

Date: 23 November 2007

SH-13-5

To: Office of the Minister of Finance

From: Tax Strategy, Treasury

Note that the fiscal costs in this aide memoire and the aide memoire on 15 November are incorrect due to a mistake in calculating the New Zealand Superannuation impact. Refer to the document "Treatment of NZ Super in tax change scenarios" for an explanation of the error and for the revised fiscal numbers for this note. Revised fiscal numbers for the 15 November aide memoire were not produced.

### **AIDE MEMOIRE: TAX SCENARIOS 23 NOVEMBER**

This note provides the cost for introducing a tax free zone to \$9500 and increasing the 33% and 39% thresholds to \$40 000 and \$75 000 respectively. This net fiscal cost of this option is **\$3.149 billion**.

We have also provided a second scenario that has a 10% bottom rate to \$18 000 (with the same changes to the 33% and 39% thresholds). This second scenario gives a similar weekly tax reduction for those earning more than \$18 000. This second scenario is cheaper, with a net fiscal cost of **\$3.067 billion**.

Further details on these two scenarios are attached.

While the first scenario is around \$80 million more costly on a net basis, on a gross basis it is \$600 million more costly. This large relative change arises due to current legislation for the setting of benefits and NZ Superannuation (NZS). These reasons are expanded below:

Under legislation, benefits are set on a net basis; this means any tax reduction to beneficiaries would be offset by an equivalent reduction in benefit appropriations. The tax free zone of \$9 500 under the first scenario provides a larger tax reduction at the income level of a beneficiary. Therefore the reduction in benefit appropriations under the first scenario is higher (by around \$230 million)

Legislation provides that NZS is calculated by reference to the net ordinary time average wage (NOTAW). The tax reduction at the NOTAW would be similar under each scenario which implies that the new net NZS will also be similar under each scenario. But because the tax reduction at the income level of NZS under the first scenario is much higher, this means that that gross NZS payments must be lower under this first scenario. The reduction in superannuation appropriations are \$260 million higher under the first scenario.

The first scenario includes a reduction to benefit and NZS appropriations of around \$1.1 billion; the reduction for the second scenario is around \$0.6 billion. The magnitude of these reductions to appropriations is indicative of the extent to which recipients of transfer payments are represented at the bottom of the income spectrum. We will be doing more work to better understand the composition of taxpayers on low incomes.

If tax reductions for NZS and benefit recipients were different to the reductions provided through the current legislation, both the level of appropriations and the net fiscal cost will change.

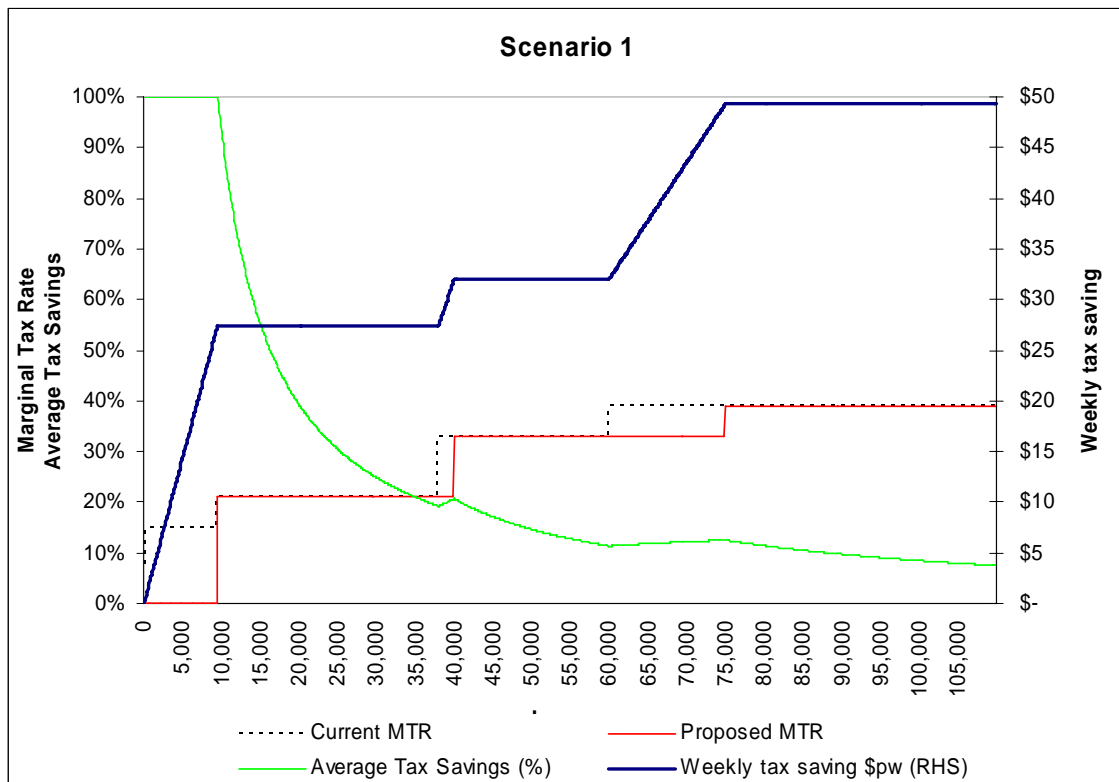
## Scenario 1

Threshold <sup>1</sup>	Rate
0k	0%
9.5k	21%
40k	33%
75k	39%

1. LIR removed

Fiscal Cost (\$ million)	2009/10
Gross Cost	4867
NZS Impact	-552
Benefit appropriations	-526
<b>Disposable income</b>	<b>3789</b>

Extra tax revenue	-947
NZS Fund Contributions	129
Investment Income	178
<b>Net Fiscal Cost</b>	<b>3149</b>



## Scenario 2

Threshold <sup>1</sup>	Rate
0k	10%
18k	21%
40k	33%
75k	39%

1. LIR removed

Fiscal Cost (\$ million)	2009/10
Gross Cost	4273
NZS Impact	-288
Benefit appropriations	-299
<b>Disposable income</b>	<b>3686</b>

Extra tax revenue	-922
NZS Fund Contributions	129
Investment Income	174
<b>Net Fiscal Cost</b>	<b>3067</b>

