The Treasury

Budget 2017 Information Release

Release Document July 2017

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[36]	to maintain legal professional privilege	9(2)(h)
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[38]	to enable the Crown to negotiate without disadvantage or prejudice	9(2)(j)
[39]	to prevent the disclosure of official information for improper gain or improper advantage	9(2)(k)
[40]	Not in scope	

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Reference:	T2016/1640	SH-13-5-2-3
Date:	5 September 2016	
To:	Minister of Finance (Hon Bill English)	
Deadline:	None	

THE TREASURY
Kaitohutohu Kaupapa Rawa

Aide Memoire: Income Policies for Low-income Populations

Purpose

This Aide Memoire responds to your request for information on low income earners and government policies/responses directed toward these people ahead of our advice on potential tax cuts. Three key areas are assessed – impacts of the Child Material Hardship Package, possible implications of the Terranova case, and minimum wage earners.

Child Material Hardship Package

Scoping work in 2015 identified a portion of the population that would stand to benefit from a material hardship package. The package was borne out of a particular concern for a group of children living in families experiencing deeper levels of material hardship – 60,000 to 100,000 children, or 30,000 to 50,000 families. Around two thirds of these children are from beneficiary families or from families moving between benefit and work. The remaining one third of these children are from working families.

The package was designed to have a meaningful impact for recipient families, particularly those on very low incomes, and will reduce the depth of hardship these families and their children experience.

- *110,000 beneficiary families will on average get an extra $23 net income per week.*
- *4,000 families not on a benefit and earning less than around $27,000 a year before tax, will get an extra $24.50 per week from an automatic increase to the minimum family tax credit.*
- *50,000 working families not on a benefit and earning $36,350 or less a year, get an extra $12.50 a week from the in-work tax credit, as well as up to $9 a week from the Accommodation Supplement (as an indirect consequence of benefits rising).*

It is important to note that trends in hardship are driven by a wide range of factors, and therefore, it is not feasible to precisely isolate the impact of the package. The changes took effect on 1 April 2016, and Treasury does not yet have information on how the changes have affected the population. The impact of the package will be picked up in the Household Economic Survey in 2017/18 and subsequently reported on in the 2019 Household Incomes Report by MSD. It is expected that the package will move few families out of material hardship, but will reduce the depth of hardship for these families. The total fiscal cost is estimated to be $240 million per year.

<u>TerraNova</u>

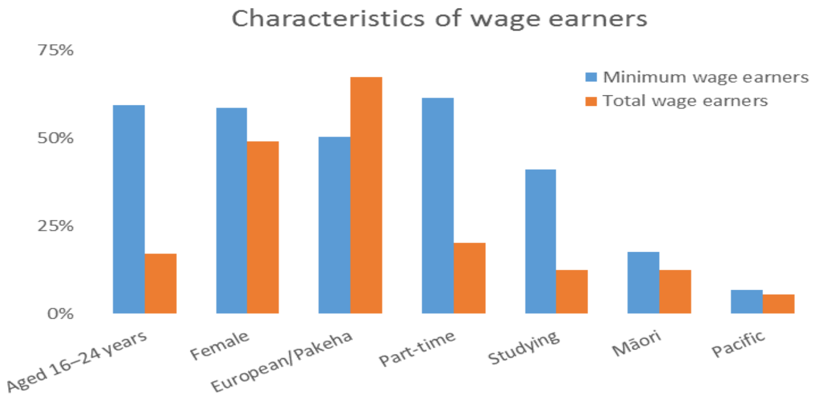
Following the Court of Appeal's 2014 finding that the Equal Pay Act provides for pay equity (equal pay for work of equal value), there have been two additional pay equity claims raised by occupational groups. The negotiations from the original claim against Terranova are ongoing, but are likely to impact approximately 55,000 care and support workers. Claims by other occupational groups are on-hold until Terranova negotiations are resolved. [38]

[38]

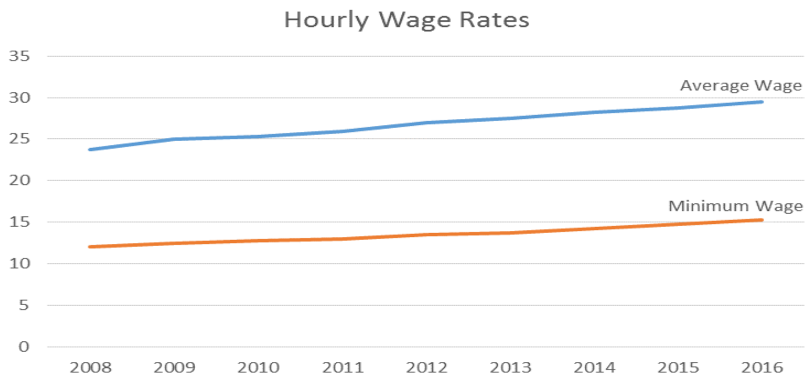
[38]

<u>Minimum wage</u>

Before its most recent increase, there were approximately 75,000 people earning minimum wage, and a further 680,000 earning up to $1.30/hour above this. The graph below compares the proportion of minimum wage earners with total wage earners for a variety of groups. It shows that a higher proportion of young and part time workers, as well as students, receive minimum wage. A number of other groups are also shown to be disproportionately reflected in minimum wage workers.



The minimum wage has remained at approximately 50% of the average wage since 2008, with a slightly higher growth rate of 27%, compared to average wage growth of 24%.



Summary

There is likely to be significant crossover in the people affected by each of the three areas described above. While the exact crossover is unclear, minimum wage earners with children, for example (except those with high-earning partners or working a very high number of hours) are eligible for the increased payments from the Child Material Hardship Package.

We plan to report to you on preliminary options for personal tax cuts on 12 September. Those options will include tax-only options, as well as relatively minor changes to transfers. The purpose of that report is to update you on the direction of the work and to seek your views on how you would like us to proceed.

[34] Analyst, Labour Market & Welfare, [39]
Eina Wong, Senior Analyst, Tax Strategy, [39]

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Preliminary Options for Tax Cuts for Budget 2017

Date:	13 September 2016	**Report No:**	T2016/1650
		File Number:	SH-13-5-2-3

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Discuss** with officials	20 September 2016

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Eina Wong	Senior Analyst	[39]	[23] (mob)	✓
Suzy Morrissey	Team Leader, Tax Strategy	[39]	[23] (mob)	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Preliminary Options for Tax Cuts for Budget 2017

Executive Summary

The Government has indicated potential tax cuts of up to $3 billion could be a part of Budget 2017 if economic and fiscal conditions allow. This report presents preliminary options of varying fiscal costs that target tax cuts and transfers to improve incomes for lower-income families.

Because the preliminary half-year economic and fiscal forecasts for 2016 are not yet available, we have modelled the options based on low ($0.9 billion), medium ($1.5 billion) or high ($2.3 billion) fiscal costs. We have also included changes to payments for Working for Families as well as main benefits. This report discusses three options that may be of particular interest based on fiscal and distributional impacts, while maintaining the integrity of our tax system.

These options may be further refined depending on the desired level of changes and how they fit within the Government's direction of fiscal, economic and social policy. We would like to discuss these options with you.

Ideally, we would also model the impacts on economic efficiency or marginal excess burdens for each of the options. Given the time and resource required, we have not done this, but we are working on developing this capability and will aim to include these impacts once options are further refined.

Any changes to the tax and transfer system will need to take into consideration the technological changes that Inland Revenue is undertaking as part of its Business Transformation. Inland Revenue is conducting further work on the timing issues, but currently, the most preferred time for changes to the personal tax schedule or benefits is 1 April 2018, with changes to Working for Families on 1 April 2019.

Recommended Action

We recommend that you:

a **note** that the preliminary half-year economic and fiscal forecasts for 2016 are not yet available, and we are not yet able to advise whether the available operating allowance would support a particular desired level of tax cuts and transfers

b **note** that officials have provided preliminary options for personal tax changes with changes to payments for Working for Families tax credits and main benefits to test the direction of the work with you

c **note** that the focus of the options is on improving the incomes of lower-income families, and that any tax cuts at the lower income tax brackets will also benefit higher-income families

d **note** that, if you wish, we can modify design aspects of the options to address the balance of efficiency, equity, or fiscal objectives desired

e **note** that impacts on efficiency or marginal excess burdens have not yet been analysed for these preliminary options, but that we are working on the analysis to include for further refined options

f **note** that there are administrative constraints that impact the timing for when changes to taxes or transfers could occur without operational risks

g **agree** that you meet with officials to discuss the contents of this report.

Agree/Not agree.

Suzy Morrissey
Team Leader, Tax Strategy

Hon Bill English
Minister of Finance

THE TREASURY
Kaitohutohu Kaupapa Rawa

Budget Report: Advice on Personal Tax Cuts for Budget 2017

Date:	7 November 2016	**Report No:**	T2016/1948
		File Number:	SH-13-5-2-3

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Agree** to recommendations	Tuesday, 8 November 2016

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Eina Wong	Senior Analyst, Tax Strategy	[39] (wk)	[23] (mob)	✓
Suzy Morrissey	Team Leader, Tax Strategy	[39] (wk)	[23] (mob)	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Executive Summary

The Government has indicated that tax cuts could be part of Budget 2017 if economic and fiscal conditions allow. This report follows our previous report on potential tax and transfer options directed at improving income adequacy of low-income families. We have modelled the fiscal costs, distributional impacts, and labour supply impacts of changes that could be implemented on 1 April 2018.

While the 2010 tax reforms placed New Zealand's tax framework in a relatively desirable position and are effective at raising tax revenue, officials consider that there is a case for lowering personal taxes based on first-principle equity and efficiency grounds. Our starting position is to lower personal taxes while maintaining our existing level of tax revenue and taking the Government's budget constraint as given. However, in the absence of increasing other tax bases, there is still a case for reducing personal taxes if there is available operating allowance.

There are two options presented in this report. The first considers reducing the number of tax brackets from four to three, with reductions of the first two rates. This option benefits most families, and costs about $1.3 billion. The second option is similar to the first, but instead of reducing the bottom tax rate, we include an increase in the Working for Families family tax credit by $20 per week per child. This option distributes more benefits to families in comparison, and costs $1.7 billion. Both options have very small labour supply impacts.

The main considerations in evaluating these options were based on equity objectives without adversely impacting economic efficiency. The options considered are based on discussions with you and subsequent feedback from your office.

We do not comment on the trade-offs with other spending or debt choices in this report. Further advice on this has been provided to you in the Treasury's fiscal strategy report on 4 November [T2016/2045 refers]. Our report discusses tax options of around $1.4 to $1.7 billion for illustration, should you choose to implement a tax reduction in Budget 2017. We also indicate at a very high level what a more ambitious welfare option could include if Ministers wish to delay tax and transfer changes. Separate advice will be provided on adjustments for fiscal drag.

We would like to discuss with you your preferences on refining the options in this report or the previous report [T2016/1650 refers], and whether you would like us to consider alternative supplementary benefits or transfers. To understand your preferences, we ask that you agree if our assumptions for a "target" income group of individuals is appropriate. This target income group is defined as those whose incomes fall between $14,000 and $48,000, in order to focus on improving income adequacy of low-income families.

Recommended Action

We recommend that you:

a **note** that officials understand that personal tax reductions could be part of Budget 2017 decisions, and we have considered further preliminary options to illustrate potential impacts

b **note** that following the significant tax reforms in 2010, New Zealand's tax framework is in a relatively desirable position, with a relatively simple tax framework that is efficient at raising revenue; however, we consider that there is room to lower personal tax rates on first-principle equity and efficiency grounds c **note** that Treasury's starting position regarding personal tax cuts is for revenue-neutral changes given the Government's budget constraint; however, in the absence of other base-broadening measures, there is still a case for cutting personal tax rates if there is available operating allowance

d **note** that the two additional tax cut options included in this report are based on previous discussions with you and subsequent feedback from your office

e **note** that the main considerations in evaluating these options were based on equity objectives for lower-income families without adversely impacting economic efficiency, as well as the potential fiscal envelope available out of potential Budget 2017 operating allowances

f **note** that this report does not comment on the trade-offs with other spending or debt options

g **note** that The Treasury's fiscal strategy report discusses these trade-offs in more detail and has been provided to you on 4 November

h **agree** to meet with officials to discuss tax options

Agree/disagree

i **agree** to direct officials to develop more detailed analyses of changes to the Accommodation Supplement

Agree/disagree.

j **note** that if you agree to recommendation (h), this would involve modelling resources from MSD to estimate the impacts of changing Accommodation Supplement payments, and

j if you agree to recommendation (h), **agree** that the "target" income group of individuals for changes to tax and transfers are those whose incomes fall between $14,000 and $48,000

Agree/disagree

Suzy Morrissey
Team Leader

Hon Bill English
Minister of Finance

Budget Report: Advice on Personal Tax Cuts for Budget 2017

Purpose of Report

1. You have indicated to officials that you would like to consider tax cuts as part of Budget 2017 decisions. This report presents two additional options to illustrate impacts of tax cuts that could be considered. It follows our recent advice on other potential options for tax cuts [T2016/1650 refers]. The primary purpose of both reports is to provide you with what tax options could look like so you can consider them against other spending or debt choices, and to seek feedback from you about how you would like officials to progress with the analysis.

2. This report does not comment on the trade-offs between spending, debt or tax options. Rather, further discussion on these trade-offs has been provided to you in The Treasury's fiscal strategy report [T2016/2045 refers].

Context with Budget Strategy

3. Because the Government's fiscal strategy has not been decided, we are providing the options in this report as illustrative, with fiscal costs around $1.5 billion. The fiscal strategy report advises on possible increases in operating and capital allowances; however, the preliminary fiscal forecast and spending and capital pressures indicate that it is questionable whether the allowances will accommodate a tax option of this size.

4. This report discusses tax options of around $1.4 to $1.7 billion for illustration, should you choose to implement a tax reduction in Budget 2017. We will also discuss at a very high level what a more ambitious welfare option could include if Ministers wish to delay tax and transfer changes. Separate advice will be provided on adjustments for fiscal drag [T2016/2059 refers].

5. If the operating allowance limits a tax package to $1 billion or less, a tax cut of this magnitude would limit the ability to redistribute tax cuts to low-income families and, at the same time, have a negligible effect on economic growth. Instead, if the available funds are limited, more targeted improvements could be achieved through transfers to low-income families alone. We discuss this in more detail later in the report.

Background

The New Zealand tax framework and potential changes

6. The 2010 tax reforms were significant, with the main changes being:

    - Reductions in the personal tax rates
    - An increase in the GST rate, accompanied by commensurate increases in benefits and transfers to families with children
    - A reduction in the corporate tax rate

7. The changes were made with the primary objectives of improving economic efficiency and international competitiveness, with distribution-neutral impacts. The reforms have placed us in a relatively desirable position compared to other OECD countries, with a relatively simple tax framework that is efficient at raising revenue. Our assessment is that our broad-base, low-rate system is the best system for New Zealand.

8. We believe that there is room to enhance that framework with reductions to personal taxes. Personal taxes are considered to be relatively inefficient tools to raise revenue as they distort households' labour/leisure and savings decisions, for example, and can have negative impacts on growth.[1] While personal tax rates were reduced relatively significantly in 2010, we could lower them further within the bounds of possible operating allowances, and without significantly affecting equity and efficiency trade-offs.

9. In the bigger picture, unless the fiscal strategy indicates that spending or debt pressures have changed significantly and that the Government's budget constraint should be readjusted, our starting position is for any tax changes to be revenue-neutral. Possible increases to other tax bases to offset reductions in personal taxes could include, for example: widening the taxation of capital gains, introducing a land tax, or broadening the GST base. We have been directed to not prioritise a revenue-neutral tax change via an increase in the GST rate for Budget 2017.

10. For completeness, we would not prioritise increases to the GST rate as a tax-switch to offset reductions to personal taxes at this time. Increases to the GST rate could create revenue risk and inefficiencies if its broad base is eroded through exemptions. A tax switch would also require a wider review of the tax system which may not be timely because it hasn't been long since the 2010 reforms.

11. We would also not prioritise reducing the corporate tax rate. Although it would likely benefit to foreign investors by lowering taxes on economic rents, it could make New Zealanders as a whole worse off. It may also increase certain tax structuring incentives. This in turn would reduce revenue from personal taxation but in a non-neutral and unprincipled manner. These issues are explained in a recent report [T2016/1968 refers].

Equity-based personal tax cuts

12. Reductions to personal taxes involve trade-offs among key objectives of: efficiency/growth, equity, fiscal integrity, ease of compliance/administration, and fiscal cost. There is no perfect or optimal tax and transfer system, and any tax structure will incorporate value judgments of the central decision maker. Even within one of the stated objectives, such as equity-based changes, there are different concepts of what is fair and those concepts may result in different design and redistribution outcomes, as well as impacts on other objectives. In other words, if the overarching objective is to improve equity, the changes will likely have impacts on efficiency, fiscal cost, and compliance or administration, as well as winners and losers.

13. There are several factors to consider in designing changes:

- Distributional impacts, and the impact on individuals' average tax rates for individuals, and how these rates differ across the income distribution with changes to the personal tax schedule.

- Impact on effective marginal tax rates (EMTRs), and how this may impact on the labour or leisure decisions at different points on the income distribution. This takes into account any transfers such as benefits or tax credits and abatement rates.

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1 Consumption taxes such as GST also affect labour/leisure and savings decisions, but our flat rate helps to mitigate the impacts.

- Fiscal costs.

- Tax compliance, and how changes to thresholds and rates may increase incentives for tax structuring. Research indicates that individuals can be very responsive to tax changes, with annual incomes "peaking" just before a higher threshold. This was shown to be the case when tax rates were cut in 2010, for example.

- Long run macroeconomic impacts.

- Potential administrative implications.

14. Based on previous discussions with you and subsequent feedback from your office, we have considered potential changes that may provide benefits to lower-income families within the potential fiscal envelope available. We provided you with some possible options recently that considered changes to the tax rates or threshold in the lowest two tax brackets [T2016/1650 refers]. In this report, we provide you with two options that reduce the number of tax brackets from four to three, as well as reducing average tax rates.

15. Ultimately, the impacts of any proposed tax changes should be assessed against changes to the "excess burden" of taxation, the excess of the money measure of the welfare change over the tax paid. The Government can assess whether the efficiency gains or losses are acceptable given other impacts of the policy. Welfare measures allow for a more accurate assessment to be made by taking into account different individuals' responses to policy changes. They may also allow for a preferred level of inequality aversion.

16. Presently, we are able to measure some but not all of the response to tax changes, which could under- or over-estimate efficiency or welfare impacts. We have been developing modelling code that will allow us to measure welfare changes occurring as a result of tax changes. We will be able to report the excess tax burden shortly.

Composition of taxpayers

17. To help us understand where changes could be targeted in the personal tax and transfer framework, we can look at the types of taxpayers in each income tax band. In Appendix 4, we provide analysis that outlines the extent to which individual taxable income is a good proxy for economic wellbeing, and the extent to which tax changes are the most targeted way of improving incomes as compared with transfer policies. We used administrative data on individuals from Inland Revenue for tax year 2014/15.

18. In that analysis, our assumption is that the target group is likely to be those individuals who are not already receiving transfers, and those who are not young or students. For those receiving transfers, more assistance can be given directly through the transfer system. Young individuals or students are likely in a transitional part of their lifecycles with temporarily low incomes.

19. Provided that Ministers agree with officials' assumptions about the appropriate "target group", the descriptive results indicate that many of the targeted group have incomes between $14,000 and $48,000. This is a relatively large tax band and captures 35% of taxpayers in our target group. The analysis below focuses on improving equity objectives for this group of taxpayers.

20. In deciding design details of a tax reduction, we would not prioritise cuts for the lowest tax bracket. Not only are the economic benefits at this range likely to be small when there are more direct means of increasing assistance, but there would also be higher fiscal costs and efficiency implications as everyone higher in the income distribution would gain significantly more from these tax cuts.

Additional Potential Options (Reducing a Tax Bracket)

21. In our previous report [T2016/1650 refers], we presented a series of options with low, medium, and high fiscal costs. These options included combinations of tax cuts, Working for Families (WFF) family tax credit increases, and benefits increases, keeping four tax brackets.

22. This report presents two options that reduce the number of tax brackets to three:

Table 1. Other illustrative tax options

Status Quo

$1	$14,000	10.5%
$14,001	$48,000	17.5%
$48,001	$70,000	30%
$70,001	+	33%

Option A

$1	$14,000	10.0%
$14,001	$52,000	16%
$52,001	+	33%

(Tax cuts only)

Option B

$1	$14,000	10.5%
$14,001	$52,000	16%
$52,001	+	33%

(With increase in WFF of $20 per week for all child rates)

23. The tax changes above are very similar, apart from the lowest rate. Option A lowers average tax rates across the income distribution relative to the status quo, and as a result, has a higher fiscal cost compared to the tax cuts in Option B. Option B, while giving away less in the form of tax cuts for those in the lowest tax bracket, is presented jointly with an increase in the family tax credit of $20 per week per child. The purpose is to illustrate that greater benefit may be given to lower-income families than a tax cut in the lowest bracket.

24. The annual increases to the WFF tax credits are as follows:

Table 2. Potential increases to WFF tax credit (specifically, the family tax credit)

	Status Quo	Option B
1st child		
ages 0-15	$4,822	$5,862
ages 16-18	$5,303	$6,343
2nd child		
ages 0-12	$3,351	$4,391
ages 13-15	$3,822	$4,862
ages 16-18	$4,745	$5,785

25. To illustrate, for a hypothetical family with two children aged 16 and 14, WFF tax credits fully abates at a family income level of $93,546 under the status quo (and assuming eligibility for in-work tax credit). Under Option B, full abatement occurs at family income of $102,790, assuming abatement thresholds and rates do not change.

26. The family tax credit is currently expected to be adjusted for its cumulative inflation amount, which will be around 5.5% on 1 April 2019. The fiscal costs of Option B have taken this into account, and the costs provided below are additional if Option B is implemented on 1 April 2018. The increase in Table 2 would exceed that amount and restart the inflation clock on 1 April 2018 (or when the change is implemented).

27. The fiscal cost of the options are:

Table 3. Fiscal costs of illustrative options

	Option A	Option B
Gross cost	$1.4 b	$1.9 b
With 10% clawback	$1.3 b	$1.7 b

28. The gross cost of the WFF change by itself is approximately $700 million. This WFF cost illustrates a potential package within the possible operating allowances, but the WFF could be scaled back almost linearly if desired. For example, a $10 weekly increase to all child rates would cost approximately $350 million.

29. Clawback refers to the additional revenue that the Government receives from a personal tax cut or welfare transfer increase, which is largely due to increased spending that generates GST. The level of clawback depends on the proportion of disposable income that households spend on goods and services that generate GST or are subject to excise duties. This proportion trends to be higher at lower household income levels because households with lower disposable incomes tend to spend a greater proportion of incomes on goods and services subject to excise duties or GST. In this analysis, we have used an average 10% clawback rate, assuming that personal tax and transfer changes affect households uniformly. The clawback rate will be higher when personal tax and transfer changes are targeted at lower-income households.

30. We will report to you shortly on the more technical aspects that we have identified in a recent review of the clawback calculation. Once we have done that, we will include fully-modelled clawback estimates in our future reports, rather than the average 10% estimate that we have used in this report.

Analysis of Options

31. Earlier in this report, we identified several factors to assess when considering personal tax changes. In this section, we compare the options against these factors. All changes are modelled to occur on 1 April 2018.

Distributional Impacts

32. The distributional impacts are reported by income deciles, and are on a family basis. The results are shown in detail in Appendix 2 and in the figures below.

Figure 1. Average weekly gain per family

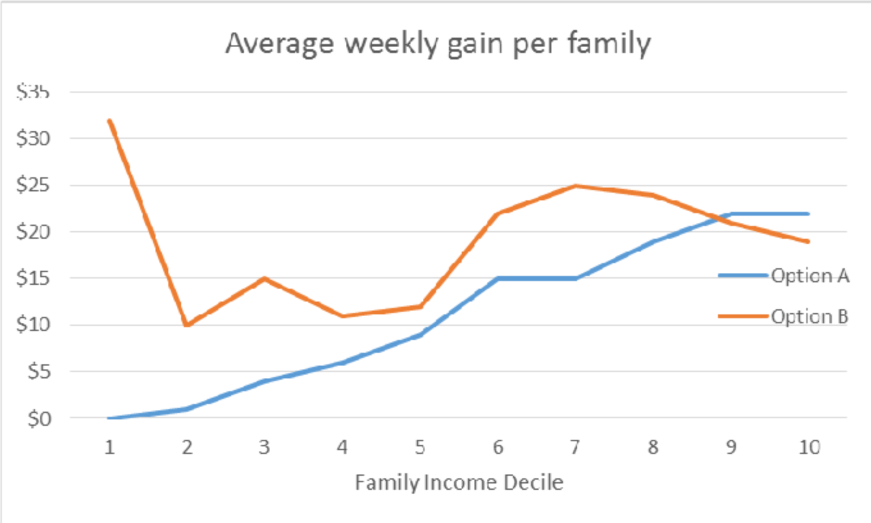
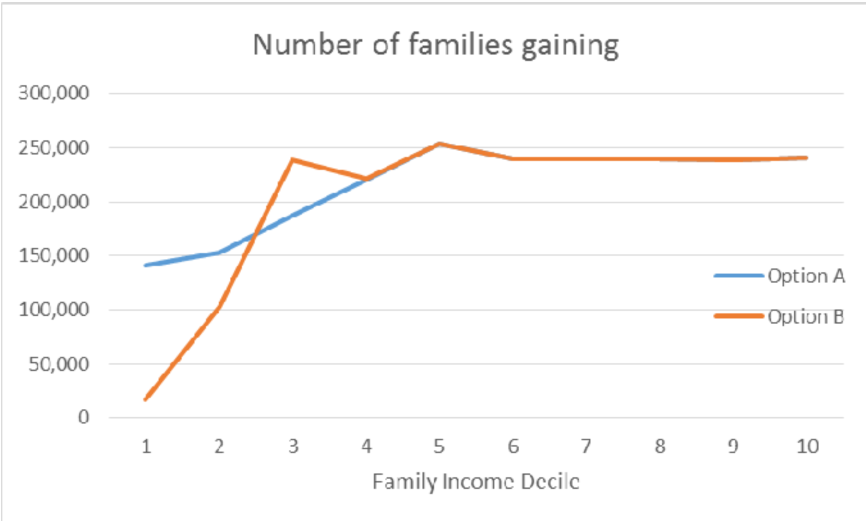


Figure 2. Number of families gaining



33. Unsurprisingly, there are more families gaining in the bottom two deciles (up to $19,900 annual income) under Option A with the small tax cut from 10.5% to 10%. However, the average gain per family is significantly smaller with Option A, with the average family gaining about $1 per week. For both options, some families in the bottom two deciles experience a negative impact, althoughthis will not be significant (less than $1), indicated in Appendix 2. These families will have many changes in circumstance throughout the year, typically interacting with work, the welfare system, Accommodation Supplement, and WFF.

34. In Option B, while there are fewer families gaining in these bottom two deciles in comparison, those families also gain an average of $32 per week for the bottom decile, and $10 per week for families in income decile 2. The large gain for families in income decile 1 is likely because those families that gain (approximately 17,000 families) on average have more children than gaining families in other deciles. In deciles 3 and 4, there are also more families gaining compared to Option A, and higher average weekly gains.   For income decile 5 and above, families receive higher average weekly gains compared to Option A.

35. If Option B results are preferred, other ways of addressing income adequacy for the bottom deciles is to also consider increasing the rates of the main working-age benefits or one of the major supplementary benefits such as Accommodation Supplement. We discuss this later in the report.

Average tax rates

36. Average tax rates for hypothetical individuals are given in the following table:

Table 4. Change in average tax rates

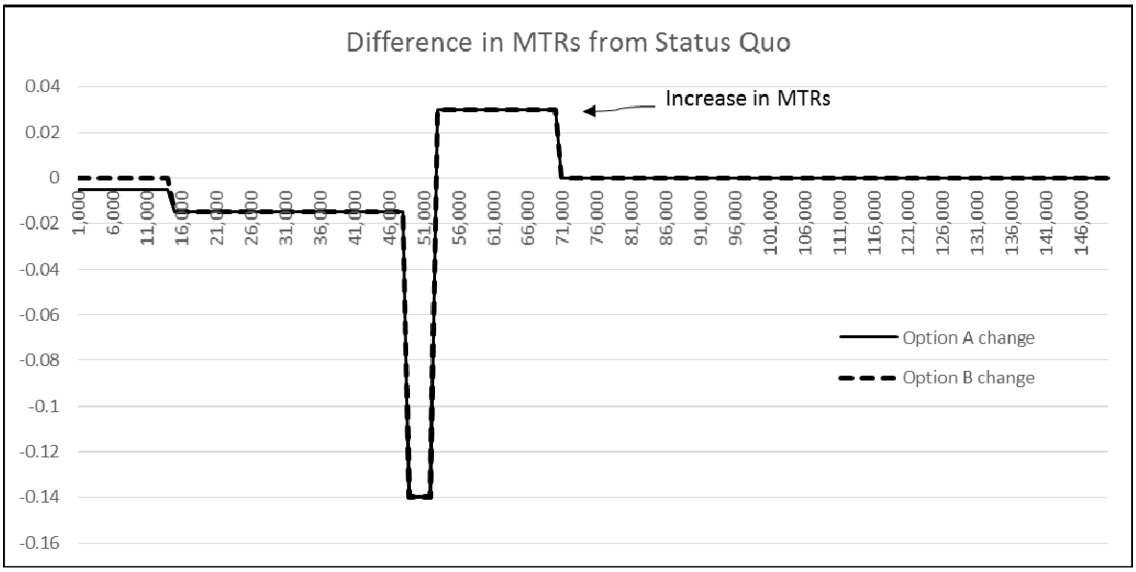
	Annual Income	Status Quo	Option A	Option B
20 hours, minimum wage	$ 15,860	11.32%	10.70%	11.14%
40 hours, minimum wage	$ 31,720	14.41%	13.35%	13.57%
20 hours, average wage	$ 29,095	14.13%	13.11%	13.35%
40 hours, average wage	$ 58,189	18.0%	16.36%	16.48%
40 hours, 2x average wage	$116,378	25.2%	24.68%	24.74%

37. Average tax rates are an indication of whether proposed tax changes are more or less equitable across the income distribution. For progressive tax structures, average tax rates increase with incomes. Both of these options keep the tax structure relatively progressive because the changes are at the lower and middle incomes of the distribution.

38. In both options, average tax rates decrease for earners compared to the status quo, with bigger changes under Option A. The greatest gains using this measure go to those who earn around the full time average wage, around $58,000. This is because they will benefit from the relatively large decrease in marginal tax rate from the current 30% to 16% for earned income between $48,000 and $52,000.

39. The chart below shows the difference in marginal tax rates with both options, compared to the status quo:

Figure 3. Difference in marginal tax rates relative to status quo



40. While Option A reduces average tax rates more than Option B, we should take into account the EMTRs under both scenarios.

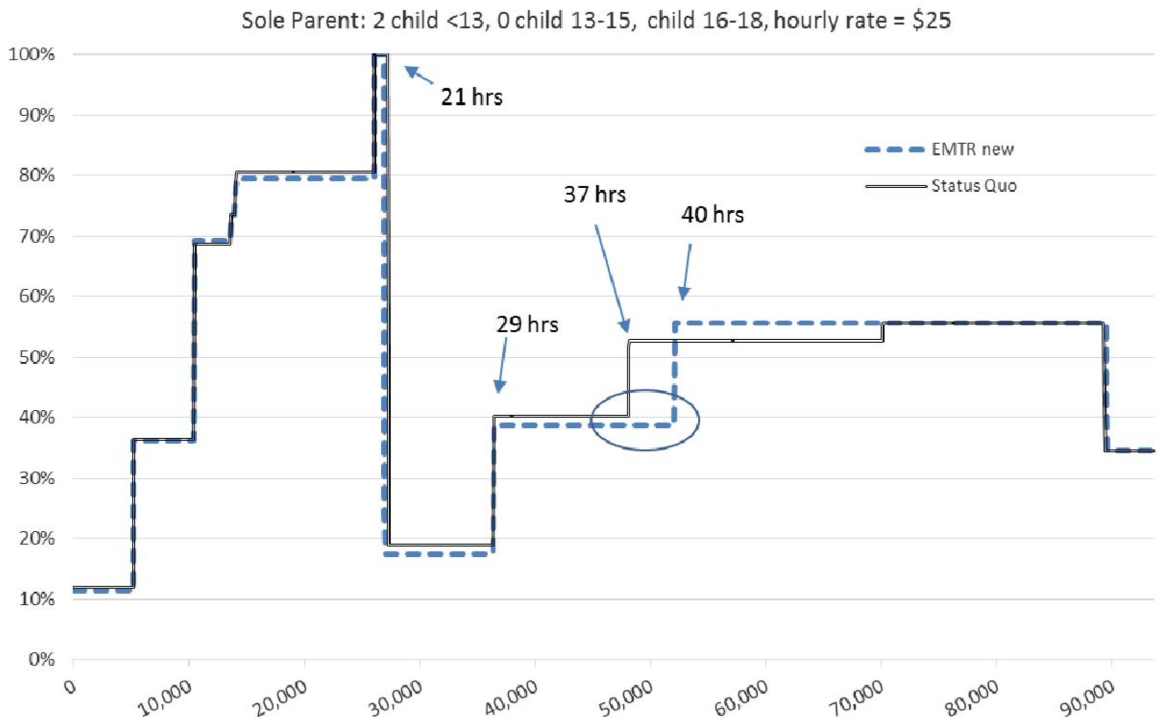
EMTRs and labour supply impacts

41. Social assistance via our tax and transfer system impacts individuals' incentives as it can reduce the relative return from work. The withdrawal, or abatement, of assistance raises EMTRs, which reduces incentives to work. Increases in transfers can also work to help individuals overcome barriers to work, such as increasing child care assistance. However, trade-offs exist and depend on population heterogeneity.

42. For the options presented above, the EMTRs will not differ from each other except in marginal cases where families are currently within the abatement range. For these families, an increase in the family tax credit delays the point of income at which the credit fully abates. We have provided advice to you recently regarding the interaction of increasing the family tax credit and abatement thresholds [T2016/1847 refers].

43. When compared to the status quo, the tax options similarly will not increase EMTRs for families until they earn $52,000, the point at which they move into a higher tax bracket. By extension, these families will need to work more hours before they encounter the higher EMTR. We look at a hypothetical sole parent with two children scenario to illustrate this:

Figure 4. Comparison of EMTRs under status quo and Option A



44. In Figure 4, the most notable change in EMTRs for the sole parent earning $25 per hour will be after the minimum family tax credit fully abates, around $27,000. After this point, EMTRs will be lower than the status quo until their income reaches $52,000, where the new tax threshold would be reached. In this particular hypothetical family, there may be an increased incentive to work more hours, particularly if the sole parent is currently working around 36 hours, and they may choose to work until just under 40 hours (indicated by the circled range in the figure).

45. EMTRs will be very similar under Options A and B. The difference is that at lower tax rates, EMTRs will be slightly higher (compared to the status quo) under Option B for sole parents earning under $14,000 as benefits abate.

46. Using microsimulation modelling for labour supply behavioural responses, the overall result is that with either tax option, labour supply effects will be very small. The largest responses will likely come from sole parents who are more responsive to changes in Option B with a 1.3% point increase of the population going from not working to working. In comparison, an increase of 0.7% points of the population will go from not working to working under Option A.

47. For individuals already working, more sole parents are likely to increase their working hours under Option A while couples are more likely to reduce their working hours under Option B. For couples, the population of workers working fewer hours increases by 0.2% points and 0.1% points under Options B and A, respectively. Appendix 3 provides detailed tables that compare the labour supply responses for your reference.

48. The labour supply changes are expected to reduce the total fiscal cost of the tax changes in Table 3 by 11% under Option A, and by 1% under Option B. The lower adjustment for costs under Option B is due to the smaller labour supply response and the increased expenditure for WFF.

Impacts on GDP

49. The small increase in labour supply implies an increase in the level, but not growth rate, of GDP in the long run. Under Option A, GDP is expected to be only 0.6% higher, assuming that capital adjusts in the long run to the higher labour input. With Option B, for which the aggregate change in labour supply is even smaller, the long run effect on GDP is commensurately lower.

50. Although the tax options presented in this report are provided mainly to illustrate the possible design of tax reductions, we include their potential impacts on GDP to demonstrate how tax cuts could be balanced against possible spending choices or debt objectives.

Tax compliance

51. We mentioned earlier that changes to the personal tax structure generally invoke behavioural responses with regards to tax compliance. This is because individuals' elasticities of taxable incomes tend to be higher when their sources of income are not withheld at source. As a result, taxpayers might under-report income to evade tax, or structure their affairs to evade, avoid, or minimise tax. Analysis of the 2010 tax changes showed "bunching" of reported taxable income at the $48,000 and $70,000 income levels, indicating that taxpayers are responsive to changes and may structure their tax affairs around the tax schedule.

52. The options above are also likely to result in bunching at the $52,000 income level, and the peak may be relatively higher than with the current tax schedule because there would be fewer tax brackets. If this occurs, and depending on the extent that bunching occurs, it may have an impact on tax revenue, although it is difficult to quantify this impact. The modelling that we have carried out as part of this report does not take into account the compliance response.

Accommodation Supplement

53. The over-arching objective of the work on personal tax cuts is to improve income adequacy of the low-income population. Housing costs in particular have become an increasing concern as the proportion of incomes spent on housing has risen, particularly for low-income families.

54. Market rents are increasing faster than incomes of beneficiaries and low-income earners. For those who receive AS currently (about 290,000 individuals), housing is increasingly more expensive or unaffordable because rents have increased and AS maximum rates haven't increased since 2006 (with figures based on 2003 rents).

55. There's a question of whether AS gets captured by landlords through increasing household purchasing power in a supply-constrained market, resulting in higher market rents or mismatch of property to needs. Statistics indicate that housing supply is extremely constrained and may point to landlord-capture. From 2005 to 2015, nominal prices went up 62%[2], and only triggered an 11% supply increase from 2006 to 2016. If landlord-capture does exist, it is likely due to the circumstances of those receiving AS (i.e., those in housing stress), rather than the design of the payment.

2 For the same period, nominal prices increased 107% in Auckland.

56. While there may be a landlord-capture issue, AS is the most significant and targeted instrument for addressing housing costs. Increases through other instruments such as benefits or WFF will also go toward those families who are not necessarily in housing stress and so these payments are less likely to be captured by landlords; however, these payments are less targeted to those facing financial stress from housing costs.

57. The Auckland Unitary Plan will allow an increase in supply from current levels in Auckland; however, it is unlikely to reduce the price of housing from current levels. A more competitive and developable land market, rather than an increase in housing supply, may be required to prevent an increase in the ability/willingness of households to pay for housing which results in higher land prices and rents. It is important to note that while supply constraints are most significant in Auckland, housing stress in low-income households is common in many parts of NZ.

58. Officials consider that the existing housing subsidy structure (income-related rent subsidy (IRRS), accommodation supplement, and temporary additional support (TAS)) is not fit-for-purpose. AS does not adequately alleviate housing stress, and IRRS and TAS have poor work incentives and are increasingly costly. One of the key factors driving increases to TAS is the increasing inadequacy of AS to cover housing costs. MSD is progressing work on subsidy reform, and we have been keeping in close touch with the developments.

59. If improving the incomes of low-income families is a key objective of tax and transfer changes, personal tax cuts alone will not be able to achieve this. Changes will need to include one or more of the main transfer payments to those on low incomes, such as benefits, WFF, or AS. We are not able to comment on which of these payments would be preferable to include in a package because each has different target populations and different impacts. If these options are to be considered, then further analysis is needed to provide Ministers with advice, and we would like direction to progress this. This work would primarily involve modelling resources from MSD as they have the appropriate model for estimating impacts from changing AS. Treasury's Taxwell model is not compatible with MSD's.

Addressing Fiscal Drag – Out of Scope

60. We have provided advice to you on potentially addressing fiscal drag as an alternative to reducing personal taxes for a Budget 2017 decision [T2016/2059 refers]. In summary, because fiscal drag could have detrimental impacts on efficiency and equity outcomes if left untreated, there is a case for adjusting tax thresholds over time. However, because price inflation has been at all-time lows since 2010 and the anticipation is for the trend to continue and possibly for interest rates to decline further, the case for addressing fiscal drag immediately has less priority given the trade-offs with a potentially wider tax package. In addition, the efficiency gains are likely to be minimal.

61. To be clear, for the tax options discussed in this report, average tax rates will decline for all those earning beyond the first threshold. The efficiency and fairness objectives would be directionally similar to a policy of adjusting for fiscal drag.

62. If price inflation speeds up, we would revisit whether fiscal drag effects are significant and consider adjusting tax thresholds at that time.

Next Steps

63. We have provided two tax options in this report at the request of your office. The fiscal strategy for Budget 2017 has not yet been agreed, and we do not know whether the available operating allowance might accommodate a tax cut of this magnitude. If operating allowances are constrained so that the amount available for a tax cut is less than $1 billion, we suggest that focus be given on targeted transfers, rather than a combination of tax cuts and transfers. These transfers could be in the form of increasing family tax credits as discussed in this report, or perhaps transfers that are targeted at other low-income sub-populations, such as the Accommodation Supplement, although the latter would need more analysis to estimate impacts.

64. As discussed above, the fiscal strategy report presents trade-offs of spending, debt or tax decisions as part of Budget 2017. If a decision is made to delay tax and transfer changes as part of this Budget, one further option is to consider a more ambitious welfare change with a bigger fiscal cost to be implemented in perhaps two or three years' time. This would have an additional benefit of waiting to see if other pressures develop, including increasing effects of fiscal drag or other economic shocks, and allow us to assess the priority of policy changes at that time.

65. We think that a more ambitious welfare package could include a significant review of the Accommodation Supplement, with a view to at least simplifying its structure and improving targeting of payments, or perhaps reconsidering it altogether. We have not discussed this with MSD yet. Another area would be a review of the minimum family tax credit and in-work tax credit of the WFF framework, and the independent earner tax credit. At the same time, we would consider the interactions with the benefits structure, but not with a view to promote change in the latter.

66. We would like to discuss with you your preferences for potential changes to the tax and transfer framework. In particular:

    - Whether you would like us to consider refinements to either the options presented in this report, or the options in our previous report [T2016/1650 refers]

    - If you would like us to focus on alternative policies directed at low-income populations, such as changes to Accommodation Supplement, or perhaps a combination of changes to both Accommodation Supplement and WFF.

Appendix 1. Summary of Options

Note that all policy options are modelled for tax year 2018/19

Proposed tax cuts

Status Quo

$1	$14,000	10.5%
$14,001	$48,000	17.5%
$48,001	$70,000	30%
$70,001	+	33%

Option A

$1	$14,000	10.0%
$14,001	$52,000	16%
$52,001	+	33%

(Tax cuts only)

Option B

$1	$14,000	10.5%
$14,001	$52,000	16%
$52,001	+	33%

(With increase in WFF $20 per week all child rates)

Proposed increases to annual Working for Families payments

1st child

	Status Quo	Option B
ages 0-15	$ 4,822	$ 5,862
ages 16-18	$ 5,303	$ 6,343

2nd child

	Status Quo	Option B
ages 0-12	$ 3,351	$ 4,391
ages 13-15	$ 3,822	$ 4,862
ages 16-18	$ 4,745	$ 5,785

Appendix 2. Distributional Impacts of Tax Options

Option A. Tax-only changes

Deciles	Decile lower bound	Number of families with positive taxable income	% of families with positive taxable income	Number of families gaining	% of decile gaining	Average weekly gain for gaining families	Number of families disadvantaged	% of decile disadvantaged	Average weekly loss for losing families
1	$0	152,000	7%	141,000	92%	$0	7,000	2%	<$1
2	$9,800	235,000	10%	153,000	65%	$1			
3	$19,900	245,000	11%	187,000	76%	$4	*	*	*
4	$25,200	226,000	10%	220,000	97%	$6	*	*	*
5	$36,100	254,000	11%	254,000	100%	$9	*	*	*
6	$45,200	240,000	10%	240,000	100%	$15	*	*	*
7	$60,900	240,000	10%	240,000	100%	$15	*	*	*
8	$80,000	240,000	10%	240,000	100%	$19	*	*	*
9	$106,100	239,000	10%	239,000	100%	$22	*	*	*
10	$146,500	241,000	10%	241,000	100%	$22	*	*	*
All		2,312,000	100%	2,155,000	93%	$13	*	2%	$0

Option B. Tax changes with WFF increases

Deciles	Decile lower bound	Number of families with positive taxable income	% of families with positive taxable income	Number of families gaining	% of decile gaining	Average weekly gain for gaining families	Number of families disadvantaged	% of decile disadvantaged	Average weekly loss for losing families
1	$0	152,000	7%	17,000	11%	$32	5,000	1%	<$1
2	$9,800	235,000	10%	103,000	44%	$10			
3	$19,900	245,000	11%	239,000	98%	$15	*	*	*
4	$25,200	226,000	10%	221,000	98%	$11	*	*	*
5	$36,100	254,000	11%	254,000	100%	$12	*	*	*
6	$45,200	240,000	10%	240,000	100%	$22	*	*	*
7	$60,900	240,000	10%	240,000	100%	$25	*	*	*
8	$80,000	240,000	10%	240,000	100%	$24	*	*	*
9	$106,100	239,000	10%	239,000	100%	$21	*	*	*
10	$146,500	241,000	10%	241,000	100%	$19	*	*	*
All		2,312,000	100%	2,035,000	88%	$18	*	1%	$0

This analysis was carried out using Treasury's micro-simulation model of the tax and welfare system - Taxwell. All calculations should be considered as estimates.
Estimates are for the 2018/19 tax year using HES 15 inflated and population adjusted with BEFU 2016 inflation estimates.
Access to the Household Economic Survey data was provided by Statistics New Zealand under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975. The results presented here are the work of Treasury, not Statistics New Zealand.
Treasury Internal Tracking: TAR 63

Appendix 3. Labour Supply Impacts of Proposed Changes

The tables below provide more detail of the potential impacts on labour supply decisions by type of income earners.

The first two rows report the percentages of individuals working within that individual's type. For example, 59.3% of married men are currently working. Under the Option A tax proposal, 59.5% of married men would be working, indicating a 0.2% point increase in employment, or an increase from not working to working (the difference between rows 1 and 2 is equivalent to the difference between rows 3 and 4).

Rows 5 and 6 represent changes in labour supply for those *already working*. For example, for sole parents who currently work, 0.5% would work more, and 0.2% would work less. On balance, 0.3% would work more (the difference between rows 5 and 6). Overall, sole parents increase their working hours by 0.3 hours per week (row 7)

The results indicate that more sole parents are more likely to participate in the labour market under Option B (1.3% versus 0.7%). However, married couples *already working* are more likely to work less under Option B compared to Option A.

The overall results indicate that labour supply changes will be very small regardless of either tax option. As a point of reference, the labour supply impacts from the 2010 reforms were estimated to be a 0.9% point increase in the sole parent population, going from not working to working. The 2010 reforms were designed to be revenue- and distribution-neutral, however, so the impacts are not directly comparable.

Option A

		Married		Single		
		Men	Women	Men	Women	Parents
1	Salaried worker (% before reform)	59.3	56.0	54.9	46.6	46.3
2	Salaried worker (% after reform)	59.5	56.3	55.0	47.2	47.0
	Behavioural Response					
3	Non-work to work (ppt)	0.2	0.3	0.1	0.6	0.7
4	Work to non-work (ppt)	0.0	0.0	0.0	0.0	0.0
5	Workers working more (ppt)	0.1	0.1	0.0	0.4	0.5
6	Workers working less (ppt)	0.1	0.1	0.0	0.1	0.2
7	Average hours change per week	0.1	0.1	0.1	0.3	0.3

Option B

		Married		Single		
		Men	Women	Men	Women	Parents
1	Salaried worker (% before reform)	59.4	56.0	54.9	46.6	46.3
2	Salaried worker (% after reform)	59.4	56.0	55.0	47.1	47.6
	Behavioural Response					
3	Non-work to work (ppt)	0.1	0.2	0.1	0.5	1.3
4	Work to non-work (ppt)	0.1	0.2	0.0	0.0	0.0
5	Workers working more (ppt)	0.1	0.1	0.0	0.5	0.3
6	Workers working less (ppt)	0.2	0.2	0.0	0.1	0.4
7	Average hours change per week	0.0	0.0	0.1	0.3	0.3

This analysis was carried out using Treasury's behavioural micro-simulation model of the tax and welfare system, Taxwell-B. All estimates are based on Household Economic Survey 2015.
Access to the Household Economic Survey data was provided by Statistics New Zealand under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975. The results presented here are the work of Treasury, not Statistics New Zealand.

Appendix 4. Composition of Taxpayer Population

The primary objective of the personal tax cuts being considered is to improve the income adequacy of low-income families. To help us understand where changes could be targeted in the personal tax and transfer framework, we should look at the composition of individuals in the income distribution. This analysis outlines the extent to which individual taxable income is a good proxy for economic wellbeing, and the extent to which tax changes are the most targeted way of improving incomes as compared with transfer policies.

Note that the following analysis is based on individuals using Inland Revenue administrative data from 2014/15 tax year. This allows more accurate analysis of taxpayer types; however, we cannot draw conclusions on a family basis. Despite this, we think the analysis is useful for our purposes. The sample data using the Household Economic Survey for the low-income populations has some reporting issues that make it less useful for this type of analysis.

The following analysis was done on a mutually exclusive basis. That is, for us to look at who we believe are the relevant target for tax cuts and WFF increases, we first pull out those individuals who receive other forms of income or assistance, and are left with a group that does not include any of the already identified taxpayers. We then select another characteristic to single out. In this case, we single out, in the following order, those individuals who:

1. received income from NZ Superannuation
2. received income from a taxable welfare benefit
3. received a student allowance
4. were 25 or younger
5. had part year wages
6. received a WFF payment (or their partner did)

We considered that 1 and 2 are individuals whose incomes can be directly altered and tax changes may not be the optimal way of targeting changes for them. Note that welfare benefit rates are after-tax amounts, and so tax changes do not flow through to benefit recipients. Working for Families tax credits are not taxable income, and so tax changes do not affect net amounts for these recipients. New Zealand Superannuation is taxable and is a pre-tax amount, and so tax changes do affect the level of payment to super annuitants. Their amounts are also annually indexed according to after-tax median wages, meaning they get a secondary boost from tax cuts.

Individuals in groups 3 and 4 are likely to be younger and are in the stage of their lifecycles when incomes are temporarily low as they are studying or perhaps dependent on their parents as they begin adulthood. Individuals in group 5 may also have temporarily low incomes if they are between job contracts.

Those individuals who received a WFF payment (or their partner) are also singled out, so that we may use that data to look at the distribution of WFF recipients.

The table below summarises the breakdown of types of taxpayer by tax bracket:

Table A4.1. Composition of taxpayers

	Nil taxable	$0 to $14k	$14k to $48k	$48k to $52k	$52k to $70k	Over $70k	Total
super	4,400	37,600	514,700	12,300	43,600	58,400	671,000
welfare	1,400	195,300	257,500	2,000	3,700	1,200	461,100
student allowance	200	35,800	25,700	200	300	-	62,200
under 25	7,700	214,300	166,900	9,500	17,400	5,200	421,000
part year wage	3,400	102,000	38,400	2,400	5,900	8,600	160,700
getting WFF credits	42,900	32,900	135,600	15,700	47,900	22,000	297,000
residual group	40,400	92,400	540,200	85,800	310,700	473,500	1,543,000
Total	**100,400**	**710,300**	**1,679,000**	**127,900**	**429,500**	**568,900**	**3,616,000**

The ordering matters in this exercise. As an example, the number of taxpayers in the $0 to $14k column in Table A4.1 who receive a student allowance is 35,800. The number of under 25 taxpayers in that same column is 214,300. Because the under 25 row comes **after** the student allowance row, the correct interpretation is that there are 214,300 under 25 taxpayers who do **not** receive a student allowance (and who also do not receive super or welfare).

The highlighted row "residual group" is possibly the group of individuals that could be considered the target of potential personal tax reductions. By shifting the third tax threshold from $48,000 to $52,000, there are an estimated 85,800 individuals who would gain by having a marginal tax rate of 16% rather than the current 30%.

The next table presents these distributions by proportion of taxpayer type:

Table A4.2. Composition of taxpayers by type

	Nil taxable	$0 to $14k	$14k to $48k	$48k to $52k	$52k to $70k	Over $70k	Total
super	1%	6%	77%	2%	6%	9%	100%
welfare	0%	42%	56%	0%	1%	0%	100%
student allowance	0%	58%	41%	0%	0%	0%	100%
under 25	2%	51%	40%	2%	4%	1%	100%
part year wage	2%	63%	24%	1%	4%	5%	100%
getting WFF credits	14%	11%	46%	5%	16%	7%	100%
residual group	3%	6%	35%	6%	20%	31%	100%
Total	**3%**	**20%**	**46%**	**4%**	**12%**	**16%**	**100%**

As indicated in the table, of the residual "target" group, 41% (35% + 6%) of individuals would benefit from the increase of the third tax threshold to $52,000. However, 20% of individuals would also see an increase in their highest marginal tax rate by 3%.

It is interesting to note the composition of individuals earning between $0 and $14,000. Of the target group, only 6% of individuals fall into this tax bracket. These individuals may be experiencing low economic wellbeing if we consider low-income to be a proxy for wellbeing. However, it is unknown whether this state is persistent for these individuals. For example, the target group includes those who report as self-employed, and those who earn only investment income. For those who fall into the bottom tax bracket, it could be that it was an unusual year of low returns or perhaps there were tax losses from previous years.

Also of interest is the distribution of WFF recipients. WFF payments are relatively spread across the income distribution. Aggregated, the group falling into the $14,000 to $48,000 tax bracket (and to $52,000 by extension) represents nearly half of the recipients. These individuals would also see the greatest benefit of a tax cut if coupled with an increase in family tax credit, but the amount of family tax credit is not affected by a tax change.

The column of individuals with nil taxable income are those who have tax losses offsetting their income.

Treasury Report: Preliminary Options for Tax Cuts for Budget 2017

Purpose of Report

1. We present some options in this report to give you an idea of what possible tax cuts could look like for a Budget 2017 package. These tax cuts also take into consideration changes to the wider welfare system, but in limited scope, including changes to Working for Families (WFF) payment levels and to main benefits payment levels.

2. To keep the report manageable, we have inserted more detailed supplementary information in appendices, including other tax options modelled not included in the main report.

Scope of work and context

3. Officials met with you previously to discuss the work programme for the Tax and Transfer Working Group and its expected deliverables [T2016/1363 refers]. At that meeting, you directed us to focus on an "incomes policy" that focuses on the low-income population through the tax and transfer system. We have recently provided a briefing to you summarising recent Government responses for those cohorts [T2016/1640 refers]. We were also asked not to consider changes to the GST rate at this time, and that changes to address fiscal drag were not to be prioritised unless we consider advised as first-best advice.

4. We present some initial options to test with you the direction of the work. At this time, we have several unknowns/caveats that will impact the design of a tax package:

    a. The preliminary half-year economic and fiscal forecasts will not be finalised until late-October. This means that the fiscal envelope for a tax package is still unknown. Treasury recently reported to you on possible options to alter operating allowances while remaining consistent with the Government's fiscal strategy [T2016/1683 refers].

    b. We have been working on the assumption that a tax package may total up to $3 billion per year. With that goal, we have modelled Low ($ 0.9 billion), Medium ($ 1.5 billion), or High ($ 2.3 billion) annual fiscal options that we think may achieve the intended equity objectives while maintaining the overall simplicity and effectiveness of our tax system.

    c. It is possible to refine these options to be implemented in steps, depending on ministers' preferences for timing as well as constraints on Inland Revenue's ability to make technological changes during its Business Transformation (discussed later in this report).

    d. Because the options are preliminary, we have not modelled the efficiency impacts that measure changes to labour supply participation, or changes in excess burden by tax bracket. However, we provide the distributional impacts that indicate winners and losers at the family level based on changes to weekly disposable income.

    e. We are not able to comment on the tradeoffs between a possible tax package and other spending or debt targets at this time. That advice will be provided to you in early November after the economic and fiscal forecasts are finalised.

5. The current personal tax schedule is (effective from 1 October 2010):

Table 1. Current personal tax rates

Income bracket		Marginal tax rate
$1	$14,000	10.5%
$14,001	$48,000	17.5%
$48,001	$70,000	30%
$70,001 +		33%

Average tax rates

6. The table below estimates the average tax rates (ATRs) for individuals' incomes at minimum wage, average wage[1], or double average wages.

Table 2. Current average tax rates

	Yearly income (52 weeks)	ATR with current tax schedule
20 hours, minimum wage	$ 15,860	11.32%
40 hours, minimum wage	$ 31,720	14.41%
20 hours, average wage	$ 29,095	14.13%
40 hours, average wage	$ 58,189	18.0%
40 hours, 2x average wage	$ 116,378	25.2%

Motivation for Tax Cuts

7. The 2010 tax reforms following the recommendations from the Tax Working Group have placed the New Zealand tax system in a relatively desirable position compared to other OECD countries in terms of its simplicity and effectiveness. In particular, New Zealand has relatively low marginal tax rates. All else equal, this means that personal taxes are likely to have a smaller effect in distorting labour supply decisions than may be observed in other countries. Keeping tax rates broad is helpful in ensuring that the tax system is as efficient as possible. It also helps to make it fair. By keeping the tax base broad, we are able to keep tax rates low. This has a second benefit in reducing economic inefficiencies and promoting fairness. This has a high level of buy-in from the public.

8. While median household incomes have increased in real terms since 2008-09 by 10%, incomes for those at the bottom (after housing costs are taken into consideration), have not been increasing as quickly as for those at the top.[2] Before deducting housing costs, growth in incomes has been relatively evenly spread across the income distribution over this period (at around 8-10% in real terms at the top of each decile).

1 Average weekly ordinary time earnings (June 2016 quarter) was used for average wage calculations.

2 Perry, Bryan, "Household incomes in New Zealand: Trends in indicators of inequality and hardship 1982 to 2015", August 2016, p.241.

9. New Zealand's current measures of income and poverty are captured through repeated cross-sectional surveys (such as the Household Economic Survey), which do not show the persistence of low incomes or poverty for families or individuals. Longitudinal information is required to show this. Some longitudinal research in New Zealand has been done using the Survey of Family, Income and Employment survey (SoFIE), conducted from 2002-2010. Research shows that there is considerable movement of individuals in and out of income deciles, but much of this movement is short range. Out of those who start in one of the three lower household income deciles in the first year, half are still there after seven years, a quarter have moved up to around the middle, and another quarter have moved to have incomes above the middle. Research using Inland Revenue administrative data on individual incomes also shows high mobility of incomes for New Zealanders.[3]

10. This report looks at options to address some of the above issues.

Efficiency versus equity

11. When considering fairness or distributional concerns, the relevant issue to consider is how average tax rates are affected. This reflects how much of a person's income goes in tax, recognising that benefits are a negative tax. When considering economic efficiency issues often marginal tax rates are more relevant, as it is usually these rates that affect incentives to work longer or harder.

12. We understand that the primary objective for potential tax cuts as part of Budget 2017 is addressing the income levels of the poor. We have identified that within the tax framework, a starting point is to look at families in the bottom two quintiles, with family incomes below $39,500. Although not a direct comparison to family incomes, the median unequivalised household income in 2015 was $73,500.[4] If we consider a subjective poverty line to be 50% of that income, then the focus would be on households earning less than $36,750.

13. Although the initial focus is on low-income individuals and families, tax cuts in the lower tax brackets will also benefit those on middle and high incomes.

14. Changes to the personal tax structure, transfers, or benefits will impact economic efficiency in terms of labour supply participation and excess burden. While maximising economic efficiency is not the starting point of our analysis, understanding the impacts would give Ministers better information on the relative economic gains, against which you could measure equity objectives. We are working on developing this modelling capability and will aim to have this available for the next round of advice when the options are further refined.

15. As part of any potential change to the personal tax structure, ideally we review the impacts of fiscal drag. At this time, we consider that changes with the aim of addressing fiscal drag are out of scope. We discuss this later in the report.

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3 Creedy, John and Gemmell, Norman, "Types of Income Mobility: Insights from TIM Curves," Victoria University of Wellington, working paper, July 2016.

4 Perry, Bryan, "Household incomes in New Zealand: Trends in indicators of inequality and hardship 1982 to 2015", August 2016, p.241.

Descriptive Statistics – Status Quo

Low-income population

16. The table below shows the percentage of families[5] with incomes below $39,500 per year who receive at least one of the following transfers:

Table 3. Transfers for families with incomes under $39,500 by transfer category

	Core Benefits[6]	Family Tax Credit	Accommodation Supplement	NZ Superannuation
% families in category	97%	61%	74%	21%
# families in category	255,000	155,000	315,000	17,000
$ b cost for category	$ 3.1 b	$ 1.4 b	$ 1.0 b	$ 0.5 b

17. Figures in Table 3 were calculated for tax year 2019/20 if no changes are made to personal taxes or transfer regime. This allows a direct comparison of the fiscal impacts of proposed changes discussed in the next section.

18. We recently provided a briefing to you that summarised several recent Government policies/responses that were focused on the low-income population; namely, the 2015 Material Hardship package, the potential changes to wages for low-wage earners as a result of the Terranova lawsuit, and the increase in the minimum wage in April 2016 to $15.25 per hour [T2016/1640 refers]. While the Hardship package is anticipated to reduce the depth of material hardship for impacted families, given the scale of the package, it is not expected to significantly reduce the number of families experiencing material hardship. The total fiscal cost of the package is estimated to be $240 million per year.

Proposed Changes – Starting values

19. As discussed above, we have modelled several fiscal scenarios with several variants. Table 4 below summarises the fiscal costs of the options, but the discussion following will focus on three options in particular that you may find more interesting. These are highlighted in the table. We provide more detail on the remaining options in the Appendix 3.

Table 4. Summary of fiscal options (with clawback)[7]

	Low	Medium	High
Tax cuts only	$ 0.5 b	$ 1.1 b	$ 1.8 b
Tax cuts + WFF	$ 0.9 b	$ 1.5 b	$ 2.2 b
Tax cuts + benefits	$ 0.6 b	$ 1.2 b	$ 1.9 b
Tax cuts + WFF + benefits	$ 1.0 b	$ 1.6 b	$ 2.3 b

[5] Families who have at least one adult under 65 years old. Calculated using Household Economic Survey from Taxwell.

[6] Core benefits include: Job Seeker Support, Sole Parent Support, and Supported Living Payment.

[7] Fiscal costs are approximate and calculated for tax year 2019/20. If changes occur for tax year 2018/19, costings and distribution results will be broadly the same. The clawback refers to the return of tax revenue from additional spending of tax cuts via GST, corporate taxes, and other indirect taxes.

20. In detail, the tax cuts are as follows, changes in red text. The low fiscal scenario increases the bottom tax bracket by $1,000 and lowers the tax rate by 1%. The medium fiscal scenario reduces the second tax rate by 2% with no change to the thresholds. The high fiscal scenario reduces the bottom two rates by 2% with no change to the thresholds.

Table 5. Preliminary tax cuts

Status Quo			Low Scenario			Medium Scenario	High Scenario
$1	$14,000	10.5%	$1	$15,000	9.5%	10.5%	8.5%
$14,001	$48,000	17.5%	$15,001	$48,000	17.5%	15.5%	15.5%
$48,001	$70,000	30%	$48,001	$70,000	30%	30%	30%
$70,001	+	33%	$70,001	+	33%	33%	33%

21. Although not discussed in detail in the main report, we ranked the options under the high fiscal scenario with lower priority because relatively greater gains are distributed to the higher income families. This is because the higher income families benefit from the tax cuts for a larger proportion of their incomes. Appendix 3 provides more detail for your reference.

22. The WFF payments are proposed to be increased for younger children so that all payments are the same, independent of the child's age. This aligns with current legislation which increases under-16 rates while holding 16-and-over rates constant, and with Treasury's advice on the material hardship package in the 2015 Budget.

23. Benefits payments are proposed to be increased by 2.5% for Job Seeker Support, Supported Living Payment, and Sole Parent Support. The reason for increasing benefits payments is because benefits are paid on a net basis, and so beneficiaries without another source of income would not benefit from a tax cut. Superannuation rates, however, are set on a gross basis so superannuitants would see the benefit of tax cuts (but we are not proposing changes to their rates here).

24. The WFF payment changes are as follows:

Table 6. Proposed increases to WFF payments

	Status Quo		Proposals	
1st child	ages 0-15	$ 5,099	ages 0-18	$ 5,303
	ages 16-18	$ 5,303		
2nd child	ages 0-12	$ 3,544	ages 0-18	$ 4,745
	ages 13-15	$ 4,042		
	ages 16-18	$ 4,745		

25. The proposals increase benefits payments by 2.5% and the changes are as follows:

Table 7. Proposed weekly increases to benefits payments

	Sole Parent	Couple with children	Single	Single at home	Single young	Couple	Woman alone
Job Seeker	$ 8.46	$ 4.87	$ 5.46	$ 3.64	$ 4.55	$ 4.55	$ 5.68
Supported Living	$ 9.61	$ 6.01	$ 6.82		$ 5.52	$ 5.68	
Sole Parent Support	$ 8.46						

26. The table above illustrates that benefits increases will also go toward low-income families without children, unlike WFF increases.

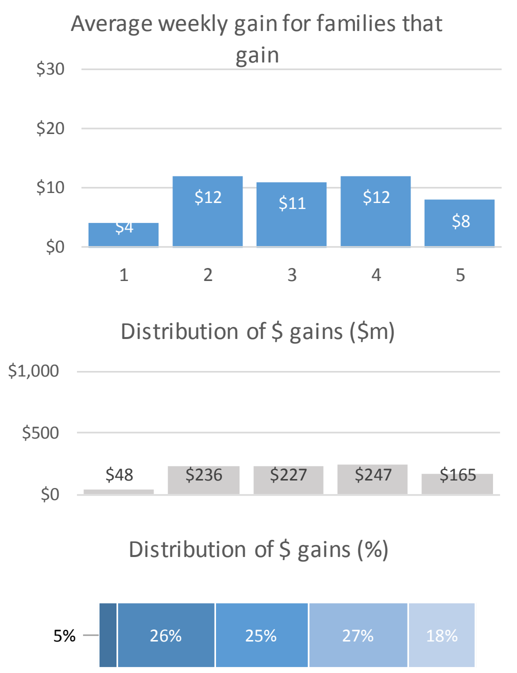
The Options

27. We have not included "tax cut only" options as these are least likely to provide tax relief to the lower income families. Rather, we have focused on options that include changes to WFF, or changes to both WFF and benefits.

28. The three options are presented in the following charts. To present the comparisons more easily, we focus on the families that gain from the changes, as the winners are more variable across income quintiles for all the options (as opposed to the disadvantaged). Also, we present the impacts on the working-age population, which decreases the total sample to those families who have at least one adult under age 65.

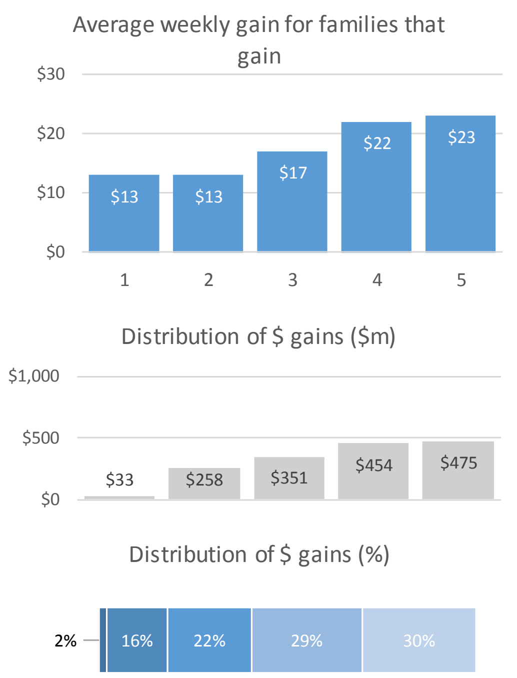
Option 1: Change tier 1 threshold and rate, and increase WfF

Fiscal cost with/without clawback ($m): **$901/$1060**



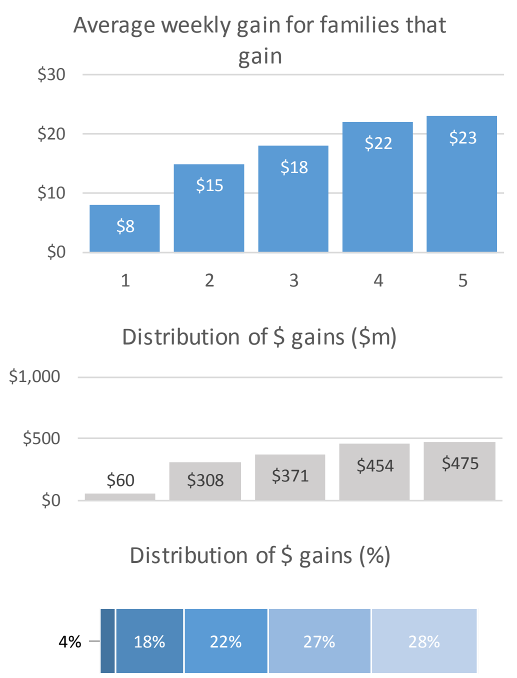
Option 2: Lower tier 2 rate, and increase WfF

Fiscal cost with/without clawback ($m): **$1505/$1770**



Option 3: Lower tier 2 rate, increase WfF, increase benefits

Fiscal cost with/without clawback ($m): **$1573/$1850**



Note. The fiscal cost estimates are based on applying the policies to all families. However, the gainers analysis has been restricted to families with at least one working age individual (i.e. families with at least one adult under 65 years of age).

Estimates provided from Taxwell using Household Economic Survey (HES).

Disclaimer: Access to the Household Economic Survey data was provided by Statistics New Zealand under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975. The results presented here are the work of Treasury, not Statistics New Zealand.

Option 1: Change tier 1 threshold and rate, and increase WFF

29. In this option, we simultaneously increase the threshold of the bottom tax bracket to $15,000 and lower the tax rate to 9.5%. Total dollar gains are greatest for those in income quintiles 2 and 4, with gains falling for highest income families. An alternative (with details in Appendix 3) is to also include benefits changes to give an even greater gain to the bottom 2 quintiles without increasing gains for higher income families.

30. As mentioned earlier in this report, we have not yet modelled behavioural changes and the impact on labour participation. However, we anticipate that because the tax rate and threshold changes are relatively small, the impacts would be relatively small.

Option 2: Lower tier 2 rate, and increase WFF

31. Option 2 allows for a larger tax cut, but only in the second tax bracket. To compensate those on lower incomes, an increase in WFF payments is also added. Relative to Option 1, the gains are smaller for income quintile 1 because the tax cuts do not go to these families, but gains are about the same for the income quintile 2 because of the WFF increases.

32. Because the change to the marginal tax rate is relatively small, we expect some, but likely small impacts to labour participation.

Option 3: Lower tier 2 rate, increase WFF, increase benefits

33. This option provides the greatest benefit to income quintile 2 (and 3), but at a slightly higher cost than Option 2. It compensates families on benefits who would not necessarily gain from the 2nd bracket tax cut to 15.5%. Relative to Option 1, average weekly gains and total dollar gains would be higher in all quintiles. The fiscal difference compared to Option 2 is relatively small (approximately $68 million per year) to include benefits increases. While the average weekly gain per family is smaller for quintile 1 compared to Option 2, there are more families that gain from the increase in WFF and benefits.

34. The impact on labour participation is expected to be similar to that of Option 2.

Impact on average tax rates

35. The following table illustrates declining ATRs for the options discussed. We assume that these hypothetical individuals do not receive transfers or benefits, which is why the ATRs under Option 3 are the same as those under Option 2.

Table 8. Proposal average tax rates

	Status Quo	Option 1	Option 2
20 hours, minimum wage	11.32%	9.93%	11.09%
40 hours, minimum wage	14.41%	13.72%	13.29%
20 hours, average wage	14.13%	13.37%	13.09%
40 hours, average wage	18.0%	17.63%	16.84%
40 hours, 2x average wage	25.2%	25.01%	24.61%

A note on disadvantaged families

36. Under our modelling, some families lose some income after the changes. These families are generally in the bottom quintile, and the numbers vary widely between options. However, the estimated loss per family is approximately $52 per year as a result of a decrease in Accommodation Supplement for non-beneficiary families. We note that the number of families losing may be overstated in our modelling as we assume full take-up rates. To obtain more accurate estimates in our subsequent advice, we will use administrative data and modelling from MSD.

37. More information on the above options on disadvantaged families is available in Appendix 3.

Potentially larger increases to WFF or benefits

38. If you prefer, more gains may be focused on lower income families by increasing payments to WFF or benefits to a greater degree, rather than by changing tax rates or thresholds. This would change the distributions of gains so that higher income families gain less proportionately.

Comparison to previous tax options considered in Budget 2016

39. The gains from the options just discussed are targeted more toward lower-income families. In comparison, the options that we considered as part of Budget 2016 were targeted more toward middle-income families.

Potential Extensions

Review the Independent Earner Tax Credit (IETC)

40. In the course of this preliminary work, we looked at the statistics for the IETC. The stated purpose of IETC was to increase labour participation for lower income individuals when it was introduced on 1 April 2009. Eligible individuals receive approximately $10 per week ($520 per year unabated) if their annual income is between $24,000 and $44,000. The bottom threshold was deliberately set to just below full-time minimum wage income. At the time (just before the 2010 tax reforms), personal tax rates were higher, with the bottom two rates being 12.5% and 21%, respectively.

41. We estimate that in 2020, approximately 38% of individuals who will receive IETC will come from families whose incomes are *above* $ 82,400. We infer that there are some recipients who have a low annual income qualifying for IETC, but may be partnered with a high-income earner. These families may or may not have children, but even if they did, they would not be eligible for WFF.

42. The projected IETC pay out in 2020 is $255 million. Of that, $92 million is forecast to be paid to those relatively higher income families earning above $ 82,400 if full take-up of the tax credit occurs. As a comparison, total IETC paid out in 2015 was $220 million.

43. Based on this early analysis, we may have a situation where the policy intent to increase work incentives for lower-income individuals has resulted in lower-income individuals in high-income families receiving a significant proportion of the transfer. To date, there has not been a review of the IETC since its introduction. Given the potential fiscal impact, we suggest that this review be undertaken, but as a separate stream of work from the tax cuts. We would like to discuss this further with you.

Minimum Family Tax Credit (MFTC)

44. The issue of potential changes around the MFTC, a component of WFF tax credits, is complex. MFTC guarantees a minimum family income for a working family, and has an abatement rate of 100%, which may result in effective marginal tax rates above 100% for these families. Before reporting on any options, there is a need for further research and discussion between the main agencies involved, namely Inland Revenue, the Ministry of Social Development and Treasury. Officials will report on this topic in more detail separately in October.

Timing and Administrative Implications

45. If Ministers would like to implement a tax package as part of Budget 2017, there are several timing options. The options are restricted by the ability of Inland Revenue to make changes to its systems, given that they have current commitments to the Business Transformation (BT) programme.

46. Inland Revenue advises that systems risks are minimised if changes are scheduled to avoid peak times of change for BT and with other operational constraints in mind. In particular, they advise that risks are minimised if any Working for Families changes are made on 1 April 2019.

47. Late 2017 will be one of the peak periods of effort for BT, with extensive system testing taking place at that time. It is important that testing takes place in a stable environment. For this reason, there are risks associated with making changes to Inland Revenue's heritage systems in October 2017, and in particular, extreme risks for making changes to Working for Families in that period.

48. Mid-year adjustments to Working for Families require complex changes to Inland Revenue's systems. The FIRST system is equipped to cope with 1 April changes, and the legislation can also incorporate these changes relatively easily. However, a 1 October start date would require significant amendments to the Tax Acts, and very complicated changes to FIRST.

49. April 2018 is the conversion date for 20 to 25 tax types in Inland Revenue's new system. It is also the implementation date for the Accounting Income Method, and the application date for PAYE changes. April 2018 is a critical time, not only for Inland Revenue but also for payroll and accounting software providers. While it may be possible to implement WFF changes at that time, there would likely be operational tradeoffs.

50. At this early stage in the development of possible options, Inland Revenue has provided a generalised overview of the risks over the next two years during the BT programme. As the options become more specific, Inland Revenue will undertake an assessment of the implementation costs, timing and feasibility of the initiatives.

Timing for changes

51. Reflecting the administrative constraints, the following are possible date options for implementing a staggered tax package that may fit more easily within the operating allowances:

    a. Tax-only and benefit changes on 1 April 2018, followed by WFF changes on 1 April 2019 (most preferred);

    b. All changes to occur on 1 April 2018 (with administrative difficulty).

c. Tax-only changes on 1 October 2017, with potential changes to WFF or benefits rates on 1 April 2018 or 2019 (with administrative difficulty);

52. These are preliminary views from Inland Revenue and they are undertaking further work on likely operational and Business Transformation consequences. For refinement of the tax package options, we would find it helpful to understand your timing preferences.

Out of Scope

Fiscal drag

53. Since the most recent changes to tax rates in 2010, the current rates have not been subject to indexation for inflation or real wage growth. This means that movements in nominal incomes (the combined effects of inflation and real wage growth) have led to 'fiscal drag' and have moved income earners, on average, on to higher average tax rates.

54. However, fiscal drag has quite uneven effects: average tax rates (ATRs) have increased the most for those with incomes close to the $48,000 tax threshold where the marginal tax rate rises from 17.5% to 30%, but increased by very little at sufficiently high levels of income. At income levels below the bottom threshold of $14,000, average tax rates have not changed at all.

55. A key question is whether the Government wants to compensate for fiscal drag in some way when changing the personal tax schedule or whether there are other more important considerations. As indicated earlier in this report, our focus on tax cuts has been more on equity objectives for families in the lower income brackets, rather than efficiency objectives. For this reason, we have not prioritised addressing fiscal drag here.

56. We intend to report to you separately in early October on the implications of indexing personal tax thresholds for inflation. In Appendix 5, we provide more detail on adjustments to the current tax thresholds if the government were to do so now, taking account changes since October 2010.

Accommodation Supplement

57. As discussed above, changes to tax rates and benefits will also impact the amount of Accommodation Supplement (AS) to current recipients. We understand that the Minister for Social Housing is exploring changes to housing subsidies with a focus on reducing housing stress for Accommodation Supplement recipients. Initial work will be going to STR Cabinet Committee on 10 October. Because of the complexity of that work, we think that it should be considered separately from the potential changes to tax and transfers discussed in this report, at this stage. However, we note that there are strong links with this work, particularly given the growing importance of housing costs for low-income households, and will continue to consider developments in this area.

Next Steps

58. We would like to discuss this report with you. In particular, we would find it helpful to discuss the following points:

    - Are there particular aspects of the options you would like to rule out at this time? E.g., increases to benefits payments, WFF payments.

    - Conversely, are there aspects of the options that you would like us to keep as we refine the options further?

    - Would you like us to review the IETC?

    - What are your preferences for timing of any changes?

Appendix 1. Summary of Proposed Changes

Note that all policy options are carried out for tax year 2019/20

Proposed tax cuts

Status Quo

Thresholds		Rates
$1	$14,000	10.50%
$14,001	$48,000	17.50%
$48,001	$70,000	30%
$70,001	+	33%

Low fiscal scenario

Thresholds		Rates
$1	$15,000	9.50%
$15,001	$48,000	17.50%
$48,001	$70,000	30%
$70,001	+	33%

Medium fiscal scenario

Rates
10.50%
15.50%
30%
33%

High fiscal scenario

Rates
8.50%
15.50%
30%
33%

Proposed increases to annual Working for Families payments

Status Quo

1st child

ages 0-15	$5,099
ages 16-18	$5,303

2nd child

ages 0-12	$3,544
ages 13-15	$4,042
ages 16-18	$4,745

Proposals

1st child

No age limitations	$5,303

2nd child

No age limitations	$4,745

Proposed increases to weekly benefits payments

	Sole Parent	Couple with children	Single	Single at home	Single young	Couple	Woman alone
Job Seeker	$8.46	$4.87	$5.46	$3.64	$4.55	$4.55	$5.68
Supported Living	$9.61	$6.01	$6.82		$5.52	$5.68	
Sole Parent Support	$8.46						

Quintile summary for working age families[8,9]

Quintile	Quintile thresholds (family taxable income)		Number of families
1	< $0	$16,400	396,000
2	$16,400	$39,500	396,000
3	$39,500	$70,200	396,000
4	$70,200	$116,100	395,000
5	$116,100	+	395,000
Total			1,978,000

Quintile summary for all families[9]

Quintile	Quintile thresholds (family taxable income)		Number of families
1	< $0	$20,200	473,000
2	$20,200	$36,700	466,000
3	$36,700	$62,900	514,000
4	$62,900	$109,700	485,000
5	$109,700	+	486,000
Total			2,424,000

8 Working age families have at least one adult 16-64 years of age.

9 All estimates are for tax year 2019/20 using the Household Economic Survey in Taxwell.

Appendix 2. Distribution of transfers under the status quo[9]

Distribution of transfers under the status quo - Families with at least one adult < 65

Number of families

<table>
<tr><th>Quintile</th><th>Total families</th><th>Families receiving IETC</th><th>Families receiving AS</th><th>Families receiving a core benefit</th><th>Families receiving NZS</th><th>Families receiving FTC</th><th>Families receiving IWTC</th><th>No modelled transfers</th></tr>
<tr><td>1</td><td>396,000</td><td>0</td><td>140,000</td><td>115,000</td><td rowspan="2">17,000</td><td>28,000</td><td>9,000</td><td>189,000</td></tr>
<tr><td>2</td><td>396,000</td><td>147,000</td><td>175,000</td><td>140,000</td><td>127,000</td><td>41,000</td><td>35,000</td></tr>
<tr><td>3</td><td>395,000</td><td>134,000</td><td>79,000</td><td rowspan="2">9,000</td><td>20,000</td><td>80,000</td><td>94,000</td><td>133,000</td></tr>
<tr><td>4</td><td>395,000</td><td>141,000</td><td>25,000</td><td>17,000</td><td>20,000</td><td rowspan="2">58,000</td><td>171,000</td></tr>
<tr><td>5</td><td>396,000</td><td>75,000</td><td>6,000</td><td>0</td><td>26,000</td><td>0</td><td>293,000</td></tr>
<tr><td>Total</td><td>1,978,000</td><td>497,000</td><td>425,000</td><td>264,000</td><td>80,000</td><td>255,000</td><td>202,000</td><td>821,000</td></tr>
</table>

Dollars (millions)

<table>
<tr><th>Quintile</th><th>Taxable income</th><th>Families receiving IETC</th><th>Families receiving AS</th><th>Families receiving a core benefit</th><th>Families receiving NZS</th><th>Families receiving FTC</th><th>Families receiving IWTC</th></tr>
<tr><td>1</td><td>2,898</td><td>0</td><td>417</td><td>1,188</td><td rowspan="2">499</td><td>236</td><td>22</td></tr>
<tr><td>2</td><td>10,828</td><td>76</td><td>608</td><td>1,931</td><td>1,117</td><td>133</td></tr>
<tr><td>3</td><td>20,964</td><td>63</td><td>154</td><td rowspan="2">26</td><td>410</td><td>379</td><td>318</td></tr>
<tr><td>4</td><td>35,856</td><td>80</td><td>19</td><td>269</td><td>63</td><td rowspan="2">145</td></tr>
<tr><td>5</td><td>77,616</td><td>33</td><td>7</td><td>0</td><td>440</td><td>0</td></tr>
<tr><td>Total</td><td>148,162</td><td>252</td><td>1,205</td><td>3,145</td><td>1,618</td><td>1,795</td><td>618</td></tr>
</table>

Distribution of transfers under the status quo – All families

Number of families

<table>
<tr><th>Quintile</th><th>Total families</th><th>Families receiving IETC</th><th>Families receiving AS</th><th>Families receiving a core benefit</th><th>Families receiving NZS</th><th>Families receiving FTC</th><th>Families receiving IWTC</th><th>No modelled transfers</th></tr>
<tr><td>1</td><td>473,000</td><td>0</td><td>174,000</td><td>138,000</td><td>7,000</td><td>36,000</td><td>14,000</td><td>212,000</td></tr>
<tr><td>2</td><td>466,000</td><td>110,000</td><td>167,000</td><td>115,000</td><td>195,000</td><td>112,000</td><td>28,000</td><td rowspan="2">120,000</td></tr>
<tr><td>3</td><td>514,000</td><td>159,000</td><td>95,000</td><td rowspan="2">13,000</td><td>158,000</td><td>76,000</td><td>77,000</td></tr>
<tr><td>4</td><td>485,000</td><td>133,000</td><td>37,000</td><td>80,000</td><td rowspan="2">33,000</td><td rowspan="2">82,000</td><td>183,000</td></tr>
<tr><td>5</td><td>486,000</td><td>98,000</td><td>7,000</td><td>0</td><td>73,000</td><td>313,000</td></tr>
<tr><td>Total</td><td>2,424,000</td><td>500,000</td><td>480,000</td><td>266,000</td><td>513,000</td><td>257,000</td><td>201,000</td><td>828,000</td></tr>
</table>

Dollars (millions)

<table>
<tr><th>Quintile</th><th>Taxable income</th><th>Families receiving IETC</th><th>Families receiving AS</th><th>Families receiving a core benefit</th><th>Families receiving NZS</th><th>Families receiving FTC</th><th>Families receiving IWTC</th></tr>
<tr><td>1</td><td>4,154</td><td>0</td><td>518</td><td>1,415</td><td>91</td><td>320</td><td>38</td></tr>
<tr><td>2</td><td>12,474</td><td>58</td><td>564</td><td>1,705</td><td>4,754</td><td>970</td><td>90</td></tr>
<tr><td>3</td><td>24,188</td><td>75</td><td>219</td><td rowspan="2">57</td><td>5,148</td><td>413</td><td>282</td></tr>
<tr><td>4</td><td>40,618</td><td>78</td><td>33</td><td>2,212</td><td rowspan="2">109</td><td rowspan="2">209</td></tr>
<tr><td>5</td><td>90,519</td><td>44</td><td>8</td><td>0</td><td>1,935</td></tr>
<tr><td>Total</td><td>171,953</td><td>255</td><td>1,342</td><td>3,177</td><td>14,140</td><td>1,812</td><td>619</td></tr>
</table>

Appendix 3. Details on Low, Medium, and High Fiscal Scenarios

The following three pages present fiscal cost estimates and analyses of gaining and disadvantaged families for various policy combinations.

Note: These scenarios can also be compared graphically using the accompanying spreadsheet tool which we have made available to your office.

Notes:

- All estimates are for tax year 2019/20 using the Household Economic Survey in Taxwell. Access to the Household Economic Survey data was provided by Statistics New Zealand under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975. The results presented here are the work of Treasury, not Statistics New Zealand.

- The fiscal cost estimates are based on applying the policies to all families. However, the gainers/disadvantaged analysis has been restricted to families with at least one working age individual (i.e. families with at least one adult under 65 years of age). Fiscal cost estimates are on a tax year basis for tax year 2019/20.

- Numbers of families are rounded to the nearest one thousand. Average weekly gains are rounded to the nearest dollar. Total gains are rounded to the nearest one million dollars. Note that this can mean some losses will show as zero after rounding. Also, some column totals may differ from the arithmetic sum of the displayed columns due to rounding.

Low fiscal scenario

Tax cuts only

Fiscal cost (no clawback) ($m): $630
Fiscal cost with clawback ($m): $536

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	220,000	56%	$23	5%	$2	6,000	1%	$0	0%	$0
2	313,000	79%	$65	13%	$4					
3	395,000	100%	$103	21%	$5	0	0%	$0	0%	$0
4	395,000	100%	$144	29%	$7	0	0%	$0	0%	$0
5	396,000	100%	$165	33%	$8	0	0%	$0	0%	$0
Total	1,719,000	87%	$500	100%	$5	6,000	0%	$0	0%	$0

Tax cuts + WfF

Fiscal cost (no clawback) ($m): $1,060
Fiscal cost with clawback ($m): $901

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	231,000	58%	$48	5%	$4	6,000	1%	$0	*	$1
2	377,000	95%	$236	26%	$12					
3	395,000	100%	$227	25%	$11	0	0%	$0	0%	$0
4	395,000	100%	$247	27%	$12	*	*	*	*	*
5	396,000	100%	$165	18%	$8	0	0%	$0	0%	$0
Total	1,794,000	91%	$924	100%	$10	*	*	*	*	*

Tax cuts + benefits

Fiscal cost (no clawback) ($m): $710
Fiscal cost with clawback ($m): $604

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	295,000	74%	$46	8%	$3	40,000	5%	$2	100%	$1
2	390,000	98%	$102	18%	$5					
3	395,000	100%	$124	21%	$6	0	0%	$0	0%	$0
4	395,000	100%	$144	25%	$7	0	0%	$0	0%	$0
5	396,000	100%	$165	28%	$8	0	0%	$0	0%	$0
Total	1,871,000	95%	$581	100%	$6	40,000	2%	$2	100%	$1

Tax cuts + WfF + benefits

Fiscal cost (no clawback) ($m): $1,140
Fiscal cost with clawback ($m): $969

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	303,000	77%	$79	8%	$5	37,000	5%	$2	*	$1
2	395,000	100%	$289	29%	$14	0	0%	$0	0%	$0
3	395,000	100%	$227	23%	$11	0	0%	$0	0%	$0
4	395,000	100%	$247	25%	$12	*	*	*	*	*
5	396,000	100%	$165	16%	$8	0	0%	$0	0%	$0
Total	1,884,000	95%	$1,007	100%	$10	*	*	*	*	*

*Suppressed for confidentiality, values must have more than 3000 counts (weighted) and 10 or more samples

Medium fiscal scenario

Tax cuts only

Fiscal cost (no clawback) ($m): $1,340
Fiscal cost with clawback ($m): $1,139

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	28,000	7%	$0	0%	$0	10,000	1%	$0	100%	$1
2	323,000	82%	$84	7%	$5					
3	395,000	100%	$247	21%	$12	0	0%	$0	0%	$0
4	395,000	100%	$351	30%	$17	0	0%	$0	0%	$0
5	396,000	100%	$475	41%	$23	0	0%	$0	0%	$0
Total	1,537,000	78%	$1,158	100%	$14	10,000	1%	$0	100%	$1

Tax cuts + WfF

Fiscal cost (no clawback) ($m): $1,770
Fiscal cost with clawback ($m): $1,505

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	49,000	12%	$33	2%	$13	8,000	1%	$0	*	$0
2	380,000	96%	$258	16%	$13					
3	395,000	100%	$351	22%	$17	0	0%	$0	0%	$0
4	395,000	100%	$454	29%	$22	*	*	*	*	*
5	396,000	100%	$475	30%	$23	0	0%	$0	0%	$0
Total	1,615,000	82%	$1,571	100%	$19	*	*	*	*	*

Tax cuts + benefits

Fiscal cost (no clawback) ($m): $1,420
Fiscal cost with clawback ($m): $1,207

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	129,000	33%	$34	3%	$5	61,000	15%	$3	86%	$1
2	388,000	98%	$142	11%	$7	5,000	1%	$1	14%	$2
3	395,000	100%	$247	20%	$12	0	0%	$0	0%	$0
4	395,000	100%	$351	28%	$17	0	0%	$0	0%	$0
5	396,000	100%	$475	38%	$23	0	0%	$0	0%	$0
Total	1,703,000	86%	$1,249	100%	$14	66,000	3%	$4	100%	$1

Tax cuts + WfF + benefits

Fiscal cost (no clawback) ($m): $1,850
Fiscal cost with clawback ($m): $1,573

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	143,000	36%	$60	4%	$8	60,000	8%	$3	*	$1
2	393,000	99%	$308	18%	$15					
3	395,000	100%	$371	22%	$18	0	0%	$0	0%	$0
4	395,000	100%	$454	27%	$22	*	*	*	*	*
5	396,000	100%	$475	28%	$23	0	0%	$0	0%	$0
Total	1,722,000	87%	$1,668	100%	$19	*	*	*	*	*

*Suppressed for confidentiality, values must have more than 3000 counts (weighted) and 10 or more samples

High fiscal scenario

Tax cuts only

Fiscal cost (no clawback) ($m): $2,150
Fiscal cost with clawback ($m): $1,828

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	226,000	57%	$35	2%	$3	5,000	1%	$0	0%	$1
2	331,000	84%	$173	10%	$10					
3	395,000	100%	$392	22%	$19	0	0%	$0	0%	$0
4	395,000	100%	$536	29%	$26	0	0%	$0	0%	$0
5	396,000	100%	$682	38%	$33	0	0%	$0	0%	$0
Total	1,742,000	88%	$1,818	100%	$20	5,000	0%	$0	0%	$1

Tax cuts + WfF

Fiscal cost (no clawback) ($m): $2,580
Fiscal cost with clawback ($m): $2,193

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	237,000	60%	$74	3%	$6	5,000	1%	$0	0%	$1
2	383,000	97%	$340	15%	$17					
3	395,000	100%	$495	22%	$24	0	0%	$0	0%	$0
4	395,000	100%	$660	29%	$32	0	0%	$0	0%	$0
5	396,000	100%	$682	30%	$33	0	0%	$0	0%	$0
Total	1,806,000	91%	$2,251	100%	$24	5,000	0%	$0	0%	$1

Tax cuts + benefits

Fiscal cost (no clawback) ($m): $2,240
Fiscal cost with clawback ($m): $1,904

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	301,000	76%	$63	3%	$4	33,000	8%	$2	100%	$1
2	390,000	98%	$224	12%	$11	3,000	1%	$0	0%	$2
3	395,000	100%	$392	21%	$19	0	0%	$0	0%	$0
4	395,000	100%	$536	28%	$26	0	0%	$0	0%	$0
5	396,000	100%	$682	36%	$33	0	0%	$0	0%	$0
Total	1,877,000	95%	$1,897	100%	$19	36,000	2%	$2	100%	$1

Tax cuts + WfF + benefits

Fiscal cost (no clawback) ($m): $2,670
Fiscal cost with clawback ($m): $2,270

Quintile	Number of families gaining	% of quintile gaining	Total gain ($m)	% total gain	Average weekly gain for gaining families	Number of families disadvantaged	% of quintile disadvantaged	Total loss ($m)	% total loss	Average weekly loss for losing families
1	309,000	78%	$97	4%	$6	31,000	4%	$2	100%	$1
2	395,000	100%	$392	17%	$19					
3	395,000	100%	$495	21%	$24	0	0%	$0	0%	$0
4	395,000	100%	$660	28%	$32	0	0%	$0	0%	$0
5	396,000	100%	$682	29%	$33	0	0%	$0	0%	$0
Total	1,890,000	96%	$2,325	100%	$23	31,000	2%	$2	100%	$1

*Suppressed for confidentiality, values must have more than 3000 counts (weighted) and 10 or more samples

Appendix 4. Working for Families – Overview of current state

Working for Families (WFF) targets low and middle income families who have children. It aims to increase family income to ensure that all families have enough income to raise their children and maintain a minimum standard of living. WFF includes several different tax credits. These are:

Family tax credit (FTC): available per child regardless of whether the principal caregiver is working or receiving a benefit. This is the main tax credit paid to families. Work and Income makes the payment to beneficiaries and Inland Revenue makes the payment to all other families who qualify. It is income tested.

In-work tax credit (IWTC): available for families not receiving a benefit and working full time (defined as 30 hours for a couple and 20 hours for a sole parent). It is income tested.

Minimum family tax credit (MFTC): has similar criteria to the IWTC but a more restrictive employment test to exclude self-employment. It provides a guaranteed minimum after tax income for a family in work to ensure they receive at least as much as they would on a benefit. It is income tested.

Parental tax credit (PTC): available on the birth of a child if the family does not receive a benefit or paid parental leave. It is income tested and an alternative to Paid Parental Leave payments.

Families receiving FTC are eligible for different amounts depending on the age of their children and how many children they have. Families whose eldest child is at least 16 years and under 18 could receive up to $5,303 per year for that child.

The amount of the IWTC is $72.50 per week if the family has up to three children. An additional $15 per week is paid for each additional child. So a four child family would receive up to $87.50 per week and a seven child family would receive up to $132.50 a week.

All WFF tax credits are subject to an income test, so that the amount received is abated as family income increases. Most tax credits are abated at 22.5% per dollar over the family income threshold of $36,350. So a family with income of $36,450 would have $22.50 of their WFF tax credits abated. The family tax credit is abated first, followed by the IWTC and then the parental tax credit.

The MFTC is abated separately at 100% of income, so that it reduces by $1 for every $1 after-tax income earned. However, a person may also be required to pay additional deductions from their income, such as ACC levies and student loan repayments, so that the disposable cash from an extra $1 of wages after taxes, deductions and adjustments to government payments, may be negative.

The MFTC level of the 2016/17 tax year is $23,764. This is below the level at which the other WFF tax credits begin to abate.

The numbers of families that received Working for Families tax credits in 2015 are summarised in the following table:

Table A4.1. WFF tax credits 2015

Working for families 2015	No. Families	$m	Average	Average/wk
Family Tax Credit	307,300	1,779	5,788	111
Minimum Family Tax Credit	5,100	19	3,686	71
Parental Tax Credit	14,300	15	1,042	20
In Work Tax Credit	214,100	533	2,490	48
Child Tax Credit (grandparented)	900	1	1,000	19
Total all types	**345,900**	**2,346**	**6,783**	130

Joint family income band 2015	No. Families	$m	Average	Average/wk
Under 10k	22,700	80	3,529	68
10k - 20k	83,100	613	7,380	142
20k - 30k	55,100	453	8,219	158
30k - 40k	38,700	353	9,124	175
40k - 50k	36,200	303	8,379	161
50k - 60k	30,900	217	7,036	135
60k- 80k	50,800	249	4,903	94
80k- 100k	22,900	64	2,797	54
Over 100k	5,500	13	2,395	46
Total	**345,900**	**2,346**	**6,783**	130

Appendix 5. Fiscal drag

If the Government has a current objective to minimise the impact of fiscal drag, the tax thresholds would increase now to the following to account for changes since October 2010:

Table A5.1. New tax thresholds adjusted for fiscal drag

Current upper threshold	Adjusting for CPI (6.0%)	Adjusting for wage inflation (16.1%)
$ 14,000	$ 14,840	$ 16,254
$ 48,000	$ 50,880	$ 55,728
$ 70,000	$ 74,200	$ 81,270

Indexing thresholds to headline CPI would compensate earners for increases in the cost of living, while going some way to mitigating the effect of fiscal drag. Indexing thresholds to wage inflation would correct for fiscal drag, but is more costly than indexing to CPI.

If one were convinced that the tax schedule that applied in 2010 after the tax changes provided the best feasible trade-off between fairness and efficiency concerns, there would be a case for attempting to move thresholds to take account of wage movements. However, it is an open question as to whether this is the best direction for reform or whether there are preferable alternatives.