25 February 2008 SH-13-3-0

To: Office of the Minister of Finance

From: Tax Strategy, Treasury

AIDE MEMOIRE: PHASED SCENARIO OF 21 FEBRUARY

Treasury has costed the following phased package of tax changes:

On April 1 2009

- Replace the Low Income Rebate with a tax free zone to $4 000
- 15% on income between $4 000 to $9 500
- 21% on income between $9 500 to $40 000
- 33% on income between $40 000 to $70 000
- 39% on income in excess of $70 000

On April 1 2010

- Tax free zone to $7 000
- 15% on income between $7 000 to $9 500
- 21% on income between $9 500 to $41 500
- 33% on income between $41 500 to $75 000
- 39% on income in excess of $75 000

On April 1 2010

- Tax free zone to $10 000
- 21% on income between $10 000 to $42 000
- 33% on income between $42 000 to $80 000
- 39% on income in excess of $80 000

Assumptions used

Costs are provided for June fiscal years.

Contributions to the Superfund in 2008/09 and 2009/10 are based on the increase to the future cost of superannuation from the full phased package. Again Superfund contributions are highly volatile within the forecast period, ranging from an increase from the status quo of $480 million in 2008/09 to a decrease from the status quo of $182 million in 20011/12 (from 2015/16 contributions are around $200 million higher than the status quo).

Costs for phased package

Table 1 shows the four year cost of the phased package.

Table 1: phased package

	2008/09	2009/10	2010/11	2011/12
Change to disposable income	-537	-2,524	-4,016	-5,126
Change to residual cash	**-936**	**-2,207**	**-3,167**	**-3,839**

As noted above, Superfund contributions are volatile in early years (in particular a $182 million reduction from the status quo in 2011/12). Table 2 shows the cost of the phased package where contributions are averaged across the four years; this provides a more accurate picture of the future cost of the tax changes.

Table 2: phased package with averaged superfund contributions

	2008/09	2009/10	2010/11	2011/12
Change to disposable income	-537	-2,524	-4,016	-5,126
Change to residual cash	**-572**	**-2,117**	**-3,289**	**-4,171**

Comments

The fiscal cost for the current phased package is higher in earlier years compared to the scenarios in our earlier note *Personal Tax Changes: Ready Reckoner* (15th February 2008). The main difference is retaining the 15% rate for income between the free zone and $9 500 for the first two stages.

Retaining the 15% rate adds an additional tax rate to the system in the short term and has the potential to create practical difficulties for Inland Revenue and taxpayers. Any difficulties would be short term only, but could have substantial costs associated.

Although we have not discussed this with Inland Revenue, difficulties from an additional rate would include:

- Resident withholding tax on interest: Banks needing to withhold at 0%, 15% and 21% as opposed to the current rate of 19.5% if the system is to be accurate;
- Income tax returns: likely increase in requests for personal tax summaries (where an incorrectly withholding rate has been used) and subsequent IR 3s being filed;
- Portfolio investment entity rules: IT systems around PIEs are currently stretched; we are not aware whether there would be any substantial changes required;
- FBT: an additional rate would be required for the FBT system to maintain accuracy;
- Inland Revenue systems: an additional tax rate could require some changes in Inland Revenue systems (eg on withholding tax rates). Inland Revenue systems changes are typically costly and time consuming.