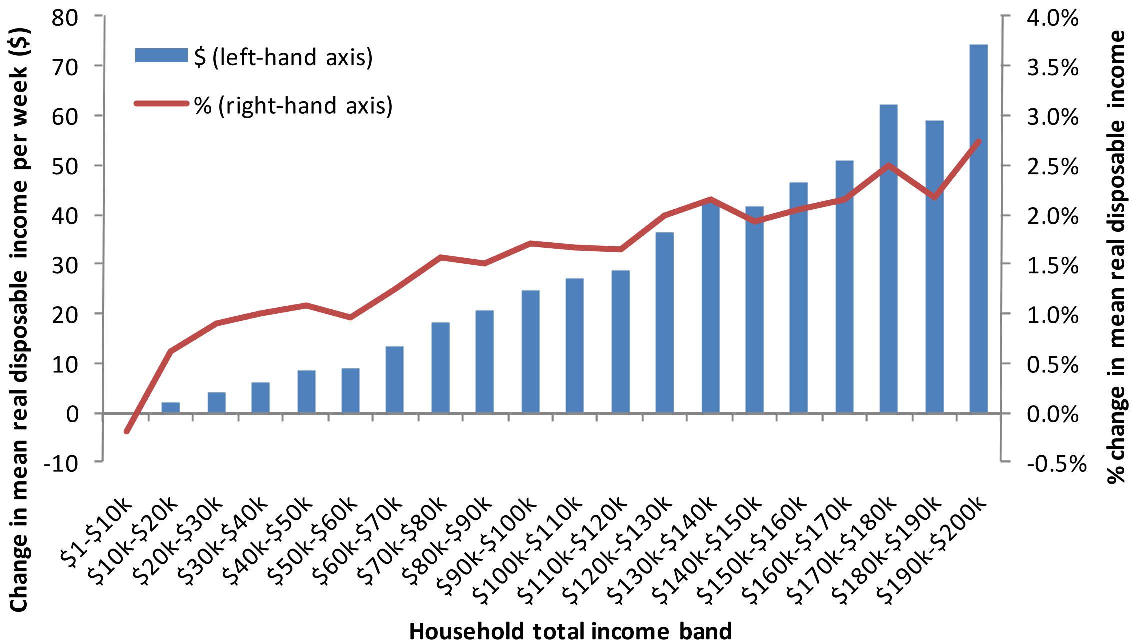


29. However, we cannot guarantee that all people in all circumstances will be better off. Where people are spending significantly more than they are earning, or where a large proportion of their total income is derived from non-taxable sources, an increase in GST may leave them worse off, at least in the short term. For example, any person receiving trustee income (taxed at the 33% trust tax rate) will not benefit from a tax reduction on that income as 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. It is also worth noting that a superannuitant couple receiving New Zealand Superannuation could receive just over $30,250 of uncompensated non-taxable income before they experience a decline in real disposable income.

30. Figure 2 below shows the impact of the GST-income tax switch on households (based on Treasury modelling using Household Economic Survey data – representing the New Zealand population). 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[4]. The proposals also include a compensation contingency fund which can be used to ensure that beneficiaries, New Zealand Superannuitants or low income earners who see an overall reduction in their net income from 1 October 2010 as a result of the tax package are adequately compensated.

[4] 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). A more complete analysis would be expected to show a smaller reduction, if a reduction at all.

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



31. This analysis only examines the income tax-GST swap. Many of the base-broadening measures will disproportionately affect higher income households, flattening the above distribution profiles somewhat. Data limitations mean it is not possible to provide a definitive integrated account of the likely distributional impact on households of the proposed base broadening measures in combination with the personal income tax and GST changes. However, the available data regarding the distribution of property and receipt of dividend and trust income, suggests that the base broadening measures will primarily impact on high income households.

32. The application date for the full implementation of the proposed personal income tax rates has not yet been decided. There are two main options, with either:

(i) rates to be reduced to 10.5%, 17.5%, 30% and **33%**, from 1 October 2010; or

(ii) rates to be reduced initially to 10.5%, 17.5%, 30% and **36%** from 1 October 2010, with the top personal rate reducing further to **33%** on 1 April 2011.

33. The fiscal implications of both of these options are set out later in this paper.

34. It would be very complex to change statutory tax rates mid-year, so a 1 October 2010 change would be effected by having a blended personal tax rate apply for the 2010/11 income year, with PAYE and RWT rates being changed on 1 October 2010. This is largely how the 1 October 2008 personal tax rate changes were implemented.

Tobacco

35. On 31 March 2010, Cabinet Economic Growth and Infrastructure (EGI) Committee agreed to increase excise and excise-equivalent duties on tobacco in three steps between now and 2012. The Committee also directed officials to assess the desirability of excluding the price impact of tobacco

excise increases from CPI-based adjustments for New Zealand Superannuation (NZS), benefits, student allowances and Working for Families tax credits, and report back to Cabinet Social Policy (SOC) Committee by 30 September 2010*, or in time for amendments to be included in Budget day legislation if requested by Budget Ministers*.

36. The estimated revenues from the agreed changes to tobacco excise, and estimated savings associated with not increasing New Zealand Superannuation and main benefits for the impact of the agreed tobacco excise increases are identified in the *Fiscal Implications* section below.

Ministry of Social Development Comment

37. The Ministry of Social Development supports the objective of the increase in tobacco excise of encouraging people to quit or not to start smoking, but notes that there are several potential unintended consequences of removing the price impact of tobacco excise increases. In particular:

- it may be perceived as running counter to the intent of the Future Focus and manifesto commitments to provide certainty by legislating for CPI adjustments of main benefits, and would require changes to the Future Focus Bill at Committee of the House stage; and

- it may increase pressure for excluding other costs from the CPI used to increase benefits and superannuation (for example alcohol, gambling, international air travel), and to use different weightings for other products for people on low incomes (for example, people receiving main benefits tend to spend a greater proportion of their income on accommodation and power bills).

38. The Ministry prefers further work on this matter, with a report back after Budget 2010 but in time for legislative amendments to be introduced prior to the 1 April 2011 Annual General Adjustment of social assistance rates and thresholds.

CONSULTATION

39. Inland Revenue, the Ministry of Social Development, and the Treasury were consulted in the preparation of this paper.

40. Due to the need for Budget secrecy, and the short timeframes involved in developing a tax reform package for Budget 2010, the ability to consult in the usual manner has been severely constrained. However, many of the key tax reform issues noted in this paper have already been considered by officials and the TWG in its review of the key medium-term tax policy challenges facing New Zealand. Accordingly, many of the reform options considered have been in the public domain for some time, with the ability for the public to comment thereon. In addition, a limited amount of external pre-Budget confidential consultation has been undertaken by officials with a small number of key stakeholders. This consultation was conducted in relation to a number of specific technical issues only (for example, legislative issues in relation to a potential transition to an increase in the rate of GST, specific depreciation issues, and in respect of GST base changes).

41. Officials have also listened to, but not actively consulted on, specific concerns raised by interested groups in respect of their expectations of what the tax reform may entail; and of the impact of the expected changes on that group. Some other implementation decisions have been deferred until after the Budget so that detailed consultation can occur. Examples of this include Working for Families integrity issues and implementation of the flow-through regime with respect to LAQCs. This consultation will form part of post-Budget reviews on these issues.

FINANCIAL IMPLICATIONS

Fiscal costs

42. The table below represents the net operating balance impact of the package where personal income tax rates are reduced to 10.5%, 17.5%, 30% and **33%**, from 1 October 2010.

$ million	Increase (decrease) in operating balance*				
	2010/11	**2011/12**	**2012/13**	**2013/14**	**4yr total**
Personal Tax (10.5, 17.5, 30, 33)	(2,455)	(3,685)	(3,935)	(4,255)	(14,330)
Net NZS compensation	(255)	(360)	(385)	(390)	(1,390)
Net main benefits compensation	(75)	(100)	(100)	(105)	(380)
WFF compensation	(45)	(65)	(65)	(65)	(240)
Other compensation	(45)	(60)	(60)	(60)	(225)
Company tax cut to 28%	(20)	(340)	(450)	(305)	(1,115)
PIES & savings vehicles capped at 28%	(15)	(40)	(55)	(60)	(170)
Inland revenue admin costs	(10)	-	-	-	(10)
GST (including clawback)	2,040	2,840	2,985	3,160	11,025
WFF de-indexation	-	15	50	40	105
WFF Integrity Measures	5	25	25	25	80
Building Depreciation (all > 50yrs)	-	685	685	690	2,060
Depreciation Loading (grandfathered)	135	245	310	345	1,035
LAQCs (incl. remission loophole)	-	70	65	55	190
Thin Capitalisation 60%	-	200	200	200	600
Depreciation - capital contributions	5	5	5	10	25
GST maintenance	15	60	60	60	195
Tobacco excise[1]	130	160	170	150	610
Tobacco excise - remove CPI flow-through[2]	5	20	40	40	105
Audit and compliance activity (incl. admin)	120	210	210	205	745
Sub-total of estimated static impact	**(465)**	**(115)**	**(245)**	**(260)**	**(1,085)**
adjustment for macroeconomic effects	5	25	205	435	670
Impact on operating balance	**(460)**	**(90)**	**(40)**	**175**	**(415)**

*all figures rounded to nearest $5m.

1 Tobacco excise policy as agreed per EGI Min (10) 6/7.

2 Policy to exclude tobacco excise increase-induced CPI flow-through to welfare assistance as per paragraphs 35 and 36.

43. The table below represents the net operating balance impact of the package where personal income tax rates are reduced initially to 10.5%, 17.5%, 30% and **36%** from 1 October 2010, with the top personal rate reducing further to **33%** on 1 April 2011.

$ million	Increase (decrease) in operating balance				
	2010/11	**2011/12**	**2012/13**	**2013/14**	**4-yr total**
Impact of base package	(460)	(90)	(40)	175	(415)
savings from phasing top rate reduction[1]	280	(30)	(40)	-	210
Impact on operating balance	**(180)**	**(120)**	**(80)**	**175**	**(205)**

*all figures rounded to nearest $5m

1 includes provisional tax adjustment

44. Cabinet previously agreed that the tax package for Budget 2010 should be broadly revenue neutral, consistent with the Government's fiscal strategy (Cabinet Minute (10) 3/2 refers). Both the tax package options presented in paragraphs 42 and 43 are consistent with Cabinet's intention because they have a positive impact on the operating balance in the final year of the forecast period, and a preliminary assessment of the impact over the projection period to 2023/24 indicates that net debt is not materially different from the net debt position without the proposed tax packages. The negative impact in the first three years of the forecast period is only a transitional effect – largely due to the time required for the revenue to accrue for some of the base broadening measures.

ADMINISTRATIVE IMPLICATIONS

Inland Revenue

45. There are administrative implications for Inland Revenue from undertaking additional audit and compliance activity and debt collection. The additional funding of $200 million over seven years for audit and compliance activity and debt collection is expected to result in additional revenue and reduced expenses of $1.4 billion over the same period.

46. In addition, Inland Revenue faces further administrative costs from implementing the other initiatives included as part of the Budget 2010 tax package. The table below summarises the administrative impact for Inland Revenue of implementing the Budget 2010 tax package, including additional audit activity and debt collection. These administrative costs are incorporated into the total impact of the tax package in paragraphs 42 and 43, and exclude the costs of a communication campaign as the funding for this will be sought separately (see below).

	$m - increase/(decrease)							
	2009/10	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17& Outyears**
Additional audit and compliance activity and debt collections	-	26.580	31.318	32.560	32.560	25.916	25.916	26.661
Other Inland Revenue implementation costs	-	8.185	0.646	0.265	0.014	-	-	-
Total Inland Revenue Administrative Costs	**-**	**34.765**	**31.964**	**32.825**	**32.574**	**25.916**	**25.916**	**26.661**

Communication costs

47. This paper seeks to establish a contingency of $3.3 million to cover the costs of communicating the October 2010 and April 2011 tax changes. Inland Revenue and Treasury will report to the Ministers in June 2010 with recommendations on the preferred options and more refined costs. Once the preferred approach is agreed, the required funding will be requested.

Ministry of Social Development

48. There are administrative implications for the Ministry of Social Development associated with implementing the Budget 2010 tax package, including IT changes to the major payment mechanisms and operational costs for Work and Income New Zealand. These costs are estimated to be approximately $1.2 million in 2010/11. Where possible, the Ministry will look to absorb these

costs into existing baselines, but where further funding is required it can be met by the *GST Compensation Contingency*, which this paper seeks to establish.

HUMAN RIGHTS IMPLICATIONS

49. The tax package, as is the case with the current tax system, makes some distinctions between groups of people on grounds prohibited under the New Zealand Bill of Rights Act 1990. For example:

- Personal tax cuts distinguish on the grounds of employment status because they are applied to earned income, and to the rates of New Zealand Superannuation, but not to main benefits or student allowances.
- The compensation payment distinguishes on the grounds of employment status as it is only payable to certain beneficiaries.

50. At this stage officials consider that these distinctions are justifiable, and will provide further advice when Cabinet considers Budget day legislation to enact the proposals in this paper.

LEGISLATIVE IMPLICATIONS

51. Most legislative changes arising from the tax reform package for Budget 2010 will be introduced in a Bill on Budget day and subsequently enacted under urgency.

52. Changes to appropriations in Votes Social Development, Revenue, Finance, Veterans' Affairs-Social Development, and Veterans' Affairs-Defence Force will be made in the 2010/11 Estimates, and any expenses in relation to these before the Estimates are enacted will be met from Imprest Supply.

53. There will be a post-Budget review for the purposes of removing integrity concerns relating to social assistance programmes. There will also be a post-Budget review to establish the legal mechanisms to implement the flow-through regime for LAQCs and certain GST base maintenance changes. Following these reviews, changes to remove integrity concerns relating to social assistance programmes, a flow-through regime for LAQCs, and the GST base maintenance changes will be included in a Bill to be introduced later in 2010, and to have effect from 1 April 2011.

54. Regulatory change may be required in respect of a number of compensation measures. This paper seeks to authorise the Minister for Social Development and Employment to issue drafting instructions to the Parliamentary Counsel Office in respect of these regulations.

REGULATORY IMPACT ANALYSIS

Regulatory Impact Analysis requirements

55. Regulatory Impact Analysis requirements apply to this paper. A Regulatory Impact Statement (RIS) is therefore attached to this paper.

Quality of the Impact Analysis

56. The Regulatory Impact Analysis Team has reviewed the RIS prepared by Treasury and Inland Revenue and considers that, given the Cabinet agreed parameters for the Budget 2010 tax policy process, the information and analysis summarised in the RIS meets the quality assurance criteria.

Consistency with Government Statement on Regulation

57. We have carefully considered the analysis and advice of our officials, as summarised in the attached RIS. We are satisfied that this tax reform package for Budget 2010 is necessary and desirable in the long-term public interest, and that regulation is necessary to enable this reform.

58. This tax reform package for Budget 2010 is also substantially consistent with the Government's commitment to deliver better and less regulation.

OTHER IMPLICATIONS

59. There are no gender or disability implications.

PUBLICITY

60. Budget day is 20 May 2010. The Offices of the Minister of Finance and the Minister of Revenue will coordinate all communications relating to the tax reform package for Budget 2010. After Budget day, Inland Revenue will provide more detailed public information in the lead up to the 1 October 2010 and 1 April 2011 changes to advise affected taxpayers of the changes and their new obligations.

RECOMMENDATIONS

61. We recommend that Cabinet:

1. **Agree** that the overall objectives of tax reform in the 2010 Budget are to:

    - achieve a step up in economic growth by improving incentives to work, save and invest;
    - improve the fairness, coherence and integrity of the tax system by reducing opportunities to avoid tax (and/or unduly gain access to social assistance); and
    - have a tax system that supports New Zealand's competitiveness globally in a sustainable manner.

2. **Agree** that in order to achieve these objectives, changes need to be made to the tax mix to tax less growth-damaging bases, reduce personal income and corporate tax rates and remove significant tax preferences.

Change in the tax mix: increase in GST and reduction in personal income tax rates

3. **Agree** that the rate of GST be increased to 15% from 1 October 2010.

4. **Note** that the current income thresholds applying to personal income tax rates will not change.

5. **Note** that there are two options for initial implementation of the planned reduction in the personal income tax rates – to reduce all personal income tax rates at 1 October 2010, or alternatively, to introduce the reductions to the bottom three rates on 1 October 2010 whilst phasing in the reduction to the top personal tax rate on 1 October 2010 and 1 April 2011. The fiscal implications of each of these options, in conjunction with the base broadening and compensating measures discussed below, are set out in later recommendations.

Compensation measures for a rise in GST

Ministerial Welfare Programme

6. **Agree** that recipients of the following payments receive a special time-limited payment equivalent to 2.02% of the after tax weekly base rate of that payment from 1 October 2010 to 31 March 2011 by way of a Ministerial Welfare Programme under section 124(1)(d) of the Social Security Act, 1964:

    - Unemployment Benefit and related benefits, Sickness Benefit, Invalids Benefit, Domestic Purposes Benefits, Independent Youth Benefit, Orphans Benefit, Unsupported Child Benefit and Widow's Benefit;
    - Student Allowances;
    - New Zealand Superannuation and Veterans Pensions.

7. **Invite** the Minister for Social Development and Employment to establish a welfare programme under section 124(1)(d) of the Social Security Act to give effect to the recommendations in this paper relating to the compensation payment.

8. **Invite** the Minister for Social Development and Employment to propose regulations to exempt the compensation payment in recommendations 6 and 7 from a person's income for the purposes of the Social Security Act 1964, the Social Security (Long-term Residential Care) Regulations 2005 and the Social Security (Temporary Additional Support) Regulations 2005.

Government Superannuation Fund and National Provident Fund

9. **Agree** that recipients of Government Superannuation Fund and National Provident Fund annuities which are subject to an annual CPI adjustment receive a 2.02% increase in payments from 1 October 2010 to 27 April 2011, after which time the automatic inflation adjustment will occur.

Student Allowances and Student Loans

10. **Note** that because Student Allowances are legislatively set on a gross basis, across the board tax cuts would, without further action, increase the rates of these payments further to recommendation 6 and put them out of line with the Unemployment Benefit.

11. **Agree** to change regulations to prevent tax cuts flowing-on to Student Allowances.

12. **Note** that the maximum entitlement to Student Loan living costs will be automatically increased on 1 April 2011 based on the CPI increase for the year ending 31 December 2010.

13. **Note** that increasing GST is expected to result in increased Student Loan borrowings and subsequent write-downs of the Student Loans scheme.

Supplementary Assistance

14. **Agree** to increase the Disability Allowance, Child Disability Allowance, Childcare Assistance and Foster Care Allowance board rates by 2.02% from 1 October 2010 to 31 March 2011.

15. **Agree** that the increase in Foster Care Allowances in recommendation 14 above will be subsequently reversed in the next CPI adjustment of this allowance so as not to double compensate.

Working for Families

16. **Agree** to increase the amount of the Family Tax Credit and the Minimum Family Tax Credit by 2.02% from 1 October 2010.

17. **Agree** that the increase in recommendation 16 above be reversed in the CPI adjustment of these credits that occur after 1 April 2011, so as not to double-compensate.

18. **Invite** the Minister for Social Development and Employment to develop a mechanism to ensure that the increases in the Family Tax Credit and Minimum Family Tax Credit in recommendation 16 above do not result in reductions in other forms of supplementary assistance during the period 1 October 2010 through 31 March 2011.

19. **Agree** to an automatic write-off of up to $30 per family receiving Working for Families tax credits for the 2010/11 tax year, which will ensure that 96% of Working for Families recipients, who will have received an overpayment as a result of the adjustment in recommendation 16 above, will not have to repay that overpayment.

Compensation Contingency

20. **Agree** that a "*GST Compensation Contingency*", of $10 million per annum be established as part of the Budget 2010 tax package to deal with any other issues directly related to compensation matters arising from the Budget 2010 tax reforms (including MSD administrative costs), and in particular where beneficiaries, New Zealand Superannuitants or low income earners would not be adequately compensated for the GST increase.

21. **Agree** to put in place a special payment mechanism to ensure that beneficiaries, New Zealand Superannuitants or low income earners who see an overall reduction in their net income from 1 October 2010 as a result of the tax package, can be compensated and that the cost of this be met from the *GST Compensation Contingency*.

22. **Agree** that if local authorities factor the GST-induced increase into the rates setting process for 2010/11, then the rates rebate scheme settings be adjusted accordingly to take account of the corresponding CPI movement, and that the cost of this be funded from the *GST Compensation Contingency.*

Tax rates for companies, portfolio investment entities (PIEs) and other savings vehicles

23. **Agree** that the company tax rate be reduced to 28% from the 2011/12 income year.

24. **Agree** that for PIEs that pay tax based on investors' marginal tax rates, the tax rates for PIEs be reduced to 10.5%, 17.5% and 28% from 1 October 2010.

25. **Agree** that for PIEs that pay tax at only one rate (currently 30%), the tax rate be changed to 28% from the 2011/12 income year.

26. **Agree** that the tax rate of other savings vehicles, including superannuation funds, life insurance policyholder income, and Category A Group Investment Funds be reduced to 28% from the 2011/12 income year.

Base-broadening and integrity measures

27. **Agree** that the safe harbour in the inbound interest allocation rules be reduced to 60% from the 2011/12 income year.

28. **Agree** to:

    (a) replace the current qualifying company and loss attributing qualifying companies rules with full flow-through treatment for income tax purposes (similar to the rules currently applying to limited partnerships), for income years commencing on or after 1 April 2011;

    AND

    (b) release an officials' paper for public consultation on the precise legal mechanism to implement these changes.

29. **Agree** that investment losses (including losses arising from residential rental properties) be excluded from the calculation of income for Working for Families tax credit purposes, from 1 April 2011.

30. **Agree** that:

    (a) integrity concerns in relation to eligibility or abatement of social assistance programmes, including trust distributions, income from non-locked PIEs, income from non-resident spouses and fringe benefits, be addressed with effect from 1 April 2011;

    AND

    (b) officials will report back to the Minister of Finance, the Minister of Revenue, and the Minister for Social Development and Employment after the Budget on the precise legal mechanisms to achieve this.

31. **Agree** to introduce legislation to remove the provision in the Income Tax Act requiring indexation of the abatement threshold for Working for Families tax credits, from the date of enactment.

32. **Agree** that the depreciation rate for all buildings with an expected useful life of 50 years or more be set to 0% from the 2011/12 income year.

33. **Agree** that the depreciation treatment of existing buildings should not be grandfathered.

34. **Agree** to remove the 20% depreciation loading on plant and equipment from the annual depreciation rate calculation with respect to assets purchased after 20 May 2010.

35. **Agree** that the depreciation treatment of assets already subject to the 20% depreciation loading should be grandfathered.

36. **Agree** to reduce the depreciation cost base to the extent that this base is funded through capital contributions made after 20 May 2010.

37. **Agree** that the redundancy tax credit be removed from 1 October 2010.

38. **Agree** that:

    (a) risks to the GST tax base arising from phoenix scheme fraud be removed with effect from 1 April 2011;

    AND

    (b) officials will report back to the Minister of Finance and the Minister of Revenue on the precise legal mechanisms for achieving this, and for addressing other GST base maintenance risks.

39. **Note** that on 31 March 2010 the Economic Growth and Infrastructure Committee agreed to increase the excise and excise-equivalent duties on all tobacco products (EGI Min (10) 6/7 refers).

40. **Agree** that Budget legislation to implement the Government's tax reform package include amendments to the New Zealand Superannuation and Retirement Income Act 2001, the Income Tax Act 2007, the War Pensions Act 1954 and other relevant Acts to exclude tobacco products from the Consumers Price Index measures applied to adjust New Zealand Superannuation, Veterans' Pension and Working For Families tax credit entitlements in 2011, 2012 and 2013.

41. **Agree** that a corresponding amendment to exclude tobacco products from inflation adjustment calculations will need to be made to the Social Assistance (Future Focus) Bill which is currently before the Social Services Select Committee.

42. **Note** that if recommendations 40 and 41 above are not agreed the fiscal cost of the package will increase.

Consequential changes to other parts of the tax system

Consequential company tax rate changes

43. **Agree** that a two year transitional period be introduced during which pre-existing imputation credits can be attached to dividends at the current maximum 30:70 imputation ratio.

Provisional tax

44. **Note** that provisional tax will be reduced as a result of the reductions in the personal tax rates and the company tax rate.

45. **Agree** that provisional tax be reduced for taxpayers who pay provisional tax on the earlier year basis from 1 October 2010 for individuals and the commencement of the 2011/12 year for companies, to reflect reductions in the personal income tax rates and the company tax rate.

Composite income tax rates

46. **Agree** that, as effective personal income tax rates will be reduced on 1 October 2010, composite income tax rates be adopted for the 2010/11 income year which would reflect a blended average of the 2009/10 income year rates and the 2011/12 income year rates. These composite rates will differ depending on whether the reduction to the top personal rate is fully implemented on 1 October 2010, or is instead phased in on 1 October 2010 and 1 April 2011.

PAYE rates

47. **Agree** that PAYE withholding rates are adjusted downwards from 1 October 2010 (and, if the phased top rate reduction is chosen, further on 1 April 2011).

Resident withholding tax (RWT) on interest

48. **Agree** that RWT rates will be adjusted downwards from 1 October 2010 (to align with the personal income tax rates being reduced from 1 October 2010), (and, if the phased top rate reduction is chosen, further on 1 April 2011).

Fringe benefit tax (FBT)

49. **Agree** that the rates and thresholds that apply for FBT calculations are adjusted to reflect the reduction in personal income tax rates.

50. **Agree** that composite FBT rates be used for the 2010/11 income year.

ACC attendant care

51. **Agree** to change the amount of tax withheld by ACC on attendant care payments from 1 October 2010 to reflect the new bottom personal income tax rate.

Maori authority tax rate (and certain other schedular payments)

52. **Note** that the Maori authority tax rate will continue to be 19.5% for the time being, and that officials will report back to the Minister of Finance and the Minister of Revenue later in 2010 with proposals on what the appropriate rates to apply to Maori authorities and certain other schedular payments should be under the new personal income tax rates.

Other consequential personal tax rate changes

53. **Agree** that secondary tax codes, employer superannuation contribution tax (ESCT), fund withdrawal tax, extra pay amounts and the retirement scheme contribution tax should reflect the new personal income tax rates.

54. **Agree** that the current amounts of child rebates and transitional tax credits should be preserved.

Other consequential changes

55. **Agree** to include, in legislation to be introduced on Budget day, amendments to the Tax Acts and other relevant Acts in respect of the changes set out in recommendations 3, 16, 19, 23-27, 29, 31-37, 40, 43-51, 53 and 54.

56. **Agree** to include, in legislation to be introduced later in 2010, amendments to the Tax Acts in respect of the changes set out in recommendations 28, 30 and 38, and to announce as part of Budget 2010 the Government's intention to include these amendments in future legislation.

57. **Agree** to include, in the legislation to be introduced at the time of the Budget and the legislation to be introduced later in 2010, other amendments to the Tax Acts of a mechanical and consequential nature that are necessary to reflect the changes being implemented by the tax reform package for Budget 2010.

Administration issues

Inland Revenue

58. **Note** the intent of Inland Revenue to increase audit and debt collection activities to continue to enhance taxpayer compliance.

59. **Agree** to provide additional funding to Inland Revenue, for the additional audit and debt collection activities as set out in recommendation 58 above.

60. **Note** that providing additional funding to Inland Revenue, as per recommendation 58 above, is expected to result in increased tax revenue and decreased Crown expenses of $1.4 billion over seven years, with an ongoing benefit of $165 million per annum.

61. **Agree** to increase Inland Revenue's administrative funding to implement the Budget 2010 tax package, as set out in recommendation 81 below.

62. **Agree** that a "*Communication Campaign Contingency*" of $3.3 million in 2010/11 to communicate the Budget 2010 tax changes be set aside from the between-Budget spending contingency and that a bid be submitted to the Minister of Finance and the Minister of Revenue for consideration at a later stage.

Ministry of Social Development

63. **Note** that implementing the proposed package will increase the administration costs of the Ministry of Social Development by an estimated $1.2 million per annum.

64. **Agree** that where possible the Ministry of Social Development should reprioritise these costs into existing baselines, and if further funding above baselines is required it can be met from the *GST Compensation Contingency*.

Fiscal impacts

65. **Note** there are two Budget 2010 tax packages that Cabinet is asked to choose between that differ in the implementation of personal income tax rates (at existing income thresholds):
    i. 10.5%, 17.5%, 30% and 33%, from 1 October 2010; or
    ii. 10.5%, 17.5%, 30% and 36% from 1 October 2010, with the top personal rate reducing further to 33% on 1 April 2011.

66. **Note** the fiscal implications of the tax package, as per recommendations 3, 6-54 and 58-61 with the full 1 October 2010 implementation of personal tax reductions as in recommendation 65i. are:

$ million	Increase (decrease) in operating balance				
	2010/11	**2011/12**	**2012/13**	**2013/14**	**4yr total**
Personal Tax (10.5, 17.5, 30, 33)	(2,455)	(3,685)	(3,935)	(4,255)	(14,330)
Net NZS compensation	(255)	(360)	(385)	(390)	(1,390)
Net main benefits compensation	(75)	(100)	(100)	(105)	(380)
WFF compensation	(45)	(65)	(65)	(65)	(240)
Other compensation	(45)	(60)	(60)	(60)	(225)
Company tax cut to 28%	(20)	(340)	(450)	(305)	(1,115)
PIES & savings vehicles capped at 28%	(15)	(40)	(55)	(60)	(170)
Inland revenue admin costs	(10)	-	-	-	(10)
GST (including clawback)	2,040	2,840	2,985	3,160	11,025
WFF de-indexation	-	15	50	40	105
WFF Integrity Measures	5	25	25	25	80
Building Depreciation (all > 50yrs)	-	685	685	690	2,060
Depreciation Loading (grandfathered)	135	245	310	345	1,035
LAQCs (incl. remission loophole)	-	70	65	55	190
Thin Capitalisation 60%	-	200	200	200	600
Depreciation - capital contributions	5	5	5	10	25
GST maintenance	15	60	60	60	195
Tobacco excise[1]	130	160	170	150	610
Tobacco excise - remove CPI flow-through[2]	5	20	40	40	105
Audit and compliance activity (incl. admin)	120	210	210	205	745
Sub-total of estimated static impact	**(465)**	**(115)**	**(245)**	**(260)**	**(1,085)**
adjustment for macroeconomic effects	5	25	205	435	670
Impact on operating balance	**(460)**	**(90)**	**(40)**	**175**	**(415)**

*all figures rounded to nearest $5m – notes to the table are contained in Appendix 1.
** the fiscal impact of recommendations 73, 75, 77 and 81 are already incorporated into the tables in recommendations 66 and 67 – numbers do not reconcile as they are aggregated differently for appropriation purposes.

[1] Tobacco excise policy as agreed per EGI Min (10) 6/7

[2] Policy to exclude tobacco excise increase-induced CPI flow-through to welfare assistance as per recommendations 39, 40, 41 and 42.

67. **Note** the fiscal impact of the tax package with the phased implementation of personal tax reductions as in recommendation 65ii are:

$ million	Increase (decrease) in operating balance				
	2010/11	**2011/12**	**2012/13**	**2013/14**	**4-yr total**
Impact of base package	(460)	(90)	(40)	175	(415)
savings from phasing top rate reduction[1]	280	(30)	(40)	-	210
Impact on operating balance	**(180)**	**(120)**	**(80)**	**175**	**(205)**

*all figures rounded to nearest $5m
[1] includes provisional tax adjustment

68. **Note** that Cabinet previously agreed that the tax package for Budget 2010 should be broadly revenue neutral, consistent with the Government's fiscal strategy (Cabinet Minute (10) 3/2 refers).

69. **Note** that the tax packages in recommendations 66 and 67 are consistent with Cabinet's intention above because they have a positive impact on the operating balance in the final year of the forecast period, and a preliminary assessment of the impact over the projection period to 2023/24 indicates that net debt is not materially different from the net debt position without the proposed tax packages.

70. **Agree** that effective personal income tax rates be reduced:

EITHER:

(a) to 10.5%, 17.5%, 30% and 33% from 1 October 2010 (this package would include all of the base broadening and compensating measures with application from the dates set out above), with fiscal implications of this package as per recommendation 66.

OR

(b) initially to 10.5%, 17.5%, 30% and 36% from 1 October 2010 (this package would include all of the base broadening and compensating measures with application from the dates set out above), with the top personal tax rate reducing to 33% on 1 April 2011. The fiscal implications of this package are as per recommendation 67.

71. **Agree** to include, in legislation to be introduced on Budget day, amendments to the Tax Acts in respect of the changes agreed to in recommendation 70.

Ministerial Welfare Programme

72. **Agree** to establish in Vote Social Development a new Benefits and Other Unrequited Expenses appropriation 'Special Compensation Payment for GST increase' with the scope of this appropriation to be: 'This appropriation is limited to providing payments for recipients of Unemployment Benefit and related benefits, Sickness Benefit, Invalids' Benefit, Domestic Purposes Benefits, Independent Youth Benefit, Orphans Benefit, Unsupported Child's Benefit and Widow's Benefit; Student Allowances; New Zealand Superannuation and Veteran's Pensions to provide compensation between 1 October 2010 and 31 March 2011 for the increase in the rate of GST'.

73. **Approve** the following appropriation, with a corresponding impact on the operating balance, to reflect recommendations 6, 7, 8, and 72 above:

	$m – Increase / (Decrease)				
Vote Social Development **Minister for Social Development and Employment**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14& Outyears**
Benefits and Other Unrequited Expenses: Special Compensation Payment for GST increase	-	130.929	-	-	-

Government Super Fund

74. **Agree** to establish in Vote Finance a new Non-Departmental Other Expense appropriation ‘GST Compensation for Government Superannuation Fund and National Provident Fund recipients’, with the scope of this appropriation to be: ‘This appropriation is limited to compensation for recipients of the Government Superannuation Fund and the National Provident Fund due to increases in GST between 1 October 2010 and 27 April 2011’.

75. **Approve** the following appropriation, with a corresponding impact on the operating balance, to reflect recommendations 9, and 74 above:

	$m – Increase / (Decrease)				
Vote Finance **Minister of Finance**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14& Outyears**
Non-Departmental Other Expenses: GST Compensation for Government Superannuation Fund and National Provident Fund recipients	-	10.000	-	-	-

Working for Families, GST compensation and flow-on impacts from GST increase

76. **Note** that all main benefits will be automatically adjusted in April 2011 to incorporate the increase to GST.

77. **Approve** the following changes to appropriations for Votes Social Development, Revenue, Finance and Veterans' Affairs as set out in the tables below, with a corresponding impact on the operating balance, to reflect recommendations 11-19 and 29-31 above.

	$m - increase/(decrease)				
	2009/10	**2010/11**	**2011/12**	**2012/13**	**2013/14& Outyears**
Vote Social Development					
Minister for Social Development and Employment					
Departmental Output Expense:					
Care and Protection Services	-	0.607	0.810	0.810	0.810
Benefits and Other Unrequited Expenses:					
Invalid's Benefit	-	(4.289)	(5.041)	(5.636)	(6.046)
Widow's Benefit	-	(0.146)	(0.150)	(0.148)	(0.153)
Orphan's/Unsupported Child's Benefit	-	2.164	2.278	2.384	2.419
Unemployment Benefit and Emergency Benefit	-	(2.953)	(2.923)	(2.714)	(2.772)
New Zealand Superannuation	-	42.218	178.498	187.929	189.513
Domestic Purposes Benefit	-	(7.928)	(8.951)	(9.719)	(10.259)
Sickness Benefit	-	(1.603)	(1.647)	(1.672)	(1.702)
Independent Youth Benefit	-	(0.047)	(0.048)	(0.047)	(0.047)
Student Allowances	-	(0.373)	(1.506)	(1.163)	(0.844)
Accommodation Assistance	-	(2.572)	(8.941)	(8.167)	(8.220)
Disability Assistance	-	6.117	8.686	8.878	9.119
Hardship Assistance	-	(1.062)	(5.127)	(5.473)	(5.651)
Childcare Assistance	-	3.033	4.055	4.215	4.342
Transition to Work	-	0.386	0.538	0.547	0.559
Employment Related Training Assistance	-	0.301	0.333	0.298	0.308
Non-Departmental Other Expenses:					
Debt Write-downs	-	11.600	17.100	17.300	17.500
Non-Departmental Capital Expenditure:					
Student Loans	-	21.200	31.100	31.500	31.900
Total Operating	**-**	**45.453**	**177.964**	**187.622**	**188.876**
Total Capital	**-**	**21.200**	**31.100**	**31.500**	**31.900**

	$m - increase/(decrease)				
	2009/10	**2010/11**	**2011/12**	**2012/13**	**2013/14& Outyears**
Vote Revenue					
Minister of Revenue					
Benefits and Other Unrequited Expenses:					
Family Tax Credit PLA	-	38.649	27.377	1.178	7.407
In-Work Tax Credit PLA	-	2.893	(3.081)	(11.224)	(8.912)
Minimum Family Tax Credit PLA	-	(0.338)	(0.546)	(0.618)	(0.545)
Parental Tax Credit PLA	-	(0.050)	(0.314)	(0.390)	(0.495)
Non-Departmental Other Expenses:					
General Tax and Family Support Bad Debt Write-Offs	-	0.400	1.700	-	-
Vote Finance					
Minister of Finance					
Non-Departmental Other Expense:					
Government Superannuation Fund Unfunded Liability PLA	-	-	17.000	17.000	17.000
Vote Veterans' Affairs - Social Development					
Minister of Veterans' Affairs					
Benefits and Other Unrequited Expenses:					
Veterans’ Pension	-	0.848	3.319	3.262	3.286
Vote Veterans' Affairs - Defence Force					
Minister of Veterans' Affairs					
Benefits and Other Unrequited Expenses:					
War Disablement Pensions	-	0.773	3.124	3.363	3.425
Total Operating	**-**	**43.175**	**48.579**	**12.571**	**21.166**

78. **Note** that the figures contained in the tables in recommendations 66, 67, 73, 75 and 77 above are based on preliminary Budget forecasts, and that figures included in Estimates documents will be based on final Budget forecasts.

79. **Note** that the Student Loans costs included in recommendation 77 above assume no inflation adjustment to the Student Loan minimum repayment threshold as a result of increasing GST, and that these costs will be included when Cabinet re-considers inflation adjustment of the repayment threshold for the 2011/12 tax year.

80. **Note** that the Annual General Adjustment process should take into account the increases that have been made to appropriations in recommendation 77 above.

Administrative costs and debt collection impacts

81. **Approve** the following changes to appropriations, with a corresponding impact on the operating balance and net debt, to reflect recommendations 58-61 above.

	$m - increase/(decrease)							
Vote Revenue **Minister of Revenue**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17& Outyears**
Departmental Output Expenses:								
Policy Advice	-	0.061	-	-	-	-	-	-
(funded by Revenue Crown)								
Services to Inform the Public About Entitlements and Meeting Obligations	-	5.447	5.825	6.056	6.056	4.82	4.82	4.959
(funded by Revenue Crown)								
Services to Process Obligations and Entitlements	-	0.478	-	-	-	-	-	-
(funded by Revenue Crown)								
Management of Debts and Outstanding Returns	-	8.206	10.304	10.712	10.712	8.526	8.526	8.771
(funded by Revenue Crown)								
Taxpayer Audit	-	12.405	15.189	15.792	15.792	12.57	12.57	12.931
(funded by Revenue Crown)								
Non-Departmental Other Expenses:								
Impairment of Debt Relating to General Tax and Family Support	-	(77.000)	(154.000)	(154.000)	(146.300)	(138.600)	(130.900)	(123.200)
Total Operating	**-**	**(50.403)**	**(122.682)**	**(121.440)**	**(113.740)**	**(112.684)**	**(104.984)**	**(96.539)**
Departmental Capital Expenditure:								
Capital Investment	-	8.168	0.646	0.265	0.014	-	-	-
Total Capital	**-**	**8.168**	**0.646**	**0.265**	**0.014**	**-**	**-**	-

82. **Agree** that the changes to appropriations in recommendations 73, 75, 77 and 81 above be included in the 2010/11 Estimates and until these Estimates are enacted any expenses be met from Imprest Supply.

Delegated authority

83. **Authorise** the Minister of Finance and the Minister of Revenue (together with the Minister for Social Development and Employment where appropriate) to propose, for inclusion in a Bill that seeks to amend the Tax Acts, any necessary minor consequential amendments that relate to the Budget 2010 tax package.

84. **Authorise** the Minister of Finance, the Minister of Revenue, and the Minister for Social Development and Employment, to propose any technical drafting changes required to implement the compensation package.

85. **Authorise** the Minister of Finance and the Minister for Social Development and Employment to make decisions on the use of the *GST Compensation Contingency*, including the ability to establish new appropriations and to make changes to existing appropriations.

86. **Authorise** the Minister of Finance and the Minister of Revenue to make decisions on the use of the *Communications Campaign Contingency*, including the ability to establish new appropriations and to make changes to existing appropriations.

87. **Authorise** the Minister for Social Development and Employment to issue drafting instructions to the Parliamentary Counsel Office to develop regulations to:

    (a) exempt the compensation payment in recommendations 6 and 7 from a person's income for the purposes of the Social Security Act 1964;

    (b) prevent the tax package further increasing net Student Allowance amounts as set out in recommendation 11; and

    (c) increase the amounts of Disability Allowance, Child Disability Allowance, Childcare Assistance and Foster Care Allowance as set out in recommendation 14.

Legislation

88. **Note** that a Bill will be introduced on Budget day under urgency to legislate the tax reform package that will include amendments as set out in recommendations 55 and 71.

89. **Direct** Inland Revenue and Parliamentary Counsel Office to draft the necessary Bill for introduction on 20 May 2010.

90. **Note** that the Ministers of Finance and Revenue will report to Cabinet before the Budget seeking approval for the introduction of this Bill on Budget day, and for the timing of its passage through the House under urgency.

Hon Bill English
Minister of Finance

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Date

Hon Peter Dunne
Minister of Revenue

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Date

Appendix 1 – Notes to fiscal impacts table

Personal Tax (10.5, 17.5, 30, 33)	Personal tax line excludes tax on benefits and NZS (included in net figures below), includes consequential impacts on RWT, FBT, ESCT and lower PIE tax scales, includes changes to the provisional tax uplift policy and implicitly includes consequentials to other withholding rates (e.g. secondary codes, redundancy tax credit, ACC attendant care).
Net NZS compensation	Net NZS compensation includes ministerial welfare programme from 1 Oct 2010 for superannuitants plus on-going CPI flow through to NZS gross expenditure and change in tax on NZS.
Net main benefits compensation	Net main benefits compensation includes ministerial welfare programme from 1 Oct 2010 for recipients of main benefits plus on-going CPI flow through to main gross benefit expenditure and change in tax on benefits.
WFF compensation	WFF compensation includes 2.02% compensation from 1 Oct 2010 and flow-ons from tax cuts; although the Minimum Family Tax Credit (MFTC) is increased for compensation, the expenditure on MFTC reduces because recipients benefit more from the tax cuts so require a smaller payment to keep them above the minimum income.
Other compensation	Other compensation includes: increase to Student Allowances, Disability and Child Disability, Childcare assistance and Foster Care Allowance and War Diasablement Pensions from 1 Oct 2010 and main supplementary assistance from 1 April 2011, and flow-on effects to other supplementary assistance; $10m per annum contingency, increase to student loan living allowance and fees borrowing; increase to GSF and NPF payments from 1 Oct 2010; WFF write-off costs.
Company tax cut to 28%	Company tax includes 2-year imputation window.
PIES & savings vehicles capped at 28%	PIEs and savings vehicles - cost of top PIE rate and tax on superfunds from 30% to 28%.
Inland Revenue admin costs	Inland Revenue administration costs for implementing tax package other than increased audit and compliance activity (included below).
GST (including clawback)	Includes static estimate of increase in GST revenue from increasing rate to 15% and static clawback estimate from increased disposable incomes as result of the whole tax package (includes GST, company tax and excise revenue).
WFF de-indexation	Assumes WFF abatement threshold is not adjusted at the next and subsequent indexation rounds.
WFF Integrity Measures	Includes changes to exclude investment and rental losses and include income from trusts, in the definition of income for WFF purposes.
Building Depreciation (all > 50yrs)	Costing for removing depreciation on all buildings with an estimated useful life of 50 years or more. Excludes Crown and State Owned Enterprise owned buildings, and a proportion of privately owned residential buildings not

	currently claiming depreciation.
Depreciation Loading (grandfathered)	Removal of depreciation loading on all assets purchased after Budget day effective immediately.
LAQCs (incl. remission loophole)	Costing generally relates to implementation of loss limitation rules similar to limited partnerships and collection of tax on remission income when a company is liquidated.
Thin Capitalisation 60%	Reduction of safe harbour to 60% of total assets ratio for inbound thin capitalisation rules. No adjustment to outbound thin capitalisation rules. 110% domestic to world wide debt test continues to apply.
Depreciation - capital contributions	Removal of depreciation allowances when a non-taxable capital contribution is applied to purchase a depreciable asset.
GST maintenance	Relates to GST phoenix schemes.
Tobacco excise	Tobacco excise policy as agreed per EGI Min (10) 6/7.
Tobacco excise - remove CPI flow-through	Policy to exclude tobacco excise increase-induced CPI flow-through to welfare assistance.
Audit and compliance activity (incl. admin)	Figures give the total of the increase in revenue and decrease in Crown expenses net of the associated administration and impairment costs. Decrease in Crown expenses is a result of debt collection activities.
Adjustment for macroeconomic impacts	Costings above are based on static models and preliminary Budget forecasts. The macroeconomic adjustment in this line recognises Treasury's initial estimate of the impact of the dynamic effects of the tax package (largely relating to increased labour supply). The final Budget forecasts will incorporate any subsequent forecast adjustments.