The Treasury

Budget 2017 Information Release

Release Document July 2017

www.treasury.govt.nz/publications/informationreleases/budget/2017

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1]	to prevent prejudice to the security or defence of New Zealand or the international relations of the government	6(a)
[4]	to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial	6(c)
[11]	to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.	6(e)(vi)
[23]	to protect the privacy of natural persons, including deceased people	9(2)(a)
[25]	to protect the commercial position of the person who supplied the information or who is the subject of the information	9(2)(b)(ii)
[26]	to prevent prejudice to the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied	9(2)(ba)(i)
[27]	to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information - would be likely otherwise to damage the public interest	9(2)(ba)(ii)
[29]	to avoid prejudice to the substantial economic interests of New Zealand	9(2)(d)
[31]	to maintain the current constitutional conventions protecting collective and individual ministerial responsibility	9(2)(f)(ii)
[33]	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials	9(2)(f)(iv)
[34]	to maintain the effective conduct of public affairs through the free and frank expression of opinions	9(2)(g)(i)
[36]	to maintain legal professional privilege	9(2)(h)
[37]	to enable the Crown to carry out commercial activities without disadvantages or prejudice	9(2)(i)
[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.

Inland Revenue
Te Tari Taake

THE TREASURY
Kaitohutohu Kaupapa Rawa

Joint Report: Family Incomes Package - transitional arrangements for provisional taxpayers using the uplift method

Date:	21 April 2017	**Report No:**	T2017/1055
		File Number:	SH-13-5-2-3

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Steven Joyce)	**Agree** to the recommendations	Friday, 28 April 2017
Minister of Revenue (Hon Judith Collins)	**Agree** to the recommendations	Friday, 28 April 2017

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[34]	Analyst, Tax Strategy, The Treasury	[39] (wk)	[23] (mob)	✓
Dr Eina Wong	Senior Analyst, Tax Strategy, The Treasury	[39] (wk)	[23] (mob)	
Graeme Morrison	Policy Manager, Inland Revenue	[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

Joint Report: Family Incomes Package - transitional arrangements for provisional taxpayers using the uplift method

Executive Summary

Cabinet noted that the Budget 2017 Family Incomes Package will mean that provisional taxpayers using the current standard uplift method will overpay their tax in the year beginning 1 April 2018. Cabinet authorised the Minister of Finance and Minister of Revenue jointly to agree changes to alleviate the overpayment, within the overall fiscal envelope. A decision is required by Friday, 28 April 2017 so Inland Revenue can draft legislation and the fiscal forecasts can be updated by the Treasury.

Provisional tax is usually paid on the basis of earlier years' tax liabilities plus an uplift factor (the standard uplift is 105 per cent of previous year's liability), or based upon an estimate. Provisional tax is a timing matter only – any under or over-payment of provisional tax is adjusted after year end when the tax return is filed. If provisional tax is paid by way of an estimate, the taxpayer estimates their own provisional tax liability and so can factor in changes to tax rates, although estimation exposes them to use of money interest on over or under payments. The standard uplift basis does not incorporate tax cuts effective in the current year, but safe-harbours most taxpayers from use-of-money-interest.

In the past where tax cuts have been provided, a measure to allow taxpayers to reduce their provisional tax payments, and remain within the safe-harbour where applicable, has been provided. For the 2010 tax reform, for example, the uplift factor was reduced from 105 per cent to 100 per cent as a transitional arrangement for provisional taxpayers.

Options for the uplift percentage are presented. Analysis shows each option presents trade-offs. The options that most closely match payments to obligations for lower income earners result in the largest underpayments, and consequently highest year-end tax bills, for higher income earners. Conversely, reducing year-end tax bills for higher income earners requires increasing the extent of overpayments for lower income earners.

Overpayments mean taxpayers lose from the time value of money (for example, forgone interest earnings) and mean that provisional taxpayers do not receive their first year's tax reduction until year end, unlike PAYE taxpayers. Underpayments mean that taxpayers gain from the time value of money, although anecdotal evidence suggests many taxpayers prefer not to underpay as it creates a tax bill at year end.

Officials have identified three feasible options for consideration: the status quo of 105% uplift or reducing the uplift to either 103 or 100 per cent. 105 per cent uplift would tend to lead to some overpayment by taxpayers. Reducing the uplift factor means that those on low-to-middle incomes will overpay by less and those on higher incomes will underpay. There are fiscal impacts from the timing of tax receipts, but these are modest.

It is an on balance decision, as no one option is clearly superior. Officials recommend the status quo (105 per cent uplift) as the other options lead to sometimes large underpayments by high income earners with only modest benefits for low and middle income earners and administrative costs are minimised. However, if more weight was placed on reducing overpayment than underpayment and/or improving accuracy for lower income taxpayers, then the 103 or 100 per cent uplift options would be preferred.

Recommended Action

We recommend that you:

a **agree** that the uplift percentage for individual provisional taxpayers using the uplift method in the tax year beginning 1 April 2018 should be either:

i. 105 per cent (the status quo and officials' preferred option); OR

Agree/disagree *Agree/disagree.*

ii. 103 per cent; OR

Agree/disagree *Agree/disagree.*

iii. 100 per cent.

Agree/disagree *Agree/disagree.*

b **note** that there are small, positive cash-flow impacts for the Government if either 105 per cent or 103 per cent are agreed, and the forecasts would be updated to reflect this.

c **note** that if either 103 per cent or 100 per cent are agreed, the two-year look back uplift would reduce to 108 per cent and 105 per cent, respectively.

d **direct** Inland Revenue to draft the necessary amendments to the Inland Revenue Acts for inclusion in a Bill to be introduced on 25 May 2017.

Directed *Directed*

Dr Eina Wong
Senior Analyst
The Treasury

Graeme Morrison
Policy Manager
Inland Revenue

Steven Joyce
Minister of Finance

Hon Judith Collins
Minister of Revenue

Joint Report: Family Incomes Package - transitional arrangements for provisional taxpayers using the uplift method

Purpose of Report

1. Absent further changes, the tax threshold changes in the Family Incomes Package will result in more provisional taxpayers who use the uplift method overpaying their tax in the 2018/19 tax year.

2. Cabinet authorised the Minister of Finance and Minister of Revenue jointly to agree changes to alleviate the overpayment. This report provides options for reducing those overpayments and subsequent refunds for affected individuals.

3. A decision is required by Friday, 28 April 2017.

Background

4. On Tuesday 18 April, Cabinet agreed the Family Incomes Package.

5. The package includes changes to tax thresholds effective 1 April 2018. This has a consequential impact on individual provisional taxpayers using the uplift method.

6. Taxpayers with more than $2,500 of tax to pay at the end of the year, or 'Residual Income Tax' (RIT), are required to pay provisional tax. Provisional tax is a way for people to pay tax on income not subject to withholding taxes. It is paid in instalments throughout the year. Provisional taxpayers are generally those who earn income from a business, from renting property, as a contractor, or from overseas.

7. Provisional taxpayers can currently use three methods to calculate the amount of tax they pay during the year:

   a *estimation* – the taxpayer estimates their tax bill for the year (use of money interest applies);

   b *ratio* – the taxpayer calculates their tax bill as a proportion of their GST taxable supplies; and

   c *uplift* – the taxpayer calculates their tax bill as 105 per cent of their bill for the previous year.[1] This is the default method for paying provisional tax and safe-harbours taxpayers from use of money interest if their RIT is less than $60,000.

8. For the 2018/19 tax year, small business taxpayers will also be able to use the Accounting Income Method (AIM) to make provisional tax payments without exposure to use of money interest. AIM users will benefit immediately from the tax threshold changes.

9. Taxpayers using the uplift method would calculate their provisional tax for 2018/19 as 105 per cent of their bill for 2017/18, based on superseded tax thresholds. Regardless of the method used, all provisional taxpayers must file tax returns and 'square-up' their final tax liabilities at the end of the year to ensure they pay the correct amount.

[1] If the previous year's tax liability is not yet confirmed, the taxpayer applies 110 per cent to their tax bill from two years ago. This is known as 'two-year look back.'

However, all else equal, more users of the uplift method would overpay their tax during the year.

10. Taxpayers using the ratio method will also be more likely to receive a refund at the end of the year, as they will also be using a method relying on previous year's tax thresholds. This report does not recommend adjusting the ratio method because of the relatively small number of taxpayers using this method (around 600 in 2015/16).

11. Although any discrepancy from the uplift method will 'wash out' during the square-up process at year-end – with over-payers receiving a tax refund and under-payers receiving a tax bill – transitional measures to alleviate the overpayment may be consistent with the Government's objectives for the Family Incomes Package.

12. The overpayment issue is transitional, affecting the 2018/19 year (and 2019/20 if they do not file their 2018/19 returns in time).

13. The Government chose to alleviate the impact of the Budget 2010 tax package on users of the uplift method by reducing the uplift percentage to 100 per cent (no uplift).

Objectives

14. There are a range of considerations in evaluating options for transitional arrangements for taxpayers:

    - *Administrative feasibility and risk:* The feasibility and operational risks of implementation by Inland Revenue.

    - *Fiscal implications:* The changes need to be within the fiscal envelope provided by Cabinet.

    - *Accuracy for taxpayers:* Over payments by taxpayers mean that taxpayers lose from the time value of money (for example, forgone interest earnings) and mean that provisional taxpayers do not receive their first year's tax reduction until year end. Under payments mean that taxpayers gain from the time value of money, although anecdotal evidence suggests many taxpayers prefer not to underpay as it can create an unexpected tax bill at year end.

    - *Compliance costs for taxpayers:* clear and consistent arrangements are generally preferred over complex arrangements.

    - *Equity:* the treatment of different taxpayers is considered fair.

Options

15. There are two main ways to alleviate the overpayment for individuals using the uplift method:

    a *reduce the RIT amount before uplift is applied;* or

    b *reduce the uplift percentage.*

16. Inland Revenue advises that an adjustment to the RIT amount would be complex to implement and difficult to communicate to those affected.

17. From a customer usability perspective, Inland Revenue considers changing the uplift percentage is less complex for provisional taxpayers to understand than an RIT threshold adjustment.

18. Although the adjustment option would be implemented easily in Inland Revenue's new START system, development work for the 2018 tax processing season will be completed in both START and the heritage system, FIRST, to minimise implementation risk. Adjusting the uplift percentage in FIRST is a simple code change, but introducing a new RIT threshold adjustment introduces new calculations FIRST does not currently perform, and is much more complex.

19. From an implementation perspective, Inland Revenue's strong recommendation is to consider the uplift percentage option as this will be easier to comprehend and reduces risk to the transformation delivery due 1 April 2018.

20. This report focusses on potential uplift percentage rates. All options presented are within the fiscal envelope considered by Cabinet.

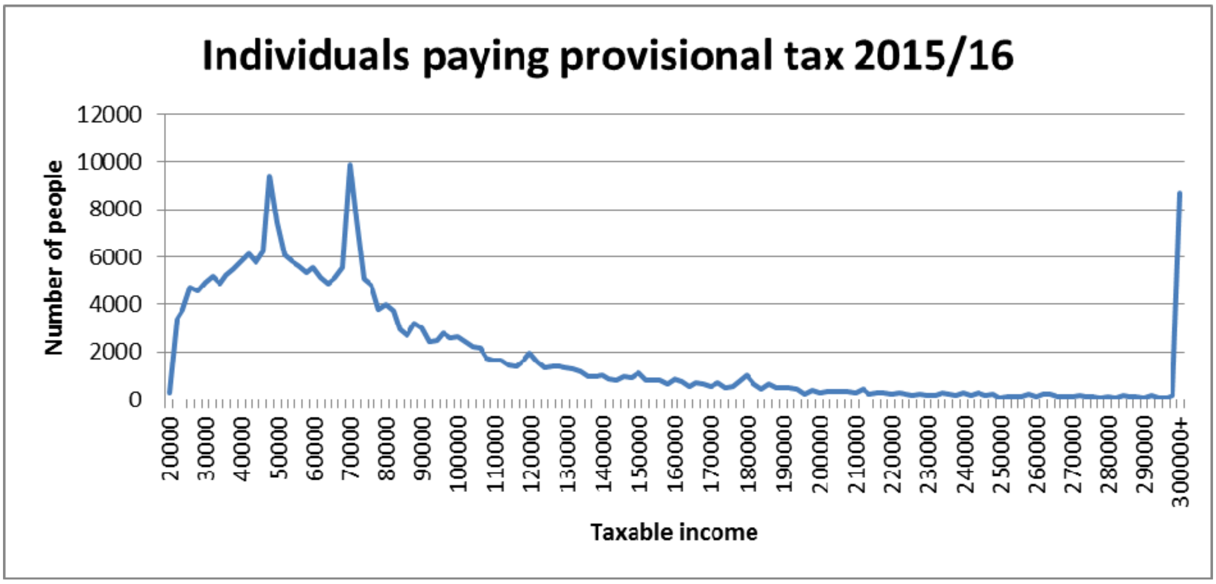
Analysis

Context

21. Around 258,000 people paid a total of $3.8 billion in provisional tax for the 2015/16 tax year. Of these, 89 per cent used the uplift method.

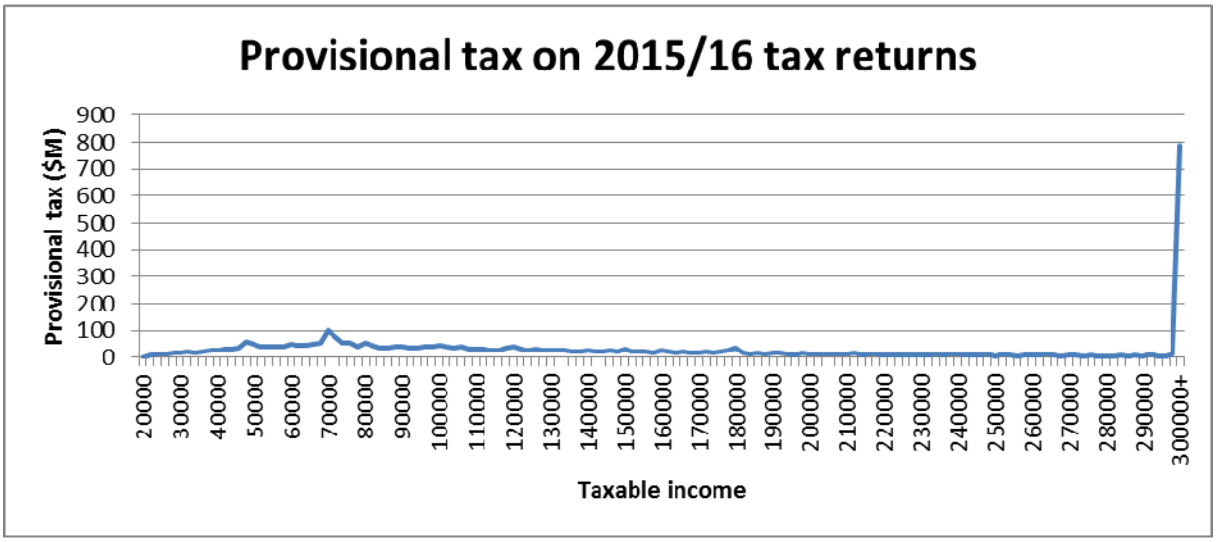
22. Around 50 per cent of all provisional taxpayers have taxable incomes less than $68,000, and around 75 per cent less than $100,000. Figure 1 provides the distribution of provisional taxpayers by income based on Inland Revenue data.

Figure 1: Distribution of provisional taxpayers



23. While most provisional taxpayers have incomes below $74,000, around 75 per cent of provisional tax is paid by people with taxable incomes above this amount. More than 40 per cent is paid by people with more than $150,000 of taxable income. Figure 2 shows the distribution of provisional tax paid by income of the payer based on Inland Revenue data.

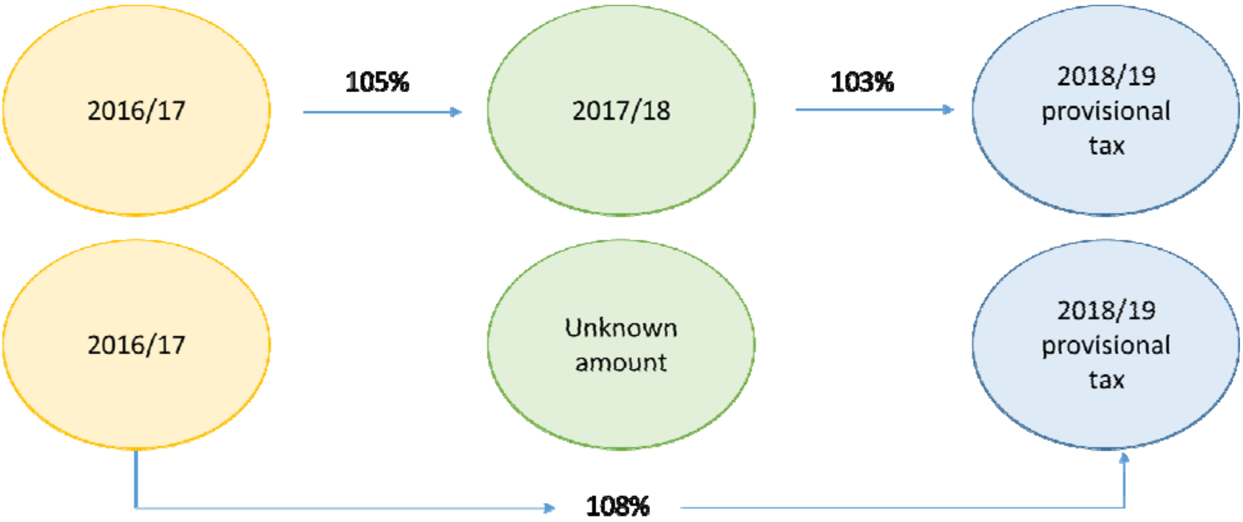
Figure 2: Distribution of provisional tax paid by income of the payer



24. The remainder of this section discusses scenarios for three potential uplift options: 105 per cent (the status quo), 103 per cent and 100 per cent. Illustrative examples at different income levels are provided for each.[2] The fiscal impact is also discussed.

25. Any changes to the uplift percentage would also be made to the two-year look back uplift. For example, if the 105 percent uplift were changed to 103 per cent, the two-year look back uplift would change to 108 per cent from 110 per cent, comprising 105 per cent for the year when the tax thresholds did not change, and 103 per cent for the year that the tax thresholds did change. Figure 3 below illustrates.

Figure 3: Two-year look back



[2] For simplicity, the scenarios assume income growth of 5 per cent. Based on the Treasury's forecasts for growth in entrepreneurial income, actual growth may be slightly higher. Higher income growth would increase taxpayer obligations relative to what is presented and overpayments would reduce. All figures exclude tax credits, also for simplicity.

Implications for taxpayers

26. Table 1 below summarises the impact of each option for three example taxpayers: a low income earner (annual income of $22,000), middle income earner ($52,000) and high income earner ($156,000). Incomes are assumed to grow by 5 per cent. Further details of these calculations is presented in Annex 1.

Table 1: Summary of examples

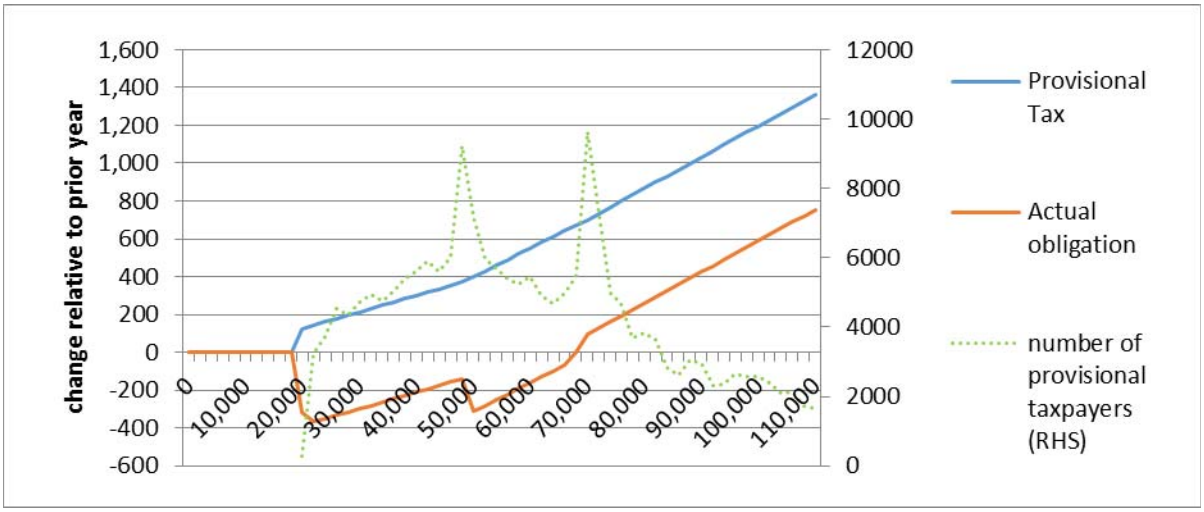
		Uplift percentage		
		105 (status quo)	**103**	**100 (no uplift)**
Taxable income	**$22,000**	$601 overpaid	$453 overpaid	$367 overpaid
	$52,000	$711 overpaid	$538 overpaid	$280 overpaid
	$156,000	$606 overpaid	$229 underpaid	$1,514 underpaid

27. This analysis shows that each option has trade-offs. The options that most closely match payments to obligations for lower income earners result in the largest underpayments, and consequently highest year-end tax bills, for higher income earners. Conversely, reducing year-end tax bills for higher income earners requires increasing the extent of overpayments for lower income earners.

105% uplift (status quo)

28. The status quo (105% uplift) would see most users of the uplift method overpay tax during the year and refunded following the square-up process. Figure 4 compares taxpayer obligations with provisional tax payments made using a 105 per cent uplift.

Figure 4: Comparison of taxpayer obligation and provisional tax payments with 105 per cent uplift



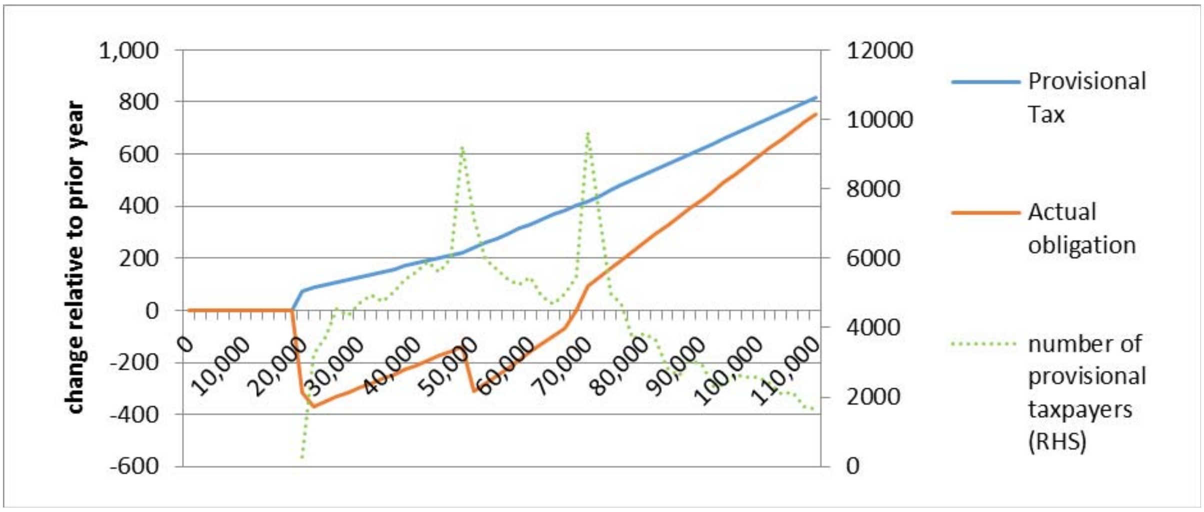
Source: Inland Revenue

29. More provisional taxpayers affected by the tax threshold changes would be overtaxed during the year than in the absence of the tax threshold changes. Although not depicted, the 33,000 former Independent Earner Tax Credit recipients would be slightly undertaxed. Overpayments would be largest for taxpayers with $52,000 of taxable income.

103% uplift

30. A 103 per cent uplift rate would reduce the level of overpayment during the year, but particularly so for high-income earners. Former Independent Earner Tax Credit recipients would be undertaxed slightly more than under the status quo, by around $100 to $150 per year. Figure 5 compares taxpayer obligations with provisional tax payments made using a 103 per cent uplift rate.

Figure 5: Comparison of taxpayer obligation and provisional tax payments with 103 per cent uplift



Source: Inland Revenue

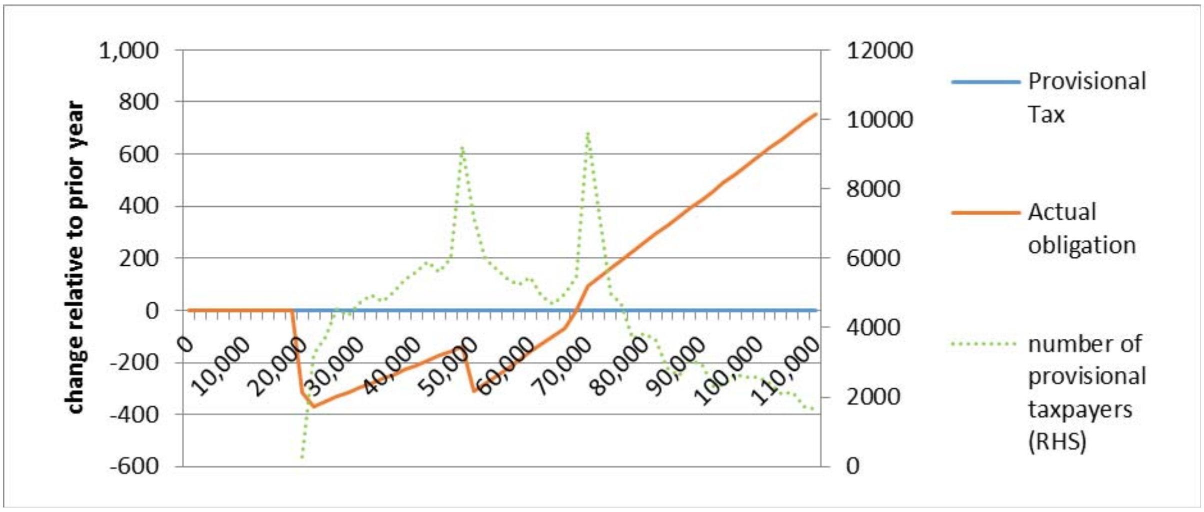
31. Most users of the uplift method will still be overtaxed. However, while it is not shown in the chart, those on the highest incomes are undertaxed.

100% uplift

32. A 100 per cent uplift rate, or no uplift, would significantly reduce the level of over-taxation during the year, but would result in many being undertaxed. Former Independent Earner Tax Credit recipients would be undertaxed much more than under the other options, by around $200 to $350 per year.

33. Figure 6 compares taxpayer obligations with provisional tax payments made using a 100 per cent uplift rate.

Figure 6: Comparison of taxpayer obligation and provisional tax payments with 100 per cent uplift



Source: Inland Revenue

34. Most users of the uplift method would be undertaxed using a 100 per cent uplift rate. High income earners would be significantly undertaxed and would face substantial tax bills at year-end.

Fiscal impact

35. A change to the uplift percentage will impact the timing of tax revenue and receipts across years. Shifts in receipts affect the Crown's cash position, which has consequences for the Crown's interest payments and ultimately flows through to net debt and the operating balance.

36. The revenue impacts of the Family Incomes Package were estimated based on the 100 per cent uplift option. The 105 or 103 per cent options in this paper will have the effect of delaying reductions in cash flows, which would improve net debt and the operating balance. However, the impacts are relatively small; the estimated impact is a one-off improvement in the operating balance and decrease in net debt of up to $5 million in 2018/19.

37. The Treasury will be able to update the forecasts to reflect Ministers' decisions if they are made by Friday, 28 April.

Recommendation

38. It is an on balance decision, as no one option is clearly superior.

39. Officials recommend the status quo (105 per cent uplift) as the other options lead to, in some cases, large underpayments by high income earners with only modest benefits for low and middle income earners and administrative costs are minimised. While there is overpayment with this option, the cost to taxpayers from the time value of money is modest.

40. The 103 or 100 per cent uplift options would be preferred if greater weight was placed on reducing overpayment than underpayment and/or improving accuracy for lower income taxpayers.

Annex 1: Further information on implications for example taxpayers

Status quo – 105 per cent uplift

Example low income earner

41. For a taxpayer with $22,000 of taxable income in the 2017/18 tax year:

    a Their obligation for the 2017/18 tax year is $2,870.

    b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $23,100.

    c Under the new tax structure, their tax obligation is:

    (23,100-22,000)*17.5% + (22,000-0)*10.5% = **$2,503.**

    d Using the uplift method, their provisional tax is:

    $2,870*105% = **$3,104.**

    e Their overpayment is **$601**, or around $12 per week. They will receive a lump-sum refund for the total after they file a tax return at the end of the year.

Example middle income earner

42. For a taxpayer with $52,000 of taxable income in the 2017/18 tax year:

    a Their obligation for the 2017/18 tax year is $8,620.

    b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $54,600.

    c Under the new tax structure, their tax obligation is:

    (54,600-52,000)*30% + (52,000-22,000)*17.5% + (22,000-0)*10.5% = **$8,340.**

    d Using the uplift method, their provisional tax is:

    $8,620*105% = **$9,051.**

    e Their overpayment is **$711**, or around $14 per week. They will receive a lump-sum refund for the total after they file a tax return at the end of the year.

Example high income earner

43. For a taxpayer with $156,000 of taxable income in the 2017/18 tax year:

    a Their obligation for the 2017/18 tax year is $42,400.

    b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $163,800.

    c Under the new tax structure, their tax obligation is:

    (163,800-70,000)*33% + (70,000-52,000)*30% + (52,000-22,000)*17.5% + (22,000-0)*10.5% **= $43,914**.

    d Using the uplift method, their provisional tax is:

    $42,400*105% = **$44,520.**

e Their overpayment is **$606**, or around $12 per week. They will receive a lump-sum refund for the total after they file a tax return at the end of the year.

103 per cent uplift

Example low income earner

44. For a taxpayer with $22,000 of taxable income in the 2017/18 tax year:

a Their obligation for the 2017/18 tax year is $2,870.

b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $23,100.

c Under the new tax structure, their tax obligation is:

(23,100-22,000)*17.5% + (22,000-0)*10.5% = **$2,503.**

d Using the uplift method, their provisional tax is:

$2,870*103% = **$2,956.**

e Their overpayment is **$453**, or around $9 per week. They will receive a lump-sum refund for the total after they file a tax return at the end of the year.

Example middle income earner

45. For a taxpayer with $52,000 of taxable income in the 2017/18 tax year:

a Their obligation for the 2017/18 tax year is $8,620.

b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $54,600.

c Under the new tax structure, their tax obligation is:

(54,600-52,000)*30% + (52,000-22,000)*17.5% + (22,000-0)*10.5% = **$8,340.**

d Using the uplift method, their provisional tax is:

$8,620*103% = **$8,878.**

e Their overpayment is **$538**, or around $10 per week. They will receive a lump-sum refund for the total after they file a tax return at the end of the year.

Example high income earner

46. For a taxpayer with $156,000 of taxable income in the 2017/18 tax year:

a Their obligation for the 2017/18 tax year is $42,400.

b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $163,800.

c Under the new tax structure, their tax obligation is:

(163,800-70,000)*33% + (70,000-52,000)*30% + (52,000-22,000)*17.5% + (22,000-0)*10.5% **= $43,914**.

d Using the uplift method, their provisional tax is:

$42,400*103% = **$43,672.**

e Their underpayment is **$229**, or around $4 per week. They will be required to pay this after they file a tax return at the end of the year.

100 per cent uplift

Example low income earner

47. For a taxpayer with $22,000 of taxable income in the 2017/18 tax year:

    a Their obligation for the 2017/18 tax year is $2,870.

    b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $23,100.

    c Under the new tax structure, their tax obligation is:

    (23,100-22,000)*17.5% + (22,000-0)*10.5% = **$2,503.**

    d Using the uplift method, their provisional tax is:

    $2,870*100% = **$2,870.**

    e Their overpayment is **$367**, or around $7 per week. They will receive a lump-sum refund for the total after they file a tax return at the end of the year.

Example middle income earner

48. For a taxpayer with $52,000 of taxable income in the 2017/18 tax year:

    a Their obligation for the 2017/18 tax year is $8,620.

    b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $54,600.

    c Under the new tax structure, their tax obligation is:

    (54,600-52,000)*30% + (52,000-22,000)*17.5% + (22,000-0)*10.5% = **$8,340.**

    d Using the uplift method, their provisional tax is:

    $8,620*100% = **$8,620.**

    e Their overpayment is **$280**, or around $5 per week. They will receive a lump-sum refund for the total after they file a tax return at the end of the year.

Example high income earner

49. For a taxpayer with $156,000 of taxable income in the 2017/18 tax year:

    a Their obligation for the 2017/18 tax year is $42,400.

    b Assuming 5 per cent income growth, their taxable income for the 2018/19 tax year is $163,800.

    c Under the new tax structure, their tax obligation is:

    (163,800-70,000)*33% + (70,000-52,000)*30% + (52,000-22,000)*17.5% + (22,000-0)*10.5% **= $43,914**.

    d Using the uplift method, their provisional tax is:

    $42,400*100% = **$42,400.**

e Their underpayment is **$1,514**, or around $29 per week. They will be required to pay this after they file a tax return at the end of the year.