Inland Revenue
Te Tari Taake
Policy Advice Division

THE TREASURY
Kaitohutohu Kaupapa Rawa

Tax Policy Report: Budget tax package: Outstanding issues

Date:	31 March 2010	**Priority:**	High
Security Level:		**Report No:**	T2010/515 PAD2010/59

Action Sought

	Action Sought	**Deadline**
Minister of Finance (Hon Bill English)	Signal decisions on each outstanding issue in advance of finalising the Budget Package Cabinet paper.	It would be useful to have decisions on the outstanding issues by **1 April** to enable completion of the Budget package Cabinet paper.
Minister of Revenue (Hon Peter Dunne)	Signal decisions on each outstanding issue in advance of finalising the Budget Package Cabinet paper.	It would be useful to have decisions on the outstanding issues by **1 April** to enable completion of the Budget package Cabinet paper.

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**		**1st Contact**
Bill Moran	Manager, Tax Strategy, The Treasury	[deleted - privacy]	[deleted - privacy]	✓
David Carrigan	Policy Manager, Inland Revenue	[deleted - privacy]	[deleted - privacy]	

31 March 2010

Minister of Finance
Minister of Revenue

Tax Policy Report: Budget tax package: Outstanding issues

Executive Summary

This report provides advice and recommendations on a range of outstanding policy issues on which decisions are required in advance of finalising the Cabinet paper on the Budget tax package. The Ministry of Social Development have been consulted on relevant sections of this report.

The issues covered in this note are:

- Impact of tax changes on public sector funding
- Impact of GST changes on the Student Loans Scheme
- [deleted – confidentiality of advice]
- Provisional tax issues
- Compensation issues
- Audit and debt collection activity
- Phasing tax rate reductions

Recommended Action

We recommend that you:

<u>Public sector funding</u>:

a **Note** that Treasury and Inland Revenue will further consider the impact of the tax changes on the public sector and will report to Ministers between the Budget and implementation of the GST and depreciation changes if required.

Noted Noted

b **Note** that Treasury intends to write to departmental chief executives immediately after the Budget providing administrative advice on the impact of the tax package on departmental funding.

Noted Noted

<u>Student Loans</u>:

c **Note** that increasing GST is expected to result in increased Student Loan borrowings and subsequent write-downs of the Student Loans scheme, and that the cost of increased write-downs, with a contingency of $10m to cover uncertainty, was included in the scenario presented to the Ministerial sub-group on 29 March:

	$m increase/(decrease)*				
	2009/10	2010/11	2011/12	2012/13	2013/14 & outyears
Operating Impact					
Debt Write-downs	-	10.5	17.5	18	18
Debt Impact					
Increased Student Loans Borrowing	-	19	32	32.5	33

* All figures are rounded to the nearest $500,000.

Noted Noted

d **Note** that, due to Budget secrecy, the Ministry of Education has not been consulted on the financial implications to the Student Loans scheme of changes in the rate of GST.

Noted Noted

e **Note** that Treasury will consult with the Ministry of Education on the financial implications in advance of the 12 April Cabinet meeting, and that this may result in revisions to the above costs.

Noted Noted

f [*information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials*]

Agreed/Not Agreed Agreed/Not Agreed

Provisional tax issues:

EITHER

g **Agree** provisional tax be reduced for taxpayers who pay provisional tax on the uplift basis. (Inland Revenue preferred option)

Agreed/Not Agreed Agreed/ Not Agreed

h **Note** that if this option is chosen it will have the revenue profile outlined in paragraph 19 of the report.

Noted Noted

OR

i **Agree** not to reduce provisional tax for taxpayers who pay provisional tax on the uplift basis. (Treasury preferred option)

Agreed/ Not Agreed Agreed/ Not Agreed

<u>Compensation issues</u>:

Superannuation

j **Note** that the original costings associated with the post-tax payments made to recipients of NZ Super and Veterans Pensions assumed they all used the standard (M) tax code, when in actual fact about 20% use other codes such as secondary tax (S).

Noted Noted

k **Agree** to use the actual tax codes to calculate the post-tax payment for recipients of NZ Super and Veterans Pensions, to ensure those superannuitants with secondary incomes receive a relatively lower payment that that those that rely solely on government assistance.

Agreed/Not Agreed Agreed/Not Agreed

l **Note** that using actual tax codes, rather than a generic code (M), would reduce the compensation by $3 million, but increase the administration costs by about $0.5 million.

Noted Noted

Contingency

m **Agree** that the proposed contingency be restricted to issues directly related to compensation matters arising from the Budget 2010 tax reforms, and in particular any where beneficiaries, New Zealand Superannuitants or low income earners would not be adequately compensated for the GST increase.

Agreed/Not Agreed Agreed/Not Agreed

Rates Rebate

n **Note** that increasing GST to 15% will increase the amount the Government pays in rates rebates by approximately $1.5 million per annum (full-year impact).

Noted Noted

o **Agree** that if councils 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, if necessary, through the contingency.

Agreed/Not Agreed Agreed/Not Agreed

MSD Administration costs

p **Agree** that, to the extent that the Ministry of Social Development cannot absorb additional administrative costs, these will be counted within the total cost of the tax package

Agreed/Not Agreed Agreed/Not Agreed

GSF/NPF

q **Agree** to a temporary increase in payments to all Government Superannuation Fund (GSF) and National Provident Fund (NPF) pensions in payment as at 30 September 2010, which are subject to annual CPI increases.

Agreed/Not Agreed Agreed/Not Agreed

r **Agree** that the increase in payments will in total be an amount equal to 2.02% of payments payable for the period 1 October 2010 to 27 April 2011 and that pensioners will receive this amount spread evenly over the seven 4-weekly payments planned to be made over this period.

Agreed/Not Agreed Agreed/Not Agreed

s **Agree** that the first payment will be made on 14 October 2010, alongside the currently planned payment to be made on that date.

Agreed/Not Agreed Agreed/Not Agreed

t **Note** the estimated total cost is $10 million in 2010/11.

Noted Noted

u **Note** that these payments will be funded via Vote finance and that a new appropriation will likely need to be established.

Noted Noted

v **Note** that the GSF and NPF will need to talk to Datacom who are the scheme administrator for both NPF and GSF (i.e. they run the payroll system) as soon as possible, and preferably before Budget day.

Noted Noted

<u>Audit and debt collection activity</u>:

w **Agree** to increase audit and debt collection funding for Inland Revenue above the already agreed amount by Budget Ministers, with the following impacts on the operating balance:

	$m increase/(decrease)							
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17 & Outyears
Administrative Costs	-	5	10	10	15	20	25	25
Gross Operating Benefits	-	40	50	50	90	135	165	165
Net Operating Benefits	**-**	**35**	**40**	**40**	**75**	**115**	**140**	**140**

*Note: Figures rounded to nearest $5m.

Agreed/Not Agreed Agreed/Not Agreed

<u>Top tax rate phasing options:</u>

x **Note** the net impact of the total tax package under options to phase the top rate reductions:

Option			net impact of package ($ million)				
	1-Oct-10	1-Apr-11	2010/11	2011/12	2012/13	2013/14	total
Base	**10.5/17.5/30/33%**	10.5/17.5/30/33%	-395	-170	-165	110	-620
1	**10.5/17.5/30**/38%	10.5/17.5/30/**33%**	-50	-155	-165	110	-260
2	**10.5/17.5/31.5**/38%	10.5/17.5/**30/33%**	35	-150	-165	110	-170

Noted Noted

y **Agree** your preference on phasing of personal tax reductions as per recommendation q (please circle):

EITHER

Base option Base option

OR

Option 1 (Treasury recommended) Option 1 (Treasury recommended)

OR

Option 2 Option 2

z **Refer** a copy of this report to the Minister for Social Development and Employment.

Refer Refer

Bill Moran
for Secretary to the Treasury

David Carrigan
Policy Manager, Policy
Inland Revenue

Hon Bill English
Minister of Finance

Hon Peter Dunne
Minister of Revenue

Tax Policy Report: Budget tax package: Outstanding issues

Purpose of Report

1. This report provides advice on a range of outstanding policy issues on which decisions are required in advance of finalising the Cabinet paper on the Budget tax package. The Cabinet paper needs to be finalised by 6 April for discussion at Cabinet on 12 April.

2. The report provides a short summary of each issue and provides recommendations for decisions in order to finalise the details of the Budget tax package.

3. The issues covered in this report are:
   - Impact of tax changes on public sector funding
   - Impact of GST changes on the Student Loans Scheme
   - [deleted – confidentiality of advice]
   - Provisional tax issues
   - Compensation issues
   - Audit and debt collection activity
   - Phasing tax rate reductions

Detail

Impact of tax changes on public sector funding

4. Officials have considered whether the tax package, and particularly the increase in GST and the denial of depreciation on buildings, will have flow on implications for the public sector.

5. Increasing GST is unlikely to impact appropriations, as appropriations are set on a GST-exclusive basis, and the Public Finance Act provides permanent authority for departments to meet their GST obligations, and for departments to provide funding to other parties to meet their GST obligations. Officials are checking that there will be no unintended consequences as a result of the GST on departments' appropriations or expenditure.

6. Similarly, increasing GST should not result in unintended consequences to fees set by regulation, as section 78 of the Goods and Services Tax Act will automatically increase fees for the GST increase.

7. The GST change is also unlikely to impact financial reporting of the public sector, as financial statements are prepared on a GST exclusive basis. However, the depreciation changes may have impacts for public sector reporting, and officials are currently considering what these impacts would be.

8. Treasury intends to send a letter to departmental chief executives immediately after the Budget providing administrative advice on the impact of the tax package on departmental funding. Treasury and Inland Revenue will further consider the impact of the tax changes on the public sector and will report to Ministers between the Budget and implementation of the GST and depreciation changes if required.

Student Loans

9. Increasing GST will have flow-on costs to the Student Loans scheme. The maximum amount available for living costs will automatically increase on 1 April 2011, in-line with

the CPI. In addition, course fees are GST inclusive. An increase in GST will likely lead to an increase in course fees, and subsequently to an increase in borrowing to cover course fees.

10. Increased borrowing by students represents an increase in the capital cost of the scheme to Government. Also, due to the interest-free nature of the scheme, there is an immediate write-down of the value of the increased loan amounts as the full value of the loan is unlikely to be recovered in full.

11. The expected financial implications for the student loans scheme from increasing GST are as follows:

	$m increase/(decrease)*				
	2009/10	2010/11	2011/12	2012/13	2013/14 & outyears
Operating Impact					
Debt Write-downs	-	10.5	17.5	18	18
Debt Impact					
Increased Student Loans Borrowing	-	19	32	32.5	33

* All figures are rounded to the nearest $500,000.

12. The operating impact, with a contingency of $10m to cover uncertainty, has been included in the scenario considered by the Ministerial sub-group at its final meeting on 29 March and the costings in paragraph 44 below.

13. Due to Budget secrecy, the Ministry of Education has not been consulted on the cost to the Student Loans scheme of changes in the rate of GST. The figures above represent Treasury's best estimate of the costs to Government. Treasury will consult with Ministry of Education in time to produce agreed cost estimates for the 12 April Cabinet paper. This consultation may result in changes to costs in the 12 April Cabinet paper relative to those presented above and will remove the need for a contingency.

[deleted – confidentiality of advice]

14. [*information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials*]

15. [*information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials*]

16. [*information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials*]

17. [*information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials*]

Provisional tax issues

18. Provisional tax can either be paid on the basis of earlier years' tax liabilities plus an uplift factor (for example, 105% or 110%) (the standard uplift), or based upon an estimate. Provisional tax is a timing matter only – any under or over-payment of provisional tax is adjusted after year end when the tax return is filed. If provisional tax is paid by way of an estimate, the taxpayer estimates their own provisional tax liability and so can factor in changes to tax rates, whereas the standard uplift basis does not incorporate tax cuts effective in the current year.

19. In the past where tax cuts have been provided, a measure to allow taxpayers to reduce their provisional tax payments has been provided. In those cases the tax reduction was unambiguous because tax rates were lowered but there was no base broadening. However, given the nature of the overall 2010 tax package, it is not clear that such a blanket reduction is justified as some taxpayers may have increased tax liabilities. Should Ministers prefer a reduction in the standard uplift, the measure will have the following revenue profile over the forecast period relative to the current base scenario:

$ million	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**total**
Provisional tax uplift	-95	35	65	-5	0

20. For the reasons outlined above Treasury recommends against reducing the standard uplift. Inland Revenue, on the other hand, notes that unless the standard uplift is reduced to account for the personal tax cuts, a significant number of provisional taxpayers will face a GST increase on 1 October without an immediate personal tax cut to compensate. This is inconsistent with the treatment of salary and wage earners who will receive the personal tax cut immediately through a reduction in PAYE. Inland Revenue, therefore, recommends in favour of reducing the provisional tax uplift.

Compensation issues

Proposed increase to superannuation payments

21. As referred to in the 11 March Joint Report - *Implications of changing the tax mix and possible additional support for certain groups* (, REP 10/03/095, IRD 2010/042), Ministers have now agreed to introduce a Ministerial Welfare Programme to pay recipients of NZ Super (NZS) and Veterans Pensions (VPs) an amount equivalent to 2.02% of their post-tax payment rates from 1 October 2010 to 31 March 2011. The costings that were included in this earlier report assumed that all recipients of NZS and VPs use the standard tax code (M) to calculate their post-tax payment rate. In reality, about 20% of recipients actually use other tax codes, such as secondary tax (S), to calculate their payment.

22. The cost of compensation would reduce by approximately $2.5 million if the actual tax codes of recipients were used (rather than the M code) to calculate a 2.02% increase on their post-tax payment. This would, however, result in NZS and VPs recipients receiving different absolute payments through the Ministerial Welfare Programme.

23. Notwithstanding the potential risk of perceived inequities, officials consider that the rate of payment should be based on the actual net rate of NZS a person is receiving, rather than the rate they would receive if they were on the M tax code. This would result in a lower payment for recipients with tax codes other than M. People in this situation will generally be better off than people relying solely on NZS for their living costs. They are also likely to receive significant benefits from the reductions in personal tax rates.

24. Calculating payments based on actual tax codes would increase the level of complexity of the Ministerial Welfare Programme making it more difficult for superannuitants and

Work and Income staff to understand and administer. MSD estimates that his change may increase the costs of administering the changes by about $0.5 million.

How the compensation contingency would work

25. The Ministerial subgroup has agreed that the Budget 2010 tax package include a contingency fund of $10 million per annum to deal with any other compensation matters that may arise after the Budget. This provision recognises the complexities of the social welfare system, and is similar to contingencies set aside for other major reforms.

26. We propose that use of the contingency be subject to the joint approval of the Minister of Finance and Minister Social Development & Employment. We propose that it be restricted to issues directly related to compensation matters arising from the Budget 2010 tax reforms, in particular where beneficiaries, New Zealand superannuitants or low income earners would not be adequately compensated for the GST increase. For example, as noted below, should councils increase rates in 2010/11 as a result of the GST increase, the contingency could be used to fund the necessary rise in rates rebates.

27. Along with any specific issues identified, we have previously signalled that the contingency would be used to provide for a general payment mechanism. This mechanism would provide a backstop to ensure that no low income individual in receipt of welfare payments would see an overall reduction in their net income from 1 October 2010 as a result of the tax package.

Rates rebates

28. The Government pays approximately $60 million per annum in rates rebates. The current income threshold for a household to be eligible for a rates rebate is $21,910, and the maximum rebate is $550 per annum. The actual amount of rates rebate that a household is eligible to receive will depend on the actual rates bill that it faces, subject to these two thresholds. Both the income threshold and maximum rebate payable are indexed from 1 July each year on the basis of the previous calendar year's All Groups CPI.

29. Officials estimate that a 2.02% movement in the CPI (due to the proposed change in GST) will increase the amount paid in rates rebates by approximately $1.5 million per annum (full-year impact). It is uncertain whether this GST-induced increase will be factored into councils' rates setting processes – and so households' rates bills – for 2010/11. However, we note that the experience in 1989 when GST was last increased was that councils did factor in the impact on a pro-rated basis for the first year.

MSD administration costs

30. The Ministry of Social Development is currently working through the detail of the administrative costs and implications of the GST compensation package and will provide separate advice on this issue next week. At this stage, it is expected that the package would involve IT costs of approximately $1 million in 2010/11, although this will depend on the final design (for example what tax codes are used for payments to recipients of NZS and VPs). There may also be other administrative costs relating to staffing and communications.

Implementation of a temporary increase in GSF and NPF pension payments from 1 October 2010

31. It is proposed that the Government Superannuation Fund (GSF) and the National Provident Fund (NPF) will, on the behalf of the Crown, provide for a temporary increase in payments of 2.02% to all pensioners in payment as at 30 September 2010, which are subject to annual CPI increases. This temporary increase (TI) would be provided until the usual annual CPI increase occurs on 28 April 2011.

32. The GSF and NPF will facilitate the payment of the TI through the scheme pension payment systems, but the TI will not form part of a member's GSF or NPF entitlement (as set out in the GSF Act or NPF Trust Deed). The increase will be paid 4-weekly along with the usual GSF and NPF pension payments.

33. GSF and NPF request that the first 4-weekly payment of the increase is made on 14 October 2010 so that it coincides with a normal 4-weekly payroll payment and that the increase for the 13 days (1 October 2010 to 13 October 2010) is incorporated into the TI percentage. If the TI percentage is not adjusted, for the increase to be effective from 1 October 2010, the payment on 14 October 2010 would need to include 13 days of backdating. This would cause more complications and cost as it would require an additional amount to be paid and then removed for the next pension payment. Alternatives could be to apply the TI from 16 September, the payment date before 1 October, but this reduces the timeline for implementation significantly.

34. We therefore propose that the first payment be aligned with the payroll run that is planned to occur on the 14th October with the increase adjusted so that the total level of compensation is based on a 2.02% temporary increase over the full period 1 October 2010 to 27th April 2011.

35. Based on a TI of 2.02%, payable for the period 1 October 2010 to 28 April 2011, the cost of the increased payments is estimated as:

	Annual Pension Payroll $ million	Estimated Cost $ million
GSF	750	8.6
NPF	100	1.2
Total	**850**	**9.8**

36. The cost will be spread evenly over the seven 4-weekly pension payments, made between 14 October 2010 and 27 April 2011.

37. Implementing an increase outside the usual annual timescale will require reprogramming of the existing GSF and NPF systems. Both GSF and NPF outsource the administration of the schemes and the extent and cost of the reprogramming will not be known with any accuracy until the position is discussed with the schemes administrator. However, an initial estimate is that additional operating costs of around $145,000 will be incurred. This includes costs of $50,000 for the GSF and NPF to write to the affected members advising them of the temporary increase; how it will be paid; and how it will integrate with their usual CPI increase in April 2011.

Audit and debt collection activity

38. Budget Ministers have agreed to fund Inland Revenue to undertake a time-limited programme of audit and debt collection activity. This activity will result in increased tax revenues and a reduction in debt impairment expenses as shown in the following table:

	$m increase/(decrease)							
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17 & Outyears
Administrative Costs	-	20	20	20	15	5	-	-
Gross Operating Benefits	-	105	190	190	145	45	10	-
Net Operating Benefits	**-**	**85**	**170**	**170**	**130**	**40**	**10**	**-**

*Note: Figures rounded to nearest $5m.

39. The net benefits of this increased activity were included in the scenario considered by the Ministerial sub-group on 29 March.

40. As discussed with you on 30 March, Treasury and Inland Revenue recommend increased funding for Inland Revenue to undertake compliance activity beyond the agreed time-limited period, and increases in the amount of activity undertaken in each year. Increasing funding further than already agreed by Budget Ministers will result in increased tax revenues and reductions in impairment expenses as shown in the following table:

	$m increase/(decrease)							
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17 & Outyears
Administrative Costs	-	5	10	10	15	20	25	25
Gross Operating Benefits	-	40	50	50	90	135	165	165
Net Operating Benefits	**-**	**35**	**40**	**40**	**75**	**115**	**140**	**140**

*Note: Figures rounded to nearest $5m.

41. The net operating benefits from further increasing audit and debt collection activity have been included in the revised scenario included in paragraph 44 of this report.

Costings & phasing tax rate reductions

42. The cost of the tax package as at 29 March 2010 was:

$ million	***2010/11***	***2011/12***	***2012/13***	***2013/14***	***total***
Operating balance before gains and losses	**-450**	**-165**	**-95**	**175**	**-535**

43. Since then, the following changes have been incorporated into the cost of the package:
    - Removal of 5-year brightline test as agreed by the Tax Sub-Group on 29 March
    - Reducing PIE and savings vehicle rates to 28%, also agreed by the Tax Sub-Group
    - Tobacco excise revenues updated for the faster-track policy option (as agreed at EGI on 31 March)
    - Inland Revenue Audit activity increased as discussed at the Joint Policy Meeting between the Ministers of Finance and Revenue on 30 March
    - Compensation for GSF and NPF from 1 October 2010

44. The cost of the package is now as follows:

$ million	2010/11	2011/12	2012/13	2013/14	total
Personal Tax (10.5, 17.5, 30, 33)	-2,365	-3,720	-4,000	-4,250	-14,335
Net NZS	-255	-360	-385	-390	-1,390
Net main benefits	-75	-100	-100	-105	-380
WFF Compensation	-45	-65	-65	-65	-240
Other compensation	-50	-70	-70	-70	-260
Company tax cut to 28%	-20	-340	-450	-305	-1,115
PIEs & savings vehicles 28%	-15	-60	-75	-80	-230
Inland revenue admin costs	-10	0	0	0	-10
GST (including clawback)	2,030	2,855	3,005	3,170	11,060
WFF de-indexation	0	15	50	40	105
WFF Integrity Measures	5	15	15	15	50
Building Depreciation (all buildings)	0	685	685	690	2,060
Depreciation Loading (grandfathering)	135	245	310	345	1,035
LAQCs (incl. remission loophole)	0	70	65	55	190
Thin Cap 60%	0	200	200	200	600
Depreciation - capital contributions	5	5	5	10	25
GST maintenance	15	60	60	60	195
Tobacco excise	125	160	170	150	605
Audit activity (incl. admin)	120	210	210	205	745
Static estimate of net impact (prelim BEFU)	-400	-195	-370	-325	-1,290
adjustment for macroeconomic effects	5	25	205	435	670
Operating balance before gains and losses	**-395**	**-170**	**-165**	**110**	**-620**

Note: the adjustment for macroeconomic effects has not been re-modelled to take account of the above changes, which are not expected to have a material impact.

45. The costs/revenues of other policy changes which have yet to be decided are:

$ million	2010/11	2011/12	2012/13	2013/14	total
Remove tobacco excise CPI flow-on to NZS/benefits	5	20	45	45	115
Provisional tax uplift	-95	35	65	-5	0

46. Ministers have asked for advice on phasing the reductions in the top tax rates to reduce the initial cost of the package. Two options are presented here:

Option 1 – delay top rate reduction until 1 April 2011

	Status quo	1-Oct-10	1-Apr-11
$1-$14,000	12.5%	10.5%	10.5%
$14,001-$48,000	21%	17.5%	17.5%
$48,001-$70,000	33%	30%	30%
>$70,001	38%	**38%**	**33%**

47. Under this option, the cost of the package becomes[12]:

$ million	2010/11	2011/12	2012/13	2013/14	total
Change from base scenario	345	15	0	0	360
Operating balance before gains and losses	**-50**	**-155**	**-165**	**110**	**-260**

Administration and compliance

48. This option is marginally more complex than implementing the entire tax cut package from 1 October. The main reason for this is that PAYE tables would need to be updated twice – once on 1 October and once on 1 April next year. It also results in some additional complexity in calculating provisional tax. However, this approach would not result in any additional compliance costs for financial institutions such as banks, as the RWT rate changes have been planned for a 1 April 2011 implementation – even if the entire tax cut package is implemented on 1 October this year. This approach would not affect PIEs as the maximum PIE rate is currently set at 30% (subject to Cabinet agreement this will be reduced to 28% from 1 April 2011 as part of the Budget).

Option 2 – phase reductions in top two tax rates

	Status quo	1-Oct-10	1-Apr-11
$1-$14,000	12.5%	10.5%	10.5%
$14,001-$48,000	21%	17.5%	17.5%
$48,001-$70,000	33%	**31.5%**	**30%**
>$70,001	38%	**38%**	**33%**

49. Under this option, the cost of the package becomes[12]:

$ million	2010/11	2011/12	2012/13	2013/14	total
Change from base scenario	430	20	0	0	450
Operating balance before gains and losses	**35**	**-150**	**-165**	**110**	**-170**

Administration and compliance

50. The administration and compliance issues are largely the same as those outlined under option 1. There would be some additional complexity for employers in calculating fringe benefit tax.

Comment

51. As it stands the base scenario has revenue shortfall of $380m in the first year and $390 over the forecast period in total. To ensure that the tax package is broadly fiscally neutral and consistent with the fiscal strategy Treasury recommends Ministers proceed with Option 1 as it provides a better balance between fiscal, economic and administrative considerations. Inland Revenue also supports Option 1 if Ministers want to reduce the cost of the package in the first year.

[1] This assumes the macroeconomic impacts of the tax changes are not affected by this option. The impact is likely to be small because it is driven by a delay of only six months on <15% of the personal tax cuts – and will be known once BEFU forecasts are finalised. Figures rounded to nearest $5m.

[2] The cost of the provisional tax uplift policy will change under these phased scenarios.