

The Treasury

Budget 2017 Information Release

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BUDGET-SENSITIVE



THE TREASURY
Kaitohutohu Kaupapa Rawa

Options to simplify the tax and transfer system

Tuesday, 31 January 2017

Tax and benefit interface is complex

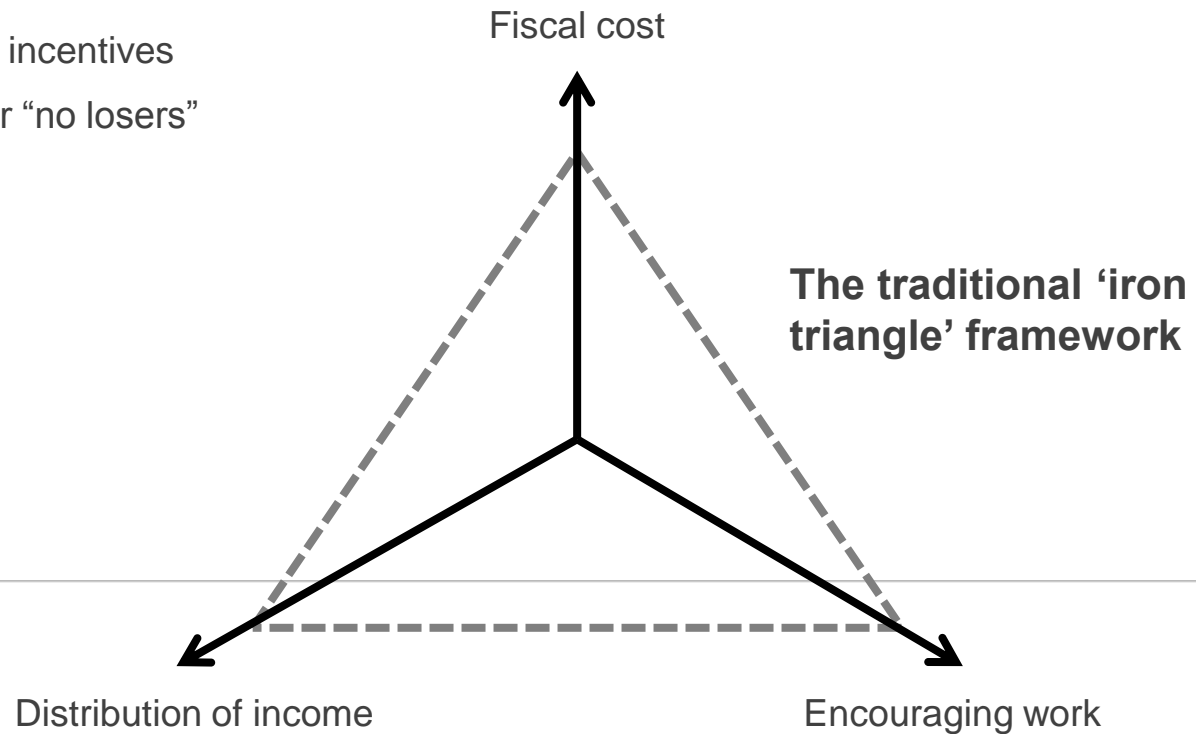
- Complexity is driven by:
 - Two main delivery agencies (Inland Revenue and MSD).
 - Multiple objectives (e.g., targeting recipients, fiscal cost, incentives, equity).
 - Range of criteria for eligibility, including:
 - Income
 - Age
 - Relationship status
 - Children
 - Employment status
 - Assets
 - Rent
 - Location
 - Hours worked
 - Disability or medical conditions
 - Hardship
 - Interdependencies with other transfers

Objectives

- Three problems created by complexity:
 - Complex for clients: costly to understand system and low uptake
 - Complex to administer: costly for government
 - Unintended consequences of tax and transfer interface, including high effective marginal tax rates that weaken work incentives
- We understand that:
 - the overarching goal is to improve work incentives; and
 - simplification of the tax and transfer system is secondary to that.

Trade-offs

- Very difficult to reform the system and achieve all three of the following goals:
 - improved work incentives
 - redistribution or “no losers”
 - low fiscal cost



Options and timeframes

- There are some policy changes that could be considered for Budget 2017 (discussed in following slides).
- A more significant overhaul of the system is beyond the scope of Budget 2017.
 - Some options would require further work and could be considered in Budget 2018.
 - A **comprehensive review** of the tax and transfer interface could be considered, which is an outstanding recommendation of the 2010 Tax Working Group.
- Options for longer term consideration include:
 - **Universal Credit** that merges all means-tested benefits, tax credits and housing assistance into one monthly payment (a UK reform) or **Universal Basic Income**.
 - Fundamental changes to **Working for Families**, which includes the In-Work Tax Credit and/or removing the Minimum Family Tax Credit (Working for Families).
 - Fundamental reform of **housing subsidies**.
 - An app/online tool that uses real-time government information so people can find out what they are entitled to when they work more (or less).

Work currently underway

- Inland Revenue's Business Transformation (BT)
 - Changes are about simplifying and streamlining the delivery of services, as well as upgrading Inland Revenue's technology platform.
- Policy changes to support BT (T2016/2192)
 - Focused on improving *how* social policy entitlements and obligations, including Working for Families, are administered by Inland Revenue rather than significant policy changes.
 - Anticipated implementation 2020/21 (Stage 3 BT).
- MSD
 - Ongoing simplification project to improve access to services.
 - Improving the take-up of in-work financial assistance (mainly AS and childcare assistance).
 - Reassessing housing subsidies.

Options for Budget 2017

- Options that could be implemented in Budget 2017
 - Tax rates/threshold adjustment (T2016/2540).
 - Remove Independent Earner Tax Credit – may not be achieving the best return for encouraging labour participation.
 - Accommodation Supplement (AS) options.
 - Benefit rates – increase main benefits.
 - Increase/better target childcare payments – target ECE, increase existing childcare subsidies.
 - Temporary Additional Support administration – remove certain conditions, support better compliance.
 - Simplify Working for Families rates.

Annex 1 – additional information about the options for Budget 2017

1. Tax rates/threshold adjustment (T2016/2540)
2. Remove the Independent Earner Tax Credit
3. Accommodation Supplement (AS) options
4. Increase main benefits
5. Increase/better target childcare payments
6. Temporary Additional Support (see Annex 2)
7. Simplify Working for Families rates

1) Tax rates/threshold adjustments

- Four indicative options for adjusting tax thresholds were presented in December 2016:

Status Quo			Option 1 - \$48k to \$55k		Option 2 - \$48k to \$62k		Option 3 - \$48k to \$70k		Option 4 – Fiscal Drag Adjustment in 18/19	
Thresholds		Rates	Thresholds		Thresholds		Thresholds		Thresholds	
\$1	\$14,000	10.50%	\$1	\$14,000	\$1	\$14,000	\$1	\$14,000	\$1	\$15,476
\$14,001	\$48,000	17.50%	\$14,001	\$55,000	\$14,001	\$62,000	\$14,001	\$70,000	\$15,477	\$53,057
\$48,001	\$70,000	30%	\$55,001	\$70,000	\$62,001	\$70,000			\$53,058	\$77,375
\$70,001	+	33%	\$70,001	+	\$70,001	+	\$70,001	+	\$77,376	+
Fiscal cost (18/19 tax year) ¹			\$ 1,100 m		\$2,000 m		\$2,700 m		\$1,100 m	

- There are 1,390,000 families with individuals who would benefit from any of the first three options. Option 4 will benefit 1,923,000 families.
- The average weekly increase in disposable income per family is \$17 for option 1, \$31 for option 2, \$41 for option 3, and \$13 for option 4.
- Changing the tax thresholds would have **relatively small labour supply gains**.
- It is likely that delivering a similar sized package through targeted payments like Accommodation Supplement would have a noticeably larger impact on work incentives.

2) Remove the IETC

- The Independent Earner Tax Credit (IETC) delivers **\$10 per week or \$520 per year** to approximately half a million **individuals earning between \$24,000 and \$48,000** of income that do not receive a benefit, Working for Families or superannuation.
- Most IETC recipients (65%) receive IETC as a **lump sum at the end of the year**.
- It is likely a **better labour supply impact could be achieved** by removing the IETC and better targeting that spending to other areas.
- Removing the IETC would **save approximately \$240m and simplify administration**.
- Removing the IETC (without other changes) would mean:
 - a **marginally negative labour supply impact for couples** with and without children, single men and single women.
 - **no labour supply impact for sole parents**.

3) Accommodation Supplement options

Increasing AS:

- a) Re-allocate areas to reflect rental costs, and
Update the AS maxima to current median rents in those areas (\$300m per year)
- b) Additionally, reduce the recipient co-payment from 30% to 25% (+\$70m per year)

Simplifications to AS

- c) De-couple the AS from actual rents, and pay a single regional rate to all recipients (still varies based on household and tenure type).
- d) Reduce differences between regional rates.

We will discuss these options in more detail.

4) Increasing main benefits

- Increase **all main benefits by \$20 per week**. (\$290m per year)
- Covers:
 - Jobseeker Support/Emergency Benefit
 - Sole Parent Support
 - Supported Living Payment
 - Youth Payment
 - Young Parent Payment
- Couples would receive \$10 each.
- This would **marginally decrease work incentives**, but would be limited as the increase is relatively modest by itself.
- It would be relatively **well-targeted to those in poverty and hardship**.
- A comparison of increasing main benefits with AS is included in Annex 2.

5) Increase/better target childcare payments

- There is likely **scope for further increases in labour participation** for those with children. For this group, childcare costs can vary considerably, with average weekly costs around \$320.
- **Further funding of childcare could support labour market objectives** as well as providing educational benefits. MSD are starting a review of the Childcare Subsidy but this will not be ready to support Budget 2017 advice.
- The affordability of Early Childhood Education (ECE) improved substantially with the introduction of 20 Hours ECE in 2006. **Levels of childcare affordability have largely been maintained since 2006**, with increases in fees being offset by increases in income. Providers may now be facing financial pressure.
- The Childcare Survey, a supplement of the Household Labour Force Survey, was to be run by Statistics NZ in 2016 but is now delayed until late 2017. **Previous childcare surveys were undertaken in 1998 and 2009**. This survey data will be important for advising on how best to target childcare payments with labour supply as the objective.

7) Simplify Working for Families rates

- **Option 1:** Raise Family Tax Credit (FTC) rates for children to one payment rate, regardless of age.

<u>Status Quo</u>		<u>Proposal</u>	
1 st child			
ages 0-15	\$ 5,099	ages 0-18	\$ 5,303
ages 16-18	\$ 5,303		
2 nd child			
ages 0-12	\$ 3,544	ages 0-18	\$ 4,745
ages 13-15	\$ 4,042		
ages 16-18	\$ 4,745		

- FTC is also paid to customers in receipt of MSD main benefits. This option has uncertain impacts on labour market incentives when coupled with tax cuts.
- Note that this has been proposed previously (T2016/1650 refers).

- **Option 2:** Replace the existing In-work Tax Credit (IWTC) formula (which increases by \$15 per week for fourth and subsequent children) with one flat rate for all recipients.
- IWTC is paid to families who are not receiving a benefit and work a minimum number of hours each week.
- If the \$72.50 weekly base payment is increased to reduce the number of large families losing from this option there could be significant cost.
- There may be a positive labour supply effect for families who gain from this option. For families with large numbers of children there could be a negative impact on labour market incentives.
- This option could be seen to work against large families and work against poverty alleviation objectives.

Annex 2 – Accommodation Supplement (AS) and housing subsidies

1. Housing subsidies overview
2. Options to increase AS
3. Discussion on other AS options
4. Increase in AS versus increase in benefits
5. Interaction between AS and IRRS
6. AS statistics

1) Housing subsidies overview

- **Accommodation Supplement (AS)** – is paid to tenants, boarders and homeowners in the private rental market.
 - AS subsidises 70% of accommodation costs above thresholds.
 - Maximum levels of assistance are set for four different areas.
 - AS abates at 25c on the dollar as income increases.
- **Income-Related Rent Subsidy (IRRS)** – provides for people in social housing.
 - People contribute 25% of their income towards rent.
 - Abates at 50c on the dollar as income increases.
- **Temporary Additional Support (TAS)** – hardship assistance paid to cover a shortfall in income and essential living costs.
 - Almost all TAS paid, at least in part, to help meet housing costs.
 - Capped at 20% of the main benefit rate.
 - Abated dollar for dollar (EMTR of 100%).
- **Key features:** Gap between IRRS and AS, increasing cost of IRRS, increasing housing stress for AS recipients (no increase in 10 years) and growing numbers receiving TAS.

2) Options to increase AS

- a) Re-allocate areas to reflect rental costs, and
Update the current AS maxima to current median rents in those areas (\$300m per year).
- b) Additionally, reduce the recipient co-payment from 30% to 25% (+\$70m per year).

	Current Areas	Max weekly rate	Proposal (a)
1	Central Auckland, North Shore	\$225	Auckland plus surrounding areas, Queenstown, Tauranga
2	Rest of Auckland, Tauranga, Queenstown, Wellington	\$165	Hamilton, Christchurch, Wellington
3	Hamilton, Christchurch, Dunedin, other provincial cities	\$120	Dunedin, other provincial centres
4	Rest of New Zealand	\$75	Rest of New Zealand

3) Discussion on other AS options

- c) De-couple the AS from rents, and pay a single regional rate to all recipients (still varies based on household and tenure type).
- d) Reduce differences between regional rates.
- Options (c) and (d) would be extremely challenging to implement for Budget 2017.
 - Interactions across the welfare system need to be better understood.
 - Practical constraints of changes to legislation and IT systems that would be required.
- These options could be included as part of fundamental reform of housing subsidies, alongside changes to IRRS and TAS, in the longer term.
- Key considerations (for discussion).

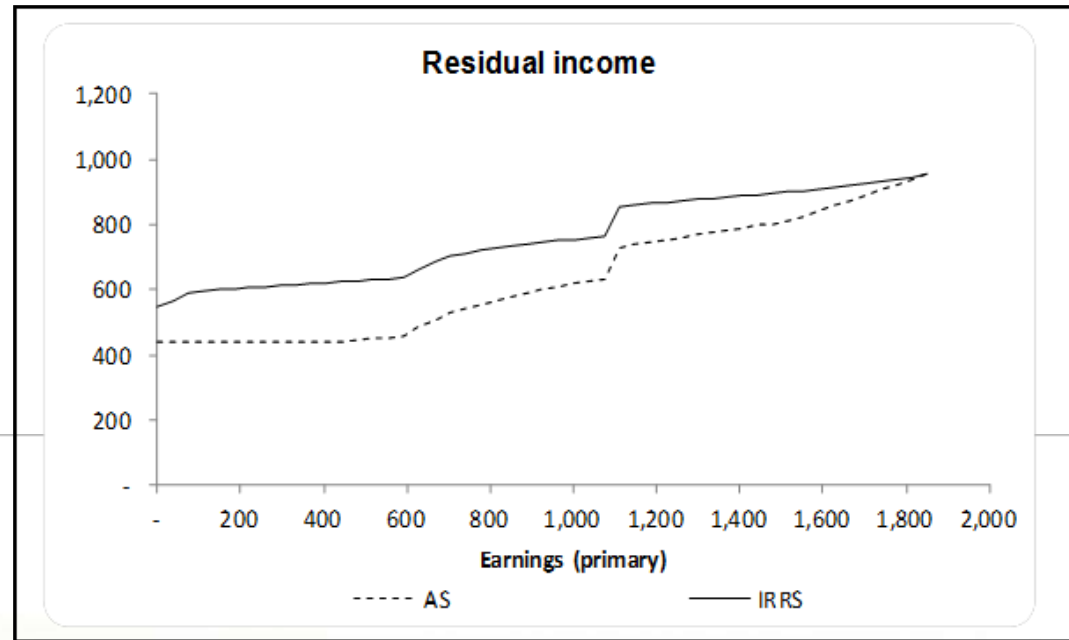
4) Increases in AS versus increases in Benefits

An equivalent aggregate increase of AS or benefits will have several trade-offs:

- If **housing stress** is the preferred target, then increasing AS will have a bigger impact (with the AS giving larger gains to a smaller group).
- **Distribution of gains** – largest AS gains go to non-beneficiaries, but benefit rate increases go to those on lowest incomes (beneficiaries).
 - The distribution of gains will also vary regionally with the AS, with the highest for Auckland recipients.
 - Increases to benefits would be more widespread (with smaller average gains).
- **Work incentives** – AS increase likely to be more positive/less negative for work incentives compared to a benefit increase, given higher gains for non-beneficiaries and reduction in TAS (note that this is an indicative assessment that has not been formally modelled)
- Greater risk of **landlord capture** through AS, although the precise extent of this is unknown.

5) Interaction between AS and IRRS

- The declining real value of the AS means there is increasing inequity between people in social housing and people in the private market. People are generally now worse off outside social housing for any change in circumstances and income.
- This reduces incentives to enter work and leave social housing.
- The graph shows the difference in residual (after housing costs) income between receiving AS and IRRS in the same circumstances.
- After housing cost income is always lower on AS as compared to IRRS.



6) AS statistics

	Recipients	Fiscal Cost	Notes
IRRS	62,000	\$755 m	
AS	290,000	\$1,200 m	31% of recipients are based in Auckland
TAS	63,000	\$200 m	Also receiving AS

- AS recipients:
 - 43% receive the maximum
 - 68% receive a benefit (not incl NZ Superannuation)
 - 12% are also receiving NZ Superannuation
 - 20% are non-beneficiaries
- AS take-up rates
 - There could be an additional 110,000 to 161,000 non-beneficiaries eligible for AS (\$450m per year), but this is likely to be an upper bound.