

To: Office of the Minister of Finance and Office of the Minister of Revenue

From: Tax Strategy, Treasury and Policy Advice Division, Inland Revenue

Date: 2 May 2008

SUBJECT: SHOULD THERE BE A NEW TAX CODE FOR SECONDARY INCOME FROM 1 OCTOBER 2008

Because there is currently no secondary tax code that reflects the 15% tax rate, people who have a primary income source that is under \$9,500 will generally have PAYE deducted on all or part of their income from a second job at too high a rate. Relatively few people have a primary income source that is under \$9,500, so at the moment this affects only a small number of people. However, because the new 12.5% tax rate will apply to those earning \$14,000 and below, under the new tax rate structure more people will have secondary income withheld at too high a rate if no change is made to the secondary tax codes.

In particular NZ Super and income tested benefits (including student allowance) would be taxed as the recipient's main source of income so any PAYE income would be taxed as a secondary source of income under a secondary tax code. As the threshold for the new 12.5% rate will be extended to \$20,000 this increases the scope for taxpayers to have this PAYE income over-withheld and creates a case for introducing a new secondary tax code. However, introducing a lower secondary tax code for the half year from 1 October 2008 is not recommended. There are several reasons for this.

We think that introducing a new secondary tax code could have significant systems implications for payroll providers and employers, and may impact on their ability to deliver tax cuts by 1 October 2008. We expect that a new code could have more significant implications for payroll and software providers than introducing new thresholds for secondary tax codes or new rates and thresholds for PAYE tables.

In addition, introducing a new secondary tax code on 1 October 2008 is likely to have additional administration costs for Inland Revenue.

Any increase in over-withholding would be smaller in absolute terms for the 2008/09 year because the 12.5% rate only applies for half the year. If a taxpayer earned exactly \$14,000 and half of this was from a secondary source, then the maximum increase in over withholding would be around \$240.

If a secondary tax code is not introduced from 1 October 2008, the main groups of taxpayers that would have secondary income over-withheld are single beneficiaries and students.

People who earn PAYE income are able to request a "special tax code" from Inland Revenue. This is an individualised PAYE tax code that Inland Revenue calculates that reflect the individual's circumstances. A person who expects to offset losses against their income, for example, can request a special tax code that reflects those losses rather than needing to apply for a refund at the end of the year. Special tax codes should alleviate this over-withholding problem for taxpayers who request them.

Recommendations

1. Agree that a new secondary tax code reflecting the 12.5% rate should not be introduced for the half year from 1 October 2008.

Agreed / Not agreed

Agreed / Not agreed

2. Agree that officials should report to Ministers after the Budget on whether a new secondary tax code from 1 April 2009 would be desirable.

Agreed / Not agreed

Agreed / Not agreed