

To: Office of the Minister of Finance

From: Tax Strategy, Treasury

Date: 30 April 2008

SUBJECT: INDEXING WORKING FOR FAMILIES FROM 1 OCTOBER 2008

Proposal

This note explores the implications of bringing forward the indexation of Working for Families to 1 October 2008 instead of 1 April 2009 (as expected under current forecast assumptions). Inland Revenue have been consulted and have provided input to this note.

Working for Families tax credits consist of a range of credits; the Family Tax Credit (FTC), In-Work Tax Credit (IWTC), Parental Tax Credit (PTC) and Minimum Family Tax Credit (MFTC). These credits are cumulative. The FTC, IWTC and PTC are all abated from a level of annual income at a rate of 20 cents in the dollar. Currently the abatement threshold for Working for Families is \$35,000.

Legislation requires the FTC and the abatement threshold for Working for Families to be adjusted for inflation each time the CPI movement cumulatively reaches 5%. The first measurement point is from 1 April 2007. Under current legislation the Order in Council must be made no later than 1 December and the increase must apply from 1 April following that date. In practise this means that the September quarter CPI result is the last quarter to test whether the 5% has been reached.

Final Treasury forecasts are such that by the September quarter the cumulative CPI increase will be 5.24% and therefore will trigger an increase to the FTC and abatement threshold by this amount on 1 April 2009. The alternative option explored in this note is to use this forecasted CPI as a basis to bring forward the indexation such that it would apply from 1 October 2008.

Note that Treasury's forecasts were subsequently revised after this note went and the final CPI forecast used was 5.22% not 5.24%

The table below sets out the weekly adjustments to the FTC.

Weekly rate	Current 1 April 2008	New Rate 1 October 2008	New Rate 1 April 2009
First child rate if under 16	\$82.00	\$86.30	\$86.30
First child rate if 16 or over	\$95.00	\$99.98	\$99.98
Subsequent child rate if under 13	\$57.00	\$59.99	\$59.99
Subsequent child rate if 13 to 15	\$65.00	\$68.41	\$68.41
Subsequent child rate if 16 or over	\$85.00	\$89.45	\$89.45

As the legislation sets the FTC and abatement threshold on an annual basis, composite rates would need to apply for the 2008/09 year. In practice this would mean the increase for the 2008/09 year would be only half the 5.24% increase, with the full increasing applying from 1 April 2009.

If indexation is to be implemented from 1 October 2008 we would need to talk to the Ministry of Social Development before announcement in Budget 2008. This is because MSD administers the FTC for beneficiaries so could have some administrative implications and the changes may have implications for other social welfare policies.

Who Gains?

Weekly gains depend on the number of children in a family and also whether the family earns above the abatement threshold. Increasing the abatement threshold will reduce the tax credit abatement for those recipient families earning above the new threshold. This means that those families currently receiving working for families and earning above the threshold would receive an additional \$7.05 per week from 1 October 2008 as a result of the increase to the abatement threshold; families earning less than the abatement threshold can only benefit from increases to FTC.

Up to 61% of families that currently receive working for families would benefit by more than \$10 per week; these families mostly earn more than \$35,000 per annum. A further 25% of families receiving working for families would get less than \$5 per week; these families mostly earn less than \$35,000.

The following table shows the weekly gain from 1 October 2008 for a number of different representative families. It also shows the additional expected weekly tax reduction that would take effect from 1 April 2009 under personal tax cut scenarios A and B.¹

	WFF Gain from 1-Oct-2008	Additional Tax Saving from Scenario B 1-April-2009	Additional Tax Saving from Scenario A 1-April-2009
Two earner family on 100% and 50% of the average wage with two children under 12	\$14.36	\$28.39	\$31.65
One earner family on 100% of the average wage with two children under 12	\$14.36	\$16.49	\$18.12
Two earner family both on 50% of the average wage with one child under 12	\$11.36	\$23.78	\$27.04
One earner family on 100% of the average wage with one child under 12	\$11.36	\$16.49	\$18.12
One earner family on 75% of the average wage with one child under 12	\$4.31	\$11.89	\$13.52

Fiscal Cost

The fiscal cost from applying indexation from 1 October 2008 would be approximately \$100 million in 2008/09 and \$15 million in 2009/10 (costs are for fiscal years). This reflects the additional cost of bringing implementation forward. The costs in the 2009/10 year reflect payments made to families who apply for their tax credit through back year assessment.

¹ Average wage used is \$45,800 this is the December 2007 quarter average weekly earnings by FTE from the Quarterly Employment Survey.

Bringing implementation forward should not affect the date of any future indexation. Legislation indicates that subsequent indexation would be required where cumulative inflation, from the date when previous indexation was triggered, reaches 5%. As noted above, the current forecasts indicate inflation to the September 2008 quarter will trigger the first indexation of the FTC and abatement threshold. Bringing the implementation date for this indexation forward does not change the date on which it is triggered and should not affect the date of future indexation.

Legislation

WFF tax credits are calculated on the basis of a full tax year, which means that an increase would normally have a 1 April start date. If the increase is brought forward to 1 October 2008, the FTC amount and the abatement threshold would need to be increased by a composite amount in order to reflect the fact that the change is happening mid-year. This will ensure that families get the full benefit of the new amount and abatement threshold from 1 October 2008.

Legislative vehicle

Under the current legislation, the indexation must be made by Order in Council before 1 December, with effect from 1 April. To ensure that the indexation applies from 1 October 2008, the indexation would need to be made by way of urgent legislation rather than Order in Council.

Composite amount for FTC for 2008/2009 year

There are five different amounts of FTC depending on the age and number of children in the family. There would need to be composite amounts for the 2008/2009 year for each of the different FTC amounts to reflect an average of the old amount and the new full year amount. Based on an increase of 5.24% the new composite rates are shown in column 2 of below table.

Annual rate	Current 1 April 2008	New Rate 1 October 2008	New Rate 1 April 2009
First child rate if under 16	\$4,264	\$4,376	\$4,488
First child rate if 16 or over	\$4,940	\$5,070	\$5,199
Subsequent child rate if under 13	\$2,964	\$3,042	\$3,120
Subsequent child rate if 13 to 15	\$3,380	\$3,469	\$3,558
Subsequent child rate if 16 or over	\$4,420	\$4,536	\$4,652
Abatement threshold	\$35,000	\$35,917	\$36,834

Composite abatement threshold for 2008/2009 year

There would need to be an end of year composite abatement threshold to reflect an average of the old abatement threshold and the new full year abatement threshold. The composite threshold for the 2008/2009 year would be \$35,917.

New abatement thresholds and FTC amounts

The legislation would need to be amended to provide for the abatement threshold (\$36,834) and the FTC amounts (as shown in column 3 of the above table) that would apply for the 2009/2010 and future income years.

Practical issues

Impact of a mid-year change on families who receive WFF tax credits

Families paid weekly or fortnightly and whose WFF tax credit entitlements change (due to changes in their family circumstances) in the second half of the year could receive overpayments of their WFF tax credit in the second half of the year. All families who receive WFF tax credits must file a return, so this issue should not result in an increased number of people filing a tax return. However this overpayment may result in some families receiving an end of year tax bill. This overpayment is likely to be very small for most families. These adjustments can commonly occur regardless of any indexation changes because of changes to family circumstances that are not taken into account during the year.

Impact on other WFF tax credits

Apart from affecting the FTC, there would also be an impact on the amount of IWTC and PTC paid out to families who receive these credits. This is because the abatement threshold for these credits would also increase by 5.24%.

Administrative Issues

Compliance/administrative impact of mid-year indexation of WFF compared to mid-year tax cuts

Bringing forward the indexation of Working for Families to 1 October 2008 would have significantly fewer compliance costs compared to introducing the proposed tax cut package from 1 October 2008. This is because introducing tax cuts part way through an income year would require the co-operation of third parties who withhold tax (software developers, payroll bureaus and employers in particular would more than likely need to make systems changes), whereas changes to Working for Families tax credits should only impact on Inland Revenue, MSD and the recipient.

Similarly, the administrative impacts for Inland Revenue of bringing forward the indexation to 1 October 2008 are not significant compared to introducing tax cuts part way through an income year. This is because Inland Revenue would have had to undertake the necessary steps to adjust for indexation from 1 April 2009 anyway. Initial estimates suggest that bringing the changes forward to 1 October 2008 would have only a small impact on administrative costs (around \$400,000 arising from an unexpected reprint of registration packs and issue of extra notices to recipients). At this stage it is not expected that an increase in baseline funding would be required. It would also place pressure on Information Technology resources to implement necessary changes, and would mean some reprioritisation of resourcing for existing initiatives.