

26 March 2008

SH-13-3-0

To Office of the Minister of Finance

From Tax Strategy, Treasury

AIDE MEMOIRE: COSTING FOR 12.5% BOTTOM RATE SCENARIO

You have asked for further information regarding a tax change scenario centred around a 12.5% bottom rate.

The scenario involves the following phased changes:

From 1 April 2009

- Abolish Low Income Rebate and introduce a bottom rate of 12.5% up to \$15,000
- 21% on income between \$15,000 and \$40,000
- 33% on income between \$40,000 and \$70,000
- 39% on income that exceeds \$70,000

From 1 April 2010

- 12.5% on income up to \$20,000
- 21% on income between \$20,000 and \$40,000
- 33% on income between \$40,000 and \$75,000
- 39% on income that exceeds \$75,000

From 1 April 2011

- 12.5% on income up to \$25,000
- 21% on income between \$25,000 and \$45,000
- 33% on income between \$45,000 and \$80,000
- 39% on income that exceeds \$80,000

Costs for the 12.5% bottom rate scenario

Costs are for income tax years and show the change to disposable income; this is consistent with the costs provided for the scenarios in the Annex to T2008/456 *Illustrative options for personal tax reductions*. We have applied a standard claw back of 17.1% to reflect static increases to other taxes. Costs do not indicate the change to residual cash.

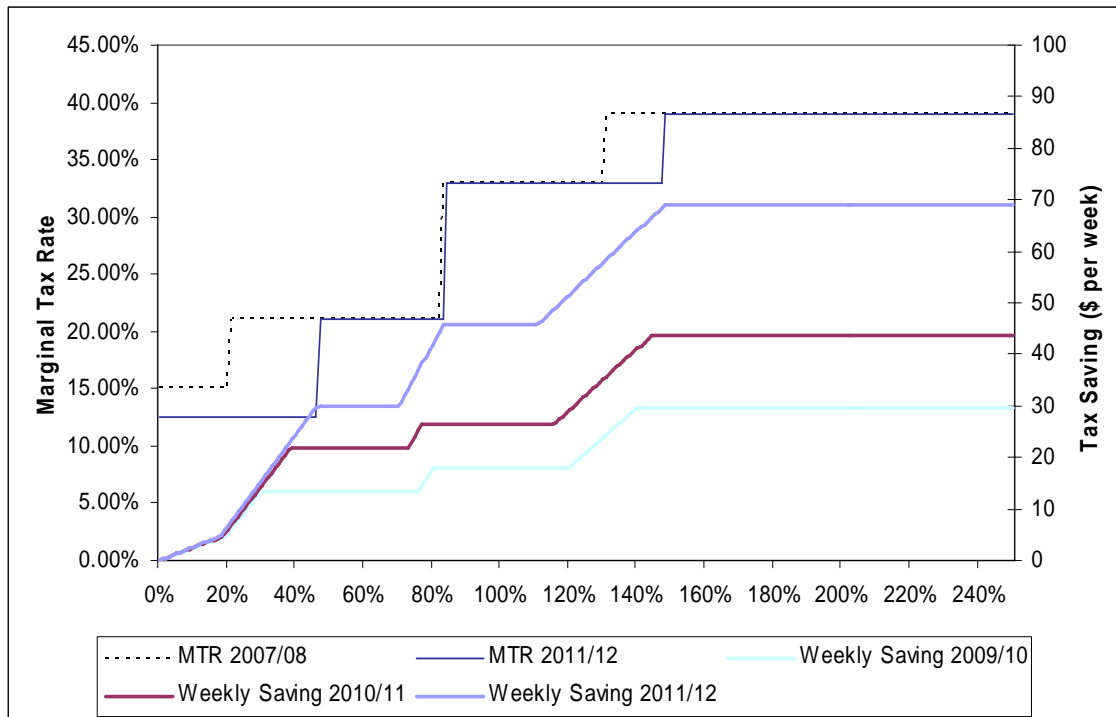
Table 1: 12.5% bottom rate scenario one:

Fiscal Cost (\$ million)	2009/10	2010/11	2011/12
Change to disposable income	-2,252	-3,228	-4,948
<i>less clawback (17.1%)</i>	385	552	846
	-1,867	-2,676	-4,102

Figure 1 shows the weekly tax savings and marginal tax rates for this 12.5% scenario. Further distributional analysis for this scenario is provided in the attached annex.

Note that weekly savings and marginal tax rates are shown relative to the average wage for each year. The average wage for the 2007/08 year is estimated at \$45,800, and rises to \$54,000 by 2011/12¹. Weekly savings are shown in nominal terms (the analysis in T2008/456 considered long term options spanning 10 years so weekly savings were converted into 2007/08 dollars)

Figure 1: Marginal tax rate changes and weekly tax savings



¹ Average wages are for March quarters and are calculated using wage growth estimates from HYEPU and the QES ordinary time average wage.

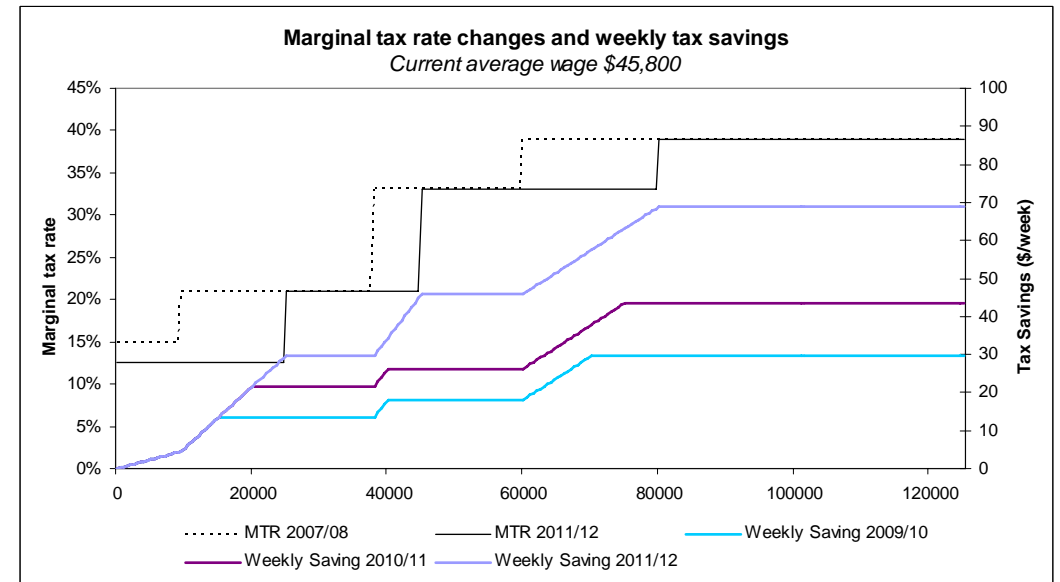
Scenario A

Design		
On 1 April 2009	On 1 April 2010	On 1 April 2011
12.5% to \$15k	12.5% to \$20k	12.5% to \$25k
21% to \$40k	21% to \$40k	21% to \$45k
33% to \$70k	33% to \$75k	33% to \$80k
39% over \$70k	39% over \$75k	39% over \$80k

Fiscal Cost (\$ million)	2011/12
Chg to disposable income	-4985
less clawback (17.1%)	852
	-4133

Incomes	Change in EMTR by 2011 ¹				
	Increase	No change	0 - 5% fall	5 - 10% fall	> 10% fall
\$0k - \$10k	0	33,553	584,673	38,827	4,766
\$10k - \$20k	0	SOME	29,398	767,114	SOME
\$20k - \$30k	SOME ²	161,622	14,640	228,534	SOME
\$30k - \$40k	SOME ²	217,843	SOME	SOME	62,601
\$40k - \$50k	0	142,649	0	SOME	150,840
\$50k - \$60k	0	272,881	SOME	0	0
\$60k - \$70k	0	0	0	169,324	0
\$70k - \$80k	0	0	0	123,536	0
\$80k - \$90k	0	108,930	0	0	0
\$90k - \$100k	0	53,549	0	0	0
\$100k+	0	181,208	0	0	0
Total³	0	1,172,234	628,711	1,327,335	218,207

Equality measures	
Status Quo Gini coefficient	0.353
New Gini coefficient (2011)	0.352
Status quo 80/20 ratio	2.942
New 80/20 ratio (2011)	2.941



1. These have been estimated using Treasury's Taxmod model which is based on Statistics NZ's Household Economic Survey dataset. In some cases there are too few observations in the sample to report groups separately.

2. There are some individuals who only have investment income and therefore do not qualify for the LIR. They will move from the 19.5% rate to the 21% rate.

3. The totals do not include those in the "some" categories.

