The Treasury

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[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.

THE TREASURY
Kaitohutohu Kaupapa Rawa

Reference: T2017/638 SH-13-5-2-3

Date: 31 March 2017

To: Minister of Finance (Hon Steven Joyce)
Associate Minister of Finance (Hon Simon Bridges)
Associate Minister of Finance (Hon Amy Adams)

Deadline: None

Aide Memoire: Tax and transfer package - small numbers of families disadvantaged

We have previously provided analysis for the three tax and transfer package options. The modelling for Packages 4, 5a and 6a (shown in Table 1) suggested there would be a small number of families disadvantaged by all three packages (T2017/595 refers). A similar result could be expected for variations of these packages. This note explains those results.

Table 1: Tax and transfer packages

	Package 4	Package 5a	Package 6a
Tax thresholds	Increase the $14,000 threshold to $18,000, and the $48,000 to $52,000.	Increase the $14,000 threshold to $22,000, and the $48,000 to $55,000.	Increase the $14,000 threshold to $22,000, and the $48,000 to $52,000.
Independent Earner Tax Credit (IETC)	Maintain the existing IETC.	Remove the IETC.	
Family Tax Credit (FTC)	Align the FTC rates to the eldest child rates, increase abatement rate to 23.75% and reduce the abatement threshold to $35,900.		
Accommodation Supplement	Update the maxima to reflect 2016 median rents, while re-allocating areas to reflect rental costs.		
Fiscal cost[1] (including clawback)	**$2,000 m**	**$2,800 m**	**$2,350 m**

Families disadvantaged by Packages 4, 5a and 6a

Table 2 summarises the number of families that could be disadvantaged by Packages 4, 5a and 6a (excluding the Accommodation Supplement (AS) component). The number of families that could be disadvantaged by the AS component is presented in Table 3. To date we have presented results for AS separate from the other components of the packages. Because of this separate presentation, some of the families disadvantaged in Table 2 may not be disadvantaged overall because of the AS changes. However, neither Treasury (Taxwell) nor MSD models can appropriately capture all of the interactions between the various components of the packages.

1 Rounded to the nearest $50 million.

Table 2: Families disadvantaged by Packages 4, 5a and 6a (excluding the AS component)

Package	Number of families disadvantaged	Average weekly loss for losing families
4	4,000	$-1
5a	3,000	$-1
6a	3,000	$-1

Source: Treasury Taxwell

Table 3: Families disadvantaged by the AS component of Packages 4, 5a and 6a

	Number of families disadvantaged	Average weekly loss for losing families
AS	700	$1.40

Source: MSD

The reasons for why families could be disadvantaged by the packages include:

1. abatement changes to Working for Families (WFF)
2. the relationship between the AS and FTC
3. a Taxwell modelling assumption about tax square-ups for transfer income, and
4. interactions between AS and Temporary Additional Support (TAS) and the Disability Allowance (DA).

1) Working for Families abatement changes

All three packages include a proposal to align the Family Tax Credit (FTC) rates to the eldest child rates, increase the Working for Families abatement rate to 23.75%, and reduce the abatement threshold to $35,900. The impact of alignment is shown in *Table 4.*

Table 4: FTC changes

	Status Quo	Aligned rates
Family tax credit annual rates		
Eldest child, aged from 16 to 18	$5,303	$5,303
Eldest child, aged from 0 to 15	$4,822	$5,303
Subsequent child, aged from 16 to 18	$4,745	$4,745
Subsequent child, aged from 13 to 15	$3,822	$4,745
Subsequent child, aged from 0 to 12	$3,351	$4,475

Increasing the abatement rate and reducing the abatement threshold will target the allocation of FTC to lower-income families. However, families with only children between 16 and 18 years old will not receive a payment increase and may have less entitlement because of the abatement changes.

2) Relationship between AS and FTC

The AS is calculated as 70 percent of housing costs above an initial ‘entry threshold’ (which the recipient pays), up to a maximum amount. Entry thresholds can vary by benefit, family type and tenure (rent, board or mortgage). For families with children, the entry threshold also includes 25% of the first child rate (aged 0-15) of the Family Tax Credit (this is the same regardless of the number of children in the family).

Increasing the 0-15 year-old first child FTC rate will increase the base rate used in the AS calculation, which reduces the AS payment. Generally, the increase in FTC will be larger than the reduction in AS. However, families with only children over 15 (and not impacted by the abatement changes) will continue receiving the same FTC entitlement but their AS payment will decrease. This also occurs during normal WFF indexation rounds for families in this situation.

3) Taxwell assumption about income tax square-ups for transfer recipients

Some transfers (ACC, student allowance, New Zealand Superannuation (NZ Super) and main benefits) are treated as taxable income and are subject to PAYE. Taxwell modelling assumes that all people in receipt of transfer income square-up their affairs at year-end by filing a tax return or requesting a personal tax summary.

If a person receives a benefit for part of the year our modelling assumes that the person will square-up their affairs by filing a tax return or requesting a personal tax summary. Where the annual gross benefit would have been more than $14,000, the the person will receive a tax refund on square-up because the PAYE is calculated based on average tax rates. If the $14,000 threshold is increased, then these people will no longer be eligible for a tax refund on squaring up their affairs.

A similar outcome could occur for NZ Super or student allowance recipients. Part year recipients of NZ Super are much less likely to occur, and our model does not capture the impact on student allowance.

Administrative data from Inland Revenue would suggest that Taxwell is overestimating the number of families disadvantaged by no longer being eligible for a tax refund. In 2015, there were 35,000 individuals with a debt (of more than $20) who had either transfer income only, or tax and transfer income but did not square up so no debt was due.

An individual is not required to file a tax return if they (in additional to satisfying other criteria) have $200 or less of certain types of income which tax has not been withheld from correctly. Depending on an individual’s marginal tax rate, this $200 of income could equate up to $66 of tax.

4) AS component

The majority of families disadvantaged by the AS proposal happen when an increase in AS is offset by a decrease in TAS. If the TAS deficiency falls below $1, the recipient will lose entitlement to TAS, resulting in a $1 loss in income. Clients receiving the Disability Allowance (DA) may lose higher amounts if the AS causes their TAS deficiency to fall below the upper limit. This is because clients need to be at the upper limit to receive the DA exception amount. The DA exception amount covers 30% of their excess disability costs, above the DA. For a very small number of clients the AS increase can trigger the complete loss of the DA exception amount.

Option for distributional neutrality

The Child Material Hardship Package and the Budget 2010 Tax Package included a fund to allow payments to a small number of households who were financially disadvantaged as an unintended consequence of the package. A similar fund could be set up for the tax and transfer package as part of Budget 2017.

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