

Chair
CABINET

BUDGET 2008 PERSONAL TAX PACKAGE – FINAL DECISIONS

Proposal

1. This paper reports back to Cabinet on delegated Ministers' final decisions in respect of the Budget 2008 Personal Tax Package.

Background

2. On 14 April 2008 Cabinet considered two possible tax packages for Budget 2008 – a **scenario A** package and an alternative **scenario B** package that would be considered if the Treasury's final forecasts were lower than the preliminary forecasts. Since then, delegated Ministers asked Treasury to provide information on an alternative **scenario C**. Scenario C is a close variation on scenario B. These are set out below.

Table 1: Scenario A

On 1 October 2008 or 1 April 2009	On 1 April 2010	On 1 April 2011
12.5% to \$15,000	12.5% to \$20,000	12.5% to \$25,000
21% to \$40,000	21% to \$40,000	21% to \$45,000
33% to \$70,000	33% to \$75,000	33% to \$80,000
39% over \$70,000	39% over \$75,000	39% over \$80,000

Table 2: Scenario B

On 1 October 2008 or 1 April 2009	On 1 April 2010	On 1 April 2011
12.5% to \$14,000	12.5% to \$17,500	12.5% to \$20,000
21% to \$40,000	21% to \$40,000	21% to \$42,500
33% to \$70,000	33% to \$75,000	33% to \$75,000
39% over \$70,000	39% over \$75,000	39% over \$75,000

Table 3: Scenario C

On 1 October 2008 or 1 April 2009	On 1 April 2010	On 1 April 2011
12.5% to \$14,000	12.5% to \$17,500	12.5% to \$20,000
21% to \$40,000	21% to \$40,000	21% to \$42,500
33% to \$70,000	33% to \$75,000	33% to \$80,000
39% over \$70,000	39% over \$75,000	39% over \$80,000

3. The weekly tax savings for selected taxpayers under scenario C are presented in the table below.

Table 4: Tax Savings under Scenario C

	Income	Current tax annual	Current tax per week	Tax Saving phase 1	Tax Saving phase 2	Tax Saving phase 3	Percent reduction in tax after phase 3
Minimum wage (30 hours)	\$18,720	\$3,361	\$64.46	\$11.89	\$17.60	\$19.59	30.4%
Minimum wage (40 hours)	\$24,960	\$4,672	\$89.60	\$11.89	\$17.60	\$21.67	24.2%
Average wage	\$45,800	\$9,984	\$191.48	\$16.49	\$22.20	\$32.03	16.7%
	\$75,000	\$20,520	\$393.56	\$28.00	\$39.46	\$49.29	12.5%
Twice the average Wage	\$93,600	\$27,774	\$532.68	\$28.00	\$39.46	\$55.04	10.3%
	\$150,000	\$49,770	\$954.55	\$28.00	\$39.46	\$55.04	5.8%

4. Cabinet delegated authority to the Prime Minister, the Minister of Finance and the Associate Minister of Finance (Hon Mallard) to take final decisions on the tax package and its implementation date once Treasury had finalised its economic and fiscal forecasts (CAB Min (08) 14/9 refers).
5. Cabinet also invited delegated Ministers to report back to Cabinet before Budget day on final decisions.

Revised fiscal forecasts

6. The final fiscal forecasts have been revised down since the preliminary forecasts due to a combination of final macroeconomic forecasts, final budget decisions and updated SOE/CE forecasts. The charts below present the final Operating Balance excluding Gains and Losses (OBEGAL), excluding New Zealand Super Fund returns, and Gross Sovereign Issued Debt forecasts and projections based on the three scenarios.
7. Scenario A is no longer affordable given our long term fiscal objective of maintaining Gross Sovereign Issued Debt around 20% of GDP. Further, scenario A would see the OBEGAL entering into a period of sustained deficits and this is something we are not prepared to do.
8. Scenarios B and C are consistent with our long term fiscal objectives and, from an efficiency and growth objective, scenario C is marginally better than B. Delegated Ministers have agreed to proceed with scenario C. Furthermore, delegated Ministers have agreed to implement the first phase of the tax package from 1 October 2008, thereby providing financial assistance earlier to New Zealand household budgets that are being squeezed by current economic conditions. Note that both scenarios incorporate our decision to delay the entry of liquid fossil fuels into the Emissions Trading Scheme.
9. However, scenario C does see the OBEGAL track very close to zero for a number of years late in the forecast and into the start of the projection period. Given this I intend to signal clearly, including in the Fiscal Strategy Report FSR, how we might respond (in very broad terms) if the operating balance were to look like it might move more materially into deficit. I intend to signal that if the operating balance/OBEGAL looked like it was heading even lower, the government would take corrective action to maintain the robustness of the fiscal position, and in the event of positive revenue surprises I would let these flow through to a higher operating balances in the first instance.

Figure 1: OBEGAL ex NZS Fund net returns (OBERAC until 2007/08)

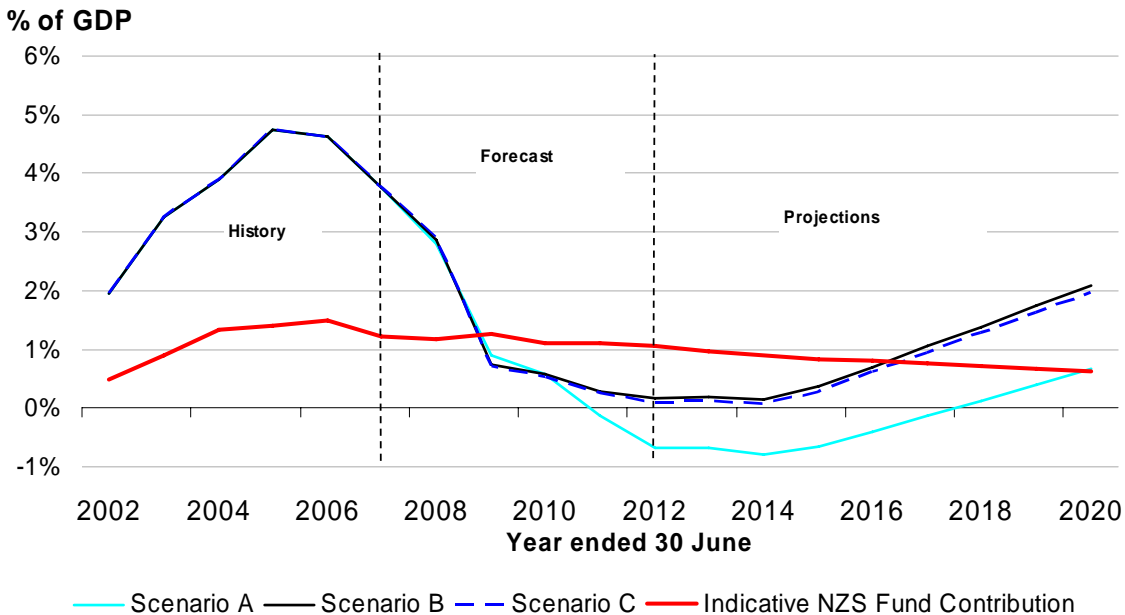
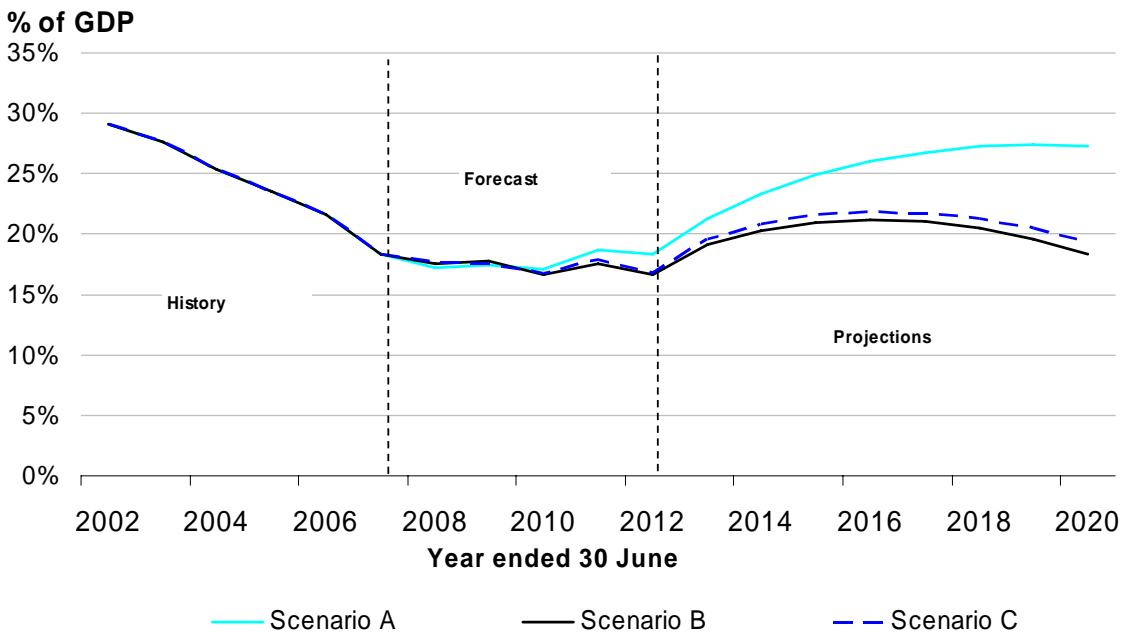


Figure 2: Gross Sovereign Issued Debt ex Settlement Cash



Working for Families

10. Legislation allows for the Family Tax Credit (FTC) and the Working for Families Tax Credit abatement threshold to be adjusted for inflation each time the cumulative CPI increase exceeds 5%. Treasury forecasts that the cumulative CPI increase (from 1 April 2007) by the September 2008 quarter will be 5.22% and therefore this would have triggered the increase from 1 April 2009. In light of current household budget pressures, delegated Ministers have agreed that this indexation should be moved forward to also take effect from 1 October 2008, which will coincide with the introduction of the tax package. The forecasted CPI of 5.22% is being used for the indexation irrespective of what the actual CPI movement to the September quarter turns out to be.

Table 5: Changes to Working for Families

Weekly rate	Old weekly rates	NEW weekly rates from 1 October 2008
First child if under 16	\$82.00	\$86.29
First child if 16 or over	\$95.00	\$99.96
Subsequent child rate if under 13	\$57.00	\$59.98
Subsequent child rate if 13 to 15	\$65.00	\$68.40
Subsequent child rate if 16 or over	\$85.00	\$89.44
	Old annual level	NEW annual level from 1 October 2008
WFF Tax Credit abatement threshold	\$35,000	\$36,827

11. The gains depend on the number of children in the family, the children's ages and whether the family earns above the abatement threshold. The table below presents some typical scenarios.

Table 6: Scenarios of gains from Working for Families Indexation

	Weekly gain from 1-Oct-2008
Two earner family on 100% and 50% of the average wage with two children under 12	\$14.30
One earner family on 100% of the average wage with two children under 12	\$14.30
Two earner family both on 50% of the average wage with one child under 12	\$11.32
One earner family on 100% of the average wage with one child under 12	\$11.32
One earner family on 75% of the average wage with one child under 12	\$4.29

12. Increasing the FTC does have an impact on other forms of social assistance (e.g. the Accommodation Supplement). I invite the Minister for Social Development to report back to Cabinet after Budget day on these consequential impacts to other parts of the social assistance system. This will allow Cabinet the opportunity to consider whether we need to alter any other parameters in the social assistance system as a result of these changes.

Consequential impacts to other parts of the tax system

13. Cabinet on 14 April 2008 considered a number of consequential impacts to other areas of the tax system (e.g. Resident Withholding Tax, Fringe Benefit Tax, and the Maori Authority Tax rate). To determine the final impacts on these issues Cabinet:

agreed that if the final tax cut package differs from that described in this paper and these differences do not affect the basis on which decisions on recommendations 6 - 23 in this paper have been made, the decisions taken on recommendations 6 - 23 in this paper apply to the amended tax cut package.

14. I can confirm that agreeing to scenario C does not affect the basis on which the consequential decisions were made.
15. I have asked officials to report back to me on secondary tax codes as a result of this package.

Financial Implications

16. The table below presents the net operating balance impact of proceeding with scenario C with an implementation date of 1 October 2008. The total reduction in personal tax revenue is shown in the subtotal line (i.e. the tax package would reduce income taxes by approximately \$3.8 billion once fully implemented). Netted against this are two further impacts. First, on the basis that taxpayers will spend a portion of their tax cut on goods that attract GST and excise taxes, there will be an offsetting tax clawback. This is estimated at 17.1% of the reduction in personal tax revenue. Further, on the basis that financial asset

holdings by the Debt Management Office will be reduced, there will be a cost in terms of reduced interest revenue.

Table 7: Financial Implications of the Tax Package

(\$ million)	2008/09	2009/10	2010/11	2011/12
Total revenue reduction	1,633	2,440	3,351	4,152
less adjustment in gross NZS appropriations	-10	-15	84	174
less adjustment in gross benefit appropriations	127	180	206	219
Subtotal	1,515	2,274	3,061	3,759
less tax 'clawback'	259	389	523	643
add reduction in investment income	87	118	158	196
Net Operating Balance Impact	1,343	2,003	2,696	3,313

17. In addition, bringing the Working for Families indexation forward to 1 October has the following operating balance impact.

Table 8: Working for Families Financial Implications

(\$ million)	2008/09	2009/10	2010/11	2011/12
Operating impact	99	17	0	0

18. Finally, as noted by Cabinet on 14 April, introducing the tax changes mid-tax year requires additional administrative funding for Inland Revenue. These fiscal impacts are set out in the table below.

Table 9: Administrative Financial Implications

(\$ million)	2007/08	2008/09	2009/10	2010/11	2011/12 and outyears
Operating impact	0.483	4.488	1.074	1.134	0.384
Capital impact	0.134	1.075	0.296	0.256	

Recommendations

I recommend that Cabinet:

1. **note** that on 14 April 2008 Cabinet considered two possible tax packages for Budget 2008 - a **scenario A** package and an alternative **scenario B** package that would be considered if the Treasury's final forecasts were lower than the preliminary forecasts:

Scenario A

On 1 October 2008 or 1 April 2009	On 1 April 2010	On 1 April 2011
12.5% to \$15,000	12.5% to \$20,000	12.5% to \$25,000
21% to \$40,000	21% to \$40,000	21% to \$45,000
33% to \$70,000	33% to \$75,000	33% to \$80,000
39% over \$70,000	39% over \$75,000	39% over \$80,000

Scenario B

On 1 October 2008 or 1 April 2009	On 1 April 2010	On 1 April 2011
12.5% to \$14,000	12.5% to \$17,500	12.5% to \$20,000
21% to \$40,000	21% to \$40,000	21% to \$42,500
33% to \$70,000	33% to \$75,000	33% to \$75,000
39% over \$70,000	39% over \$75,000	39% over \$75,000

2. **note** that subsequent to Cabinet consideration, delegated Ministers asked Treasury to provide information on an alternative scenario C:

Scenario C

On 1 October 2008	On 1 April 2010	On 1 April 2011
12.5% to \$14,000	12.5% to \$17,500	12.5% to \$20,000
21% to \$40,000	21% to \$40,000	21% to \$42,500
33% to \$70,000	33% to \$75,000	33% to \$80,000
39% over \$70,000	39% over \$75,000	39% over \$80,000

3. **note** that the final fiscal forecasts have been revised down since the preliminary forecasts due to a combination of final macroeconomic forecasts, final budget decisions and updated SOE/CE forecasts;
4. **note** that delegated Ministers have agreed to proceed with scenario C on the basis that scenario A is no longer affordable, given the Government's long term fiscal objectives, and because on an efficiency and growth objective basis, scenario C is marginally better than scenario B;
5. **note** that scenario C sees OBEGAL track very close to zero for a number of years late in the forecast and into the start of the projection period and therefore I intend to signal clearly, including in the FSR, how we might respond (in very broad terms) if the operating balance were to look like it might move more materially into deficit;
6. **note** that delegated Ministers agreed that phase 1 of the tax package should be implemented from 1 October 2008;

Working for Families

7. **note** that Treasury is forecasting the cumulative CPI (from 1 April 2007) to be 5.22% by the September quarter this year and that this would trigger the indexation of the Family Tax Credit and the Working for Families Tax Credit abatement threshold from 1 April 2009, under current legislation;
8. **note** that delegated Ministers have agreed to bring this indexation forward to take effect from 1 October 2008;

9. **note** that the indexation of Family Tax Credit rates and the Working For Families Tax Credit abatement threshold will use the Budget 2008 forecast of CPI growth between the March 2007 and September 2008 quarters, rather than the actual growth of the CPI over that period;
10. **invite** the Minister for Social Development to report back to Cabinet after Budget day on the consequential impacts to other parts of the social assistance system as a result of indexing the Family Tax Credit and the Working for Families Tax Credit abatement threshold;

Consequential impacts to other parts of the tax system

11. **note** that agreeing to scenario C does not affect the basis on which any consequential impacts to other parts of the tax system were agreed by Cabinet on 14 April 2008;

Fiscal Impacts

12. **note** the fiscal cost of the tax package is:

(\$ million)	2008/09	2009/10	2010/11	2011/12
Total revenue reduction	1,633	2,440	3,351	4,152
less adjustment in gross NZS appropriations	-10	-15	84	174
less adjustment in gross benefit appropriations	127	180	206	219
Subtotal	1,515	2,274	3,061	3,759
less tax 'clawback'	259	389	523	643
add reduction in investment income	87	118	158	196
Net Operating Balance Impact	1,343	2,003	2,696	3,313

13. **approve** the following changes to appropriations to bring forward the indexation of the Family Tax Credit and the Working for Families abatement threshold to 1 October 2008, with a corresponding impact on the operating balance:

Vote Revenue Minister of Revenue	\$m – increase/(decrease)				
	2007/08	2008/09	2009/10	2010/11	2011/12 & Outyears
Benefits and Other Unrequited Expenses:					
Family Tax Credit	-	84.000	14.000	-	-
In-Work Tax Credit	-	15.000	3.000	-	-
Total Operating	-	99.000	17.000	-	-

14. **note** that the administrative costs of implementing these tax changes are:

(\$ million)	2007/08	2008/09	2009/10	2010/11	2011/12 and outyears
Operating impact	0.483	4.488	1.074	1.134	0.384
Capital impact	0.134	1.075	0.296	0.256	

Hon Dr Michael Cullen
Minister of Finance