

GUIDE TO COSTINGS FOR TAX CUT OPTIONS WITHIN PROACTIVE RELEASE DOCUMENTS

This note sets out how personal tax change options have been costed during policy development.

Because other aspects of the government accounts and macro economic aggregates can be affected by tax changes costs can be shown in different ways depending on purpose of the costing. These variations mean that costings from one document will not necessarily be directly comparable with costings in future documents. Costs prepared since March 2008 are most comparable with those in the Budget documentation.

Change to Household Disposable Income

Reductions in personal tax affect the amount of tax paid on benefits and superannuation. Under the personal tax reductions, after-tax benefit payments do not change while after-tax New Zealand Superannuation (NZS) payments increase. Given this, gross benefit appropriations are reduced to the extent that tax paid on them is lower following the personal tax changes. With NZS, the increased after-tax payments are accompanied by decreased tax paid stemming from the tax changes, meaning gross NZS appropriations change. These changes to appropriations can affect the level of government expenses and offset some of the reduction in revenue.

The increase to households' disposable income as a result of personal tax changes reflect the reduction in tax revenue net of these offsetting changes to benefit and superannuation appropriations.

Flow on impacts to the operating balance and the residual cash position

As household disposable income increases this leads to more spending by households. This in turn increases GST and excise revenues and can increase company profits and company tax receipts. On a static basis, the Treasury assumes that where household disposable income increases by \$1 as a result of tax changes other taxes increase by 17.1 cents.

Tax changes will also affect other macro economic aggregates, so the actual increase in other taxes could be higher. Based on the revenue reduction contingency of \$1.5 billion included in the HYEPU forecasts, the total increase to other taxes was approximately 25% (including the 17.1% noted above).

As NZS payments are affected by tax changes this also affects the future cost of Superannuation and required contributions to the New Zealand Superannuation Fund. These impacts are explained in further detail in the note "Personal Tax Changes: Ready Reckoner."

Finally, a reduction in revenue reduces the amount of investment income earned by the Government.

The net impact on the operating balance from personal tax cuts is a combination of the change to household disposable income, the increase to other revenues and changes

to investment income. Contributions to the Super Fund are capital item so do not affect the operating balance. Changes to fund contributions will affect the change to residual cash position which is equal to the impact on the operating balance and changes to fund contributions.

How Costs are reflected in the Budget Proactive Release Documents

- Up to November costs reflect the reduction in tax revenue and static increases to other revenues of 17.1%
- From November costs approximate the impact on the residual cash position, which takes into account changes to gross benefit and NZS appropriations, the higher estimate of increases to other taxes of 25% from the HYEPU forecast, changes to Super Fund contributions, and reductions to investment income. The impact on disposable income reported in these notes is broadly comparable with the reduction to tax revenue included in earlier notes.
- From March 2008 costs show the change to household disposable income and the static increases to other tax revenues of 17.1%.

Budget 2008 Package

The four year cost for the Budget 2008 personal tax package is \$10.6 billion. This figure reflects the increase to taxpayers' disposable income over the four years.