

**Joint IRD/MSD/Treasury Report: Approach to non-standard tax codes in the compensation package**

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<b>Date:</b>	3 May 2010	<b>Report No:</b>	T2010/753 REP 10/05/202 IRD 2010/084
<b>Security Level:</b>			

**Action Sought**

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	<b>Action Sought</b>	<b>Deadline</b>
Minister of Finance (Hon Bill English)	<b>Discuss</b> at your meeting with Minister Dunne on 4 May <b>Agree</b> to recommendation	5 May 2010
Minister for Social Development and Employment (Hon Paula Bennett)	<b>Agree</b> to recommendation	5 May 2010
Minister of Revenue (Hon Peter Dunne)	<b>Discuss</b> at your meeting with Minister English on 4 May <b>Agree</b> to recommendation	5 May 2010

**Contact for Telephone Discussion (if required)**

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<b>Name</b>	<b>Position</b>	<b>Telephone</b>		<b>1st Contact</b>
[deleted - privacy]	Principal Analyst, MSD	[deleted-privacy]	[deleted-privacy]	✓
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Chris Gillion	Senior Policy Advisor, Inland Revenue	[deleted - privacy]	[deleted - privacy]	

**Minister of Finance's Office Actions (if required)**

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Refer copies to the Minister for Social Development and Employment and the Minister of Revenue
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**Enclosure: No**

# Joint IRD/MSD/Treasury Report: Approach to non-standard tax codes in the compensation package

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## Executive Summary

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Cabinet minute (CAB Min (10) 12/10 refers) agreed that there be 2.02% time-limited compensation payments for New Zealand superannuitants (NZS), Veterans' Pensioners (VP) and Student Allowance recipients.

Ministers had previously agreed that the compensation payment for NZS and VP recipients should be based on the actual tax codes that these recipients use – i.e. both 'M' codes as well as secondary and special tax codes (T2010/515, PAD2010/59 refers). This report seeks agreement to instead use only the 'M' code to calculate the compensation payment, as officials have recently become aware of technical complexities that make this previously preferred approach no longer possible. The fiscal cost is approximately \$2.6m, but will not require changes to budget estimates or costings as these were also done using an 'M' code.

The report also discusses when the payments for NZS and VP will be made and the treatment for recipients who are receiving payments overseas or other special rates of payment.

## Recommended Action

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We recommend that you:

- a **agree** to use only the 'M' code to calculate the compensation payment for New Zealand Superannuitants, Veterans' Pensioners and Student Allowance Recipients

*Agree/disagree.*

*Agree/disagree.*

*Agree/disagree.*

- b **note** that the compensation payment will be calculated on a pro rata daily basis, which will mean the first instalment on NZS/VP on 12 October 2010 will contain 12/14ths of the fortnightly compensation amount, and that overseas recipients will not receive any compensation as they do not face higher GST costs.

**Simon MacPherson**  
for Secretary to the Treasury

**Sue Mackwell**  
Deputy Chief Executive  
Ministry of Social Development

**Chris Gillion**  
Senior Policy Advisor  
Inland Revenue

**Hon Bill English**  
Minister of Finance

**Hon Paula Bennett**  
Minister for Social Development  
and Employment

**Hon Peter Dunne**  
Minister of Revenue

## Joint IRD/MSD/Treasury Report: Approach to non-standard tax codes in the compensation package

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### Background

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1. Cabinet minute (CAB Min (10) 12/10 refers) agreed that there be 2.02% time-limited compensation payments for New Zealand superannuitants (NZS), Veterans' Pensioners (VP) and students, among others, to compensate for the GST increase. The payments would apply from 1 October 2010 until 31 March 2011. Cabinet agreed the 2.02% would be calculated on the after tax base rate of the relevant payment.
2. Ministers had previously agreed that the compensation payment for NZS and VP recipients should be based on the actual tax codes that these recipients use – i.e. both 'M' codes as well as secondary and special tax codes (T2010/515, PAD2010/59 refers).

### Non-standard Tax Codes

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3. Officials previously recommended (and Ministers agreed) that the GST compensation payment for superannuitants should be calculated using their actual tax code (T2010/515, PAD2010/59). It was noted that this would:
  - be consistent with the notion that people will receive a 2.02% increase in their net payment from the Ministry of Social Development;
  - reduce the total cost of compensation by approximately \$2.5 million compared to using the 'M' tax code;
  - potentially give rise to perceived inequities due to NZS and VP recipients receiving different absolute payments through the Ministerial Welfare Programme; and
  - increase the level of administrative complexity, potentially increasing administration costs by about \$0.5 million.
4. Further consultation with MSD IT officials has highlighted a number of major difficulties in implementing this approach.
5. The main difficulty is that it is very complex to implement multiple secondary and special tax calculations in the IT system for a miscellaneous payment, requiring over 100 different rates of compensation to be correctly allocated to specific individuals for each different type of base payment. This puts at risk the ability to successfully make compensation payments on time. It would also mean some people could receive no GST compensation or a very low amount because they are receiving no or very little after tax NZS/VP or Student Allowance.
6. Given this new information, officials now consider it to be preferable to revert to the approach of using the 'M' tax rate to determine the level of compensation.
7. This would be consistent with the treatment of working age benefits by taking the gross base rate of NZS/VP and Student Allowances and applying the 'M' tax rate to derive an after tax base rate to which the 2.02% is applied to calculate the amount of compensation payment.

8. This would mean the only variation on compensation payment would be to reflect the different base rates (e.g. couple, single, sharing etc). This is expected to make it easier to communicate. It would, however, mean that those recipients who have a special tax code that is less than the 'M' code would receive slightly less than 2.02% of their actual net payment (see table 2 below).
9. We have checked to see approximately how many NZS/VP and Student Allowance recipients are currently using non-standard tax codes.

Tax code	NZS/VP	%	Student Allowance	%
Standard M tax code	452,325	81.4%	63,388	95.75%
Secondary tax codes	100,500	18.1%	2,807	4.24%
Special tax codes	3,175	0.5%	2	0.1%
Total	556,000		66,197	

Table 1: numbers of NZS/VP and Student Allowance recipients using each tax code

10. Special tax codes can be anywhere between 0% and 100%, meaning the net NZS/VP and Student Allowance rate received varies from the full gross rate to \$0.
11. The following table illustrates the comparison of weekly compensation payments for a single NZS/VP living alone and Student Allowance recipients with variable tax codes under the two approaches – actual tax codes or a standard 'M' code.

	Gross	Tax code (1/10/2010 rates)	Net	Compensation amount @2.02% on <b>actual codes</b>	Compensation amount @2.02% using only the <b>'M' code</b>
NZS/VP	\$373.56	M	\$327.14	\$6.61	\$6.61
Single & Living Alone	\$373.56	17.5% (Secondary tax code)	\$308.29	\$6.23	\$6.61
	\$373.56	0% (special tax code)	\$373.56	\$7.55	\$6.61
	\$373.56	80% (special tax code)	\$74.71	\$1.51	\$6.61
Student Allowance	\$184.87	M	\$161.76	\$3.27	\$3.27
	\$184.87	17.5% (Secondary tax code)	\$146.05	\$2.95	\$3.27
	\$184.87	18% (special tax code)	\$121.28	\$2.44	\$3.27

Table 2: amount of compensation for NZS/VP and Student Allowance recipients

### Fiscal implications of using an 'M' tax code

12. Using an 'M' tax code for all NZS, VP and student compensation would result in a higher cost for Government, relative to an approach that paid based on special and secondary tax rates. As noted in T2010/515, PAD2010/59 this cost was estimated to be \$2.5 million for NZS/VP. For Student Allowances it is estimated to be about \$0.1m.
13. The additional fiscal cost of using 'M' code rather than actual tax codes is therefore about \$2.6m. However, given the risks associated with implementing an approach based on actual tax codes, officials now recommend using the 'M' code for calculating all payments. This would be consistent with the previous forecasting of the costs of the compensation package (which used 'M' codes), so there would be no changes required to forecast spending.

## Other issues relating to payment of NZS/VP

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### Pay Run and per diem calculation

14. The payment cycle for NZS/VP will not align fully with the 1 October implementation date. The first payment is due on 12 October 2010 which covers the period 29 September to 12 October 2010.
15. We are proposing that the compensation payment be calculated on a pro rata daily basis which will mean the first instalment of NZS/VP on 12 October 2010 will contain 12/14ths of the fortnightly compensation amount. This means they will receive a different level of compensation payment in the first pay run than in subsequent pay runs.
16. The pro rata method is preferred because it provides consistency with any review of the NZS/VP payments or entitlement.
17. The alternative is to pay the compensation payments on an instalment basis. This would mean that from 1 October 2010 to 31 March 2011 the full fortnightly amount of compensation would be paid on each pay day that falls due during this period. This would mean a higher initial payment on the first payday after 1 October but no payment covering the last few days of March 2011.

### Overseas travellers, non-qualifying spouses and people in rest homes or hospital

18. There are a number of situations for NZS/VP clients who are living or travelling overseas. For the most part, we are looking only at the base rate after the deduction of tax, and before the deduction of any other payment, such as overseas payment direct deductions, debt repayments or income abatement.
19. We are also determining compensation payments based on whether they live in New Zealand or not. Where a person lives overseas they will not face the higher rate of GST and we propose to not make the GST compensation payment to them. The treatment we are applying is:
  - NZS/VP clients living in agreement countries (those that New Zealand has a bilateral social security agreement with) - no compensation payment as they are not tax resident in New Zealand and will not be exposed to GST impacts ;
  - Special Portability clients in Pacific island countries - no compensation as they are not tax resident in New Zealand and will not be exposed to the GST impacts;
  - General Portability clients
    - no compensation for clients who are residing (living) overseas as they will not be exposed to GST impacts;
    - compensation will be payable for those who are travelling overseas as they are still regarded as tax resident in New Zealand and intend returning to New Zealand
  - NZS/VP clients with abated rates due to receipt of an overseas pension - compensation is payable based on the full net rate of NZS/VP;
  - Special Banking Option cases (a system where a client's deductible overseas pension is paid into the SBO and they in turn receive the full rate of NZS/VP) - compensation is payable based on the full net rate of NZS;

- NZS/VP non qualified spouse clients - compensation is payable based on the net rate of payment before abatement of any income earned;
- Hospital rate for NZS - compensation component payable based on net hospital rate including the special Disability Allowance for partners of persons who are in hospital or rest home;
- Personal allowance for Residential Care Subsidy and Residential Support Subsidy cases - these rates are not to receive the compensation separately as either an increase in Personal Allowance rates or as a separate 2.02% compensation payment. The increased NZS/VP net rate and compensation payment based on NZS/VP rate will go to the rest home provider who will be faced with the GST impacts. The personal allowances will increase by convention by CPI on 1 April 2011; and
- Debts can be established for overpayments of compensation payments, in the same way overpayments of NZS/VP benefits are created.