Office of the Minister of Finance

Chair
CABINET BUSINESS COMMITTEE

BUDGET 2008 PERSONAL TAX PACKAGE – SHARING THE DIVIDENDS

Proposal

1. This paper seeks Cabinet's agreement to a three year package of personal income tax changes based on current economic and fiscal information. This paper seeks a delegated authority to the Prime Minister, the Minister of Finance and the Associate Minister of Finance (Hon Mallard) to finalise details of the package once the final economic and fiscal forecasts are known in late April.

Executive Summary

2. Over the last eight years, we have focused on building a solid economic platform of growth and fairness. In our last four Budgets, we have taken steps to reduce taxes in line with our ongoing economic and social priorities (e.g. Business tax changes, Working for Families and KiwiSaver). These tax reductions total $4.5 billion per annum.

3. Changes to personal tax rates are a logical next step on the economic course that we have charted over the past eight years. Consistent with our equity and growth objectives the tax changes have been designed with four tests in mind – tax changes

   - will not require borrowing to fund them
   - will not require cuts to public services
   - have been designed not to exacerbate inflationary pressures in the economy
   - will not lead to greater inequality in our society.

4. I am proposing the following package of tax changes to be rolled out over the next three years.

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

* The implementation date for the first round has not been finalised. This will depend upon the final economic and fiscal forecasts. This is discussed in the delegated authority section.

5. These changes will return significant dividends to taxpayers over the next three Budgets. In particular personal tax cuts will benefit:

- those with low incomes who tend to be part-time workers and those earning around the minimum wage
- those around the average wage providing additional support for families who will have also gained through the Working for Families changes
- a significant number of taxpayers that will no longer face the highest tax rate of 39%.

6. Final decisions on the design of the package and its implementation date (1 October 2008 or 1 April 2009) are not being sought in this paper. This is because Treasury has not yet finalised its economic and fiscal forecasts and it would be prudent to wait to have this information before locking in the changes. Therefore this paper also presents an alternative option that may need to be considered if the final forecasts come in weaker than Treasury's initial forecasts.

7. There are a number of consequential impacts to other parts of the tax system covered in this paper. These include changes around Portfolio Investment Entities, resident withholding tax and fringe benefit tax.

Background

Changes to personal tax rates are a logical next step…

8. Over the last eight years, we have focused on building a solid economic platform of growth and fairness. There have been four central planks to that platform: a commitment to lowering debt, strong investment in public services, taking inflationary pressures and economic imbalances seriously, and taking steps to reduce inequality in our economy and society.

9. In the last four Budgets, we have taken steps to reduce taxes in line with our ongoing economic and social priorities. These reductions total $4.5 billion per annum:

- *Businesses* have benefited from significant reforms to depreciation in Budget 2005, and the Business Tax Reform package of Budget 2007 included a cut in the corporate tax rate to 30% and a 15% R&D tax credit;

- *Families* have benefited from the introduction of Working for Families in Budget 2004 and extension in Budget 2006, lifting many New Zealand children out of poverty;

- *Savers and investors* have benefited from the introduction of KiwiSaver in Budget 2005 and the tax credits introduced in Budget 2007, along with the introduction of Portfolio Investment Entities (PIEs), capping the PIE rate at 30%, and improvements to the taxation of international portfolio investment.

Fiscal headroom has increased...

10. One of the difficulties in considering personal tax changes is the large fiscal cost to deliver meaningful changes. A significant change in fiscal headroom occurred

at the 2007 Half-Year Economic and Fiscal Update (HYEFU), where Treasury substantially revised upwards its ongoing revenue forecasts. These increases have largely been confirmed in the 2008 Budget Economic and Fiscal Update (BEFU). This headroom allows consideration of a significant tax package while maintaining government debt at prudent levels and without sacrificing public services.

...while macroeconomic pressure has decreased.

11. In recent years, macroeconomic considerations have been paramount. Inflationary pressure has been strong and additional fiscal stimulus via large tax cuts would have put more pressure on interest rates. Instead, we have allowed the automatic stabilisers to operate, resulting in larger surpluses that have been criticised in some quarters. Looking forward, macroeconomic pressures are expected to be less severe than in recent years on the back of slower economic growth.

Any changes must focus strongly on fairness...

12. Fairness is a central value to this government. Changes to personal tax need to take this value seriously by ensuring that we share the dividends of our economic success fairly across society. Crucially, this means ensuring changes don't disproportionately benefit those on the very highest incomes at the expense of those on the very lowest.

...but can also provide economic growth benefits.

13. The economic case for personal tax cuts in New Zealand is not clear cut. New Zealand's current tax system compares well internationally when all taxes are considered, including those that are absent in New Zealand such as social security and payroll taxes. Instead, I have seen the highest priority areas to improve economic performance as business taxation, saving and investment. Nevertheless, changes to personal tax can provide some support for our Economic Transformation objectives and still be consistent with our equity objective.

14. The remainder of this paper sets out proposed changes to personal taxation that will promote both growth and fairness.

Proposal

15. Table 1 presents the current *statutory* rates of personal income tax and, after taking account of the Low Income Rebate (LIR)[1], the *effective* rates of personal income tax.

[1] The Low Income Rebate provides a tax credit of 4.5% up to $9,500, which is then abated at a rate of 1.5% until incomes reach $38,000.

Table 1: Current personal tax rate structure

Current *statutory* rates of personal tax
19.5% to $38,000
33% to $60,000
39% over $60,000

Current *effective* rates of personal tax
15% to $9,500
21% to $38,000
33% to $60,000
39% over $60,000

16. I am proposing that we remove the LIR and introduce the following statutory rates and thresholds over the next three years:

Table 2: Proposed personal tax rate structure

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

* The implementation date for the first round has not been finalised. This will depend upon the final economic and fiscal forecasts. This is discussed in the delegated authority section. Note that all charts and tables in this paper assume an implementation date of 1 April 2009.

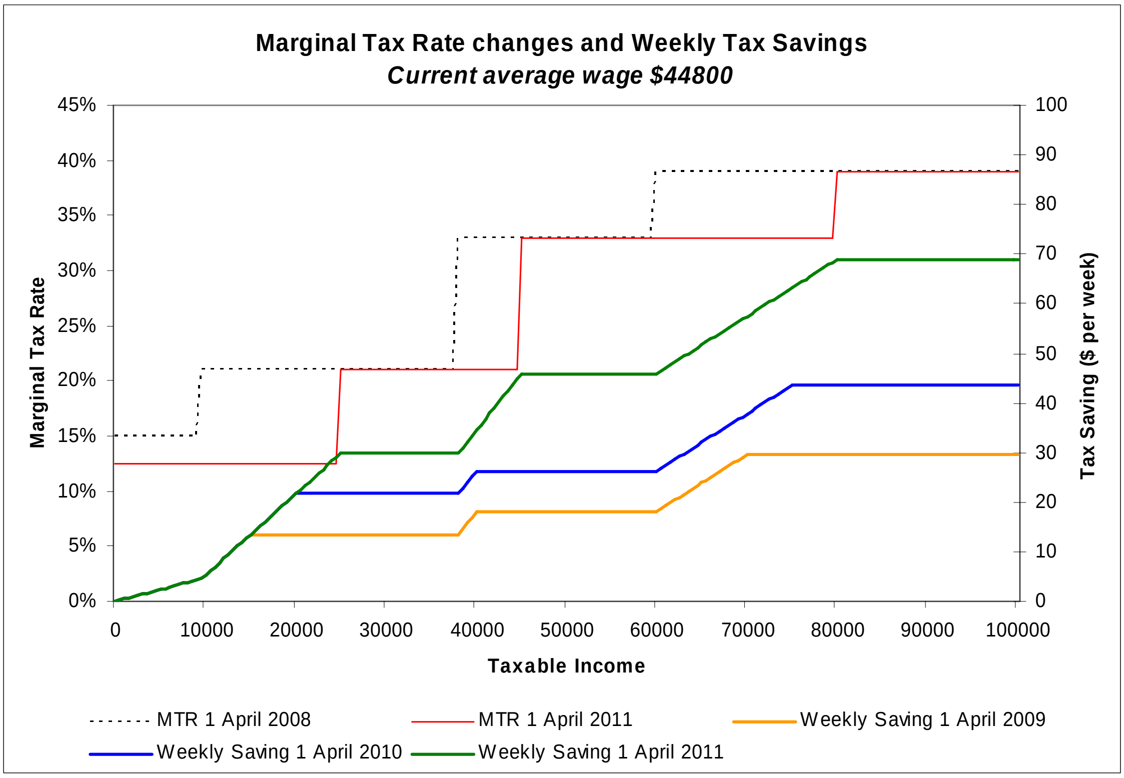
17. Figure 1 below presents how these changes translate into savings per week for taxpayers along the income distribution. Table 3 below shows the weekly tax savings for three workers over the three year phasing of the reform – a fulltime worker on the minimum wage of $12/hr, a worker at the average wage and a worker at twice the average wage.

Table 3: Weekly tax savings for three selected taxpayers

Worker	Weekly tax saving		
	Phase 1	Phase 2	Phase 3
Full-time on minimum wage ($24,960)	$13.52	$21.67	$29.82
Average wage ($44,800)*	$18.12	$26.28	$45.93
Twice average wage ($89,600)	$29.63	$43.54	$68.95

* Quarterly Employment Survey (December 2007 quarter), Statistics NZ – Average Weekly Earnings per FTE

Figure 1: Marginal tax rate savings and weekly tax savings



18. This package of tax reform effectively reduces the lowest rate of tax from 15% to 12.5% and increases the thresholds at which the 21%, 33% and 39% rates apply (the 21% and 39% thresholds are extended significantly). This has the effect of lowering the average tax rates for all taxpayers and also reduces marginal tax rates for a significant proportion of taxpayers.

19. These changes reduce taxes across the board – consistent with my objective of returning a dividend to hard-working New Zealanders. In particular:

- the reduction in the bottom rate to 12.5% ensures every taxpayer pays less in tax, and targets those in part-time work or earning around the minimum wage. Moreover, the 12.5% rate will improve incentives for those on benefits and low wages to move into work or for those working part-time to work additional days per week.

- the movement in the 33% threshold targets those around the average wage. This change provides additional tax relief to families with children who have already benefited significantly from Working for Families and importantly reduces high effective marginal tax rates for many taxpayers.

- finally, the changes to the 39% threshold will move nearly 300,000 New Zealanders off the top marginal tax rate once fully phased in. When we introduced the 39% rate in April 2000 I indicated that it would apply to those who can most afford to contribute a bit more to this country's wellbeing. Now this top rate applies to key occupational groups for whom this top rate was not intended[2]. The change in threshold addresses this.

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[2] Many teachers, nurses, police and those earning 30% above the average wage.

20. The table below shows the change in Effective Marginal Tax Rates (EMTR)[3] for taxpayers once the full 3 year package is phased in. This shows that around 65% of all taxpayers will have a reduction in their marginal tax rate by 2011 with the bulk of these (61%) achieving a reduction in their EMTR of between 5 and 10 percent. Note that even though some taxpayers have no change in their EMTR (and some can actually have a slight increase), every taxpayer does gain from these changes in terms of a reduction in tax paid.

Table 4: Change in EMTRs across the income distribution

	Change in EMTR by 2011[1]				
Incomes	**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	SOME	0	0
Total[3]	**0**	**1,172,234**	**628,711**	**1,327,335**	**218,207**

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.

Beneficiaries and Superannuitants

21. New Zealand Superannuitants will benefit from these tax cuts as the rate of New Zealand Superannuation is set in legislation on a gross basis and is also subject to being between 65% (currently 66%) and 72.5% of the Average Weekly Time Ordinary Earnings which will also be affected by tax changes. Income tested benefits are legislated on a net basis so net benefit rates will not be adjusted with these tax changes.

The Four Tests

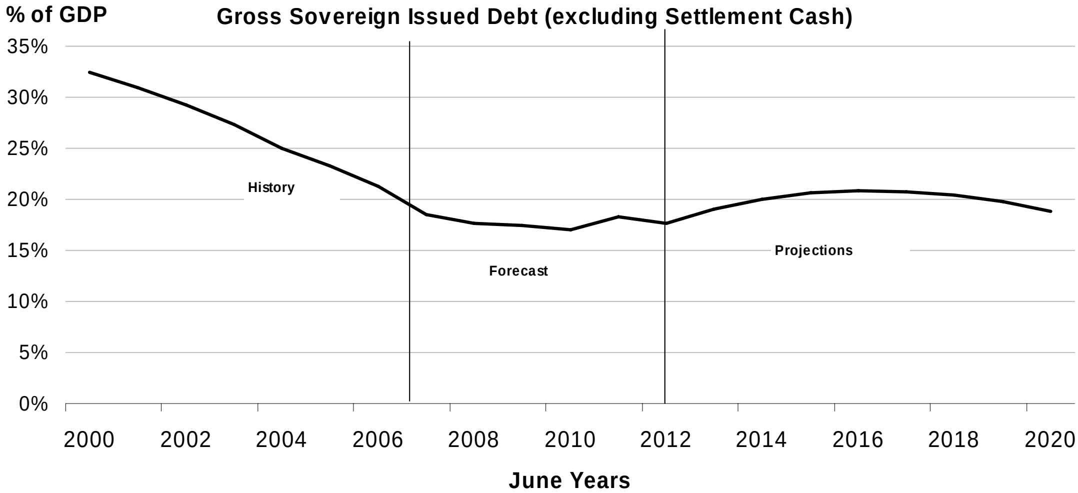
22. I have publicly stated that, in designing the personal tax changes, I would adhere to four tests. Each of these are discussed with below.

3 An Effective Marginal Tax Rate is measured as the proportion of income lost (by way of income taxes, ACC premiums, benefit and WFF abatements ETC) as a result of earning an additional $1 of income.

The package will not require borrowing to fund it

23. This government is not prepared to trade off our long standing fiscal objectives in order to implement a package of tax cuts. Since 2000 we have reduced Government debt from around 32% of GDP to under 20% of GDP today. Our current objective is to ensure that debt remains at around 20% of GDP. Based on current forecasts by Treasury, which will be finalised over April, we remain on track to achieve this.

Figure 2: Gross Sovereign Issued Debt



The package will not require cuts to public services

24. Investing in services has been fundamental to Labour-led Governments over the past eight years. In that time we have doubled the amount spent in health in nominal terms, increased school funding by 50 percent, invested heavily in child, youth and family and this Budget provides a large funding increase to the non-government organisation sectors. We have consciously prioritised this spending ahead of providing personal tax cuts.

25. Structural increases in revenue, combined with lower finance, social security and welfare costs provided us with the extra fiscal headroom to implement new initiatives and rebuild our public services. After a significant period of investment we have now created a strong foundation for our public services. Investment will continue to grow, although the rate of growth will be slower than it has been in the last eight years. Budget allowances in out years will continue to grow at a sustainable level of $1.8 billion (inflation adjusted). This is a sustainable level of investment from which we will continue to build and improve the way services are delivered and continue to invest strongly in our communities.

The tax package has been designed not to exacerbate inflationary pressures in the economy

26. This tax cut package is designed to not increase inflationary pressures in the economy. Over recent years, macroeconomic considerations, and in particular inflationary pressures, have been paramount in the design of fiscal policy. Given this, in addition to allowing the automatic stabilisers to operate, we have allowed

the structural surplus to rise above the level required by our fiscal objectives. These surpluses have been criticised in some quarters but they have helped maintain macroeconomic stability. This has been the most prudent course to take but the economic environment is now shifting. Notwithstanding the likelihood of strong inflation pressures existing in the short term, looking forward they are expected to be less severe on the back of slower economic growth. Given the lessening of these pressures the environment is more conducive to the introduction of a multi-year tax cut package.

27. Treasury is in the process of preparing its forecasts for the Budget Economic and Fiscal Update. As discussed in the Budget 2008 Cabinet paper, Treasury's initial forecasts, which incorporated a working assumption for a multi-year tax package similar in size to that proposed in this paper, showed real GDP growth slowing over the year ahead by more than previously expected, but then recovering in 2009 and 2010. Given recent economic news the final forecasts could show an even slower rebound in growth.

28. The introduction of a multi-year tax package which staggers the tax reductions over a number of years smoothes out the impact on demand and minimises any impact on inflation. However, the more any tax cut package is front-loaded and introduced earlier, the more the Reserve Bank will need to take this into account in setting monetary policy. Ultimately, monetary policy settings will also depend on other economic developments – the weaker the outlook for broader economic developments, the more room there is to accommodate fiscal policy stimulus without impacting on monetary policy settings. The Treasury is of the view that a multi-year tax package along the lines of that I am proposing here does not put macroeconomic stability at risk. As I have stated above the final forecasts are not yet available, and when they are I will be cognisant of short term imbalances in the economy when considering the final shape of the tax cut package.

The tax cut package will not lead to greater inequality in our society…

29. The tax cut package in this paper will not lead to greater inequality as the largest proportional reductions in tax paid will go to those on lower incomes. While figure 1 showed that, in absolute terms, those on higher incomes will receive higher tax savings, this reflects the nature of a progressive tax system (i.e. higher income earners pay a higher proportion of their income in tax).

30. Figure 3 below presents the absolute increase in disposable income and the percentage increase in disposable income across equivalised household[4] deciles. While the lowest income decile household receives the smallest increase in disposable income from the tax changes, the proportional increase in disposable income is the highest at close to 8%. These proportions decrease over the income distribution until those households in decile 10 have an approximate 4% increase in disposable incomes.

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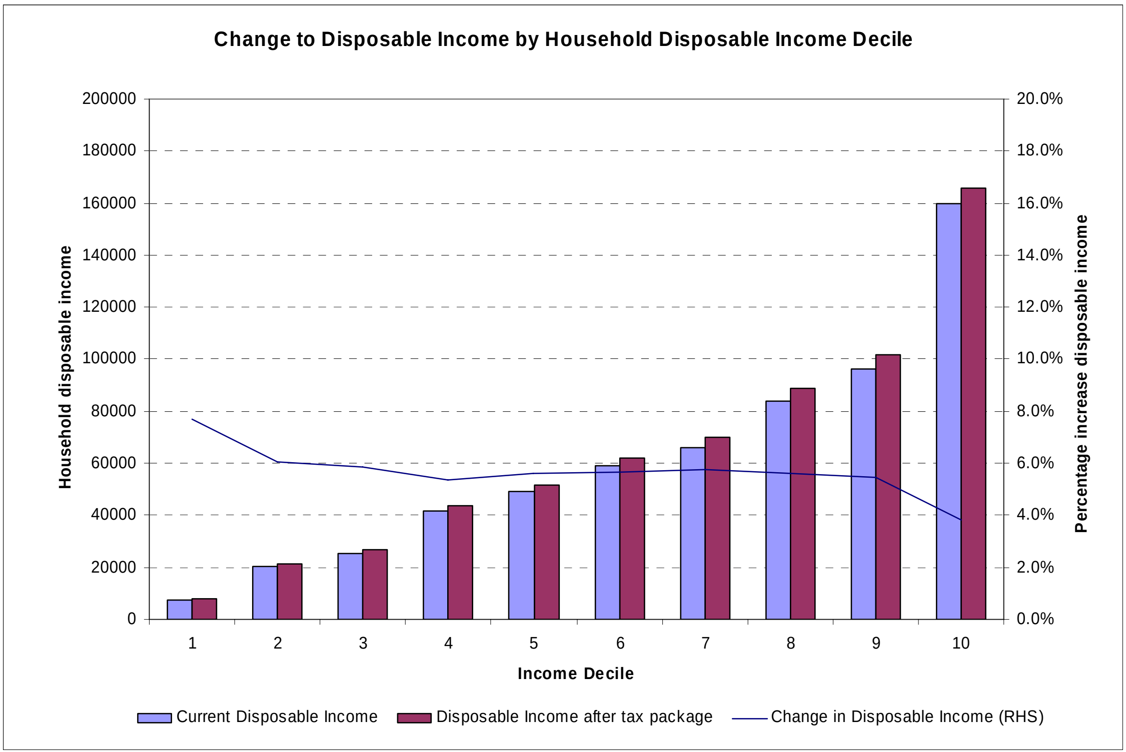
[4] Beneficiary households have been removed from this analysis as the tax cuts will not affect their net benefits. We have adjusted household income for household size. This is called equivalisation and allows us to make comparisons across different types of households.

Figure 3: Change in household disposable incomes due to the tax package



31. Alternatively, table 5 below shows the absolute tax savings and the percentage tax savings for selected taxpayers across the income distribution. This shows that the percentage reduction in taxes falls as incomes rise.

Table 5: Absolute and proportional tax savings for selected taxpayers

	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	$13.52	$19.59	$19.59	30.4%
Minimum wage (40 hours)	$24,960	$4,672	$89.60	$13.52	$21.67	$29.76	33.2%
Average wage	$45,800	$9,984	$191.48	$18.12	$26.28	$45.93	24.0%
	$75,000	$20,520	$393.56	$29.63	$43.54	$63.20	16.1%
Twice the average Wage	$93,600	$27,774	$532.68	$29.63	$43.54	$68.95	12.9%
	$150,000	$49,770	$954.55	$29.63	$43.54	$68.95	7.2%

Alternative Package

32. The current scenario will be less affordable if the final economic and fiscal forecasts come out lower than Treasury's initial forecasts. We will not know this until the end of April but Treasury has advised that there could well be a downward revision to its initial forecasts before they are finalised.

33. If there is a downward revision and it proves to be significant then we may need to consider an alternative package such as the one in table 6 below with the tax savings per week as per table 7 below.

Table 6: Alternative tax package

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 7: Absolute and proportional tax savings for selected taxpayers

	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	$49.29	9.3%
	$150,000	$49,770	$954.55	$28.00	$39.46	$49.29	5.2%

34. A key consideration, when assessing any tax package, is the extent to which it is aligned to our fiscal strategy once the economic and fiscal forecasts are finalised. The long-term aim of our fiscal strategy is to help meet future spending demands, particularly those arising from an ageing population. This strategy is implemented through the maintenance of debt at prudent levels and accumulating financial assets in the New Zealand Superannuation Fund (NZS Fund).

35. Figure 4 shows the forecast and projected levels of Government debt-to-GDP under both packages, based on the initial forecasts. On the basis that our debt objective is to maintain gross sovereign-issued debt broadly stable at around 20% of GDP over the next 10 years, the current proposal is consistent with the debt objective whereas the alternate tax package sees debt-to-GDP falling below 20% of GDP. If, however, the fiscal forecasts are revised downward, the projections of debt under each package will be higher.

36. In addition to their impact on debt, the two proposals also need to seen in the context of the corresponding paths for the fiscal surplus. Because the NZS Fund retains its after tax investment returns, the OBEGAL (ex NZSF net revenue) is a broad indicator of whether we can meet Fund contributions from current revenues. As figure 5 below shows, under the current proposal the level of surplus will fall below the NZS Fund contributions for approximately eight years. I intend to explain in the Fiscal Strategy Report how the fall in the surplus is consistent with our fiscal strategy because greater than expected operating surpluses over the last few years have allowed us to build up financial assets and reduce the ratio of debt-to-GDP. The alternative tax proposal would see the surplus tracking far closer to the NZS Fund contributions, and correspondingly, debt-to-GDP is lower.

Figure 4: Gross Sovereign Issued Debt – with alternative package

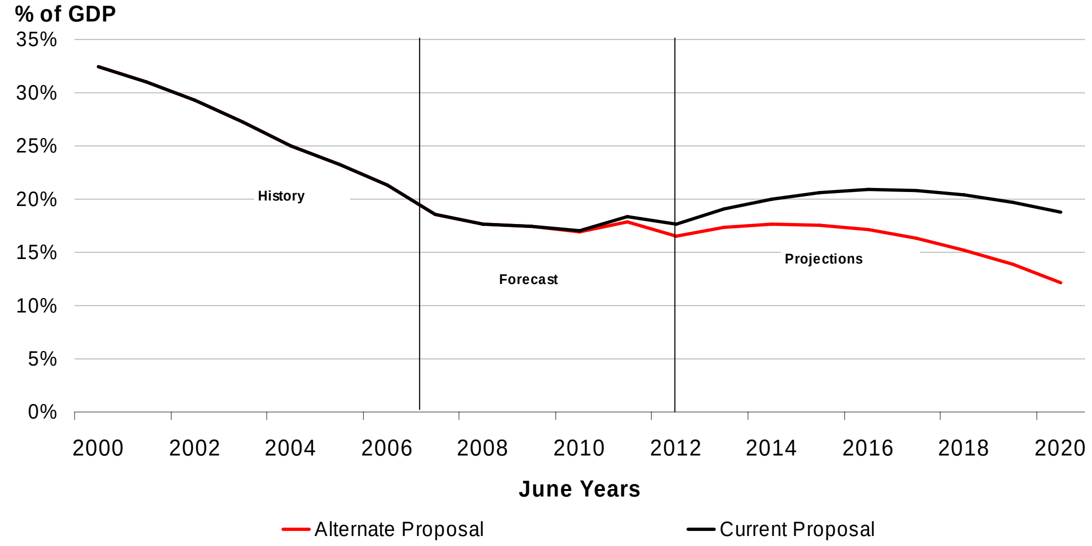
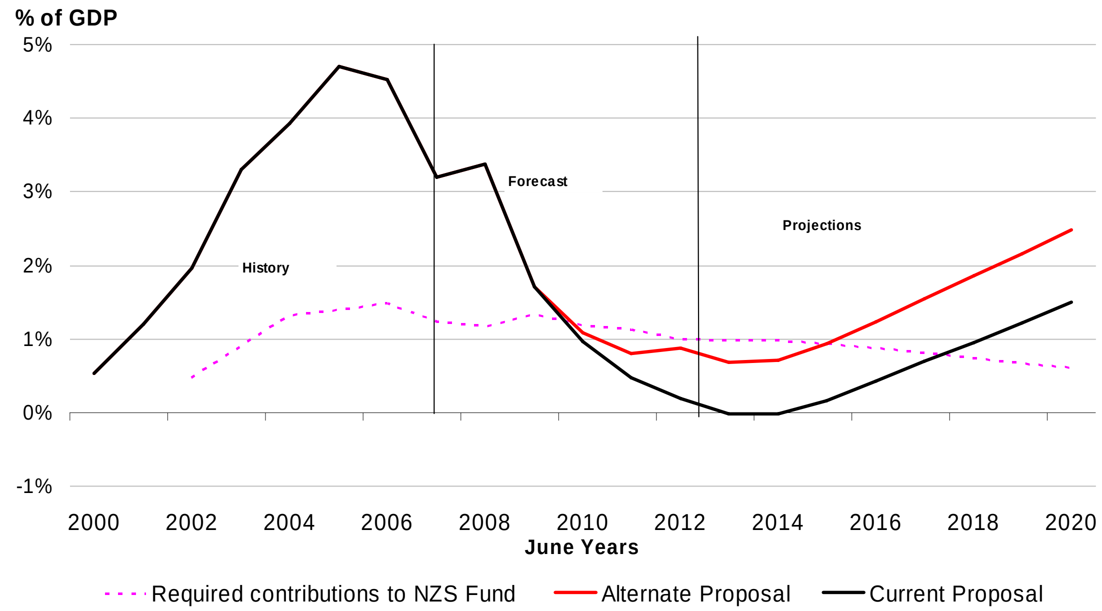


Figure 5: Operating Balance – with alternative package



Implementation date

37. An implementation date for the first round of tax changes has not yet been decided. There are two main options:

- 1 October 2008 – this is the earliest possible date that Inland Revenue could implement the tax change following Budget night legislation under urgency.

- 1 April 2009 – this coincides with the start of the tax year and would minimise administrative and consequential tax issues.

38. I want to reserve a decision on this until we have the final economic and fiscal forecasts from Treasury in late April.

Consequential impacts to other areas of the tax system

39. Changing the tax rates requires some consequential changes to other parts of the tax system – primarily withholding tax rates. Some of the major consequential changes are:

2008-09 Tax Rates if a 1 October 2008 start date applies

40. Because tax is calculated on an income year basis, if a 1 October 2008 start date is chosen, the income tax rates used for the 2008-09 income year would be a blended average of 2008-09 and 2009-10 income year rates. These would be:

Table 8: Transitional composite rates of tax

Income Range	Tax Rate
$0 - $9,500	13.75%
$9,501 - $15,000	16.75%
$15,001 - $38,000	21%
$38,001 - $40,000	27%
$40,001 - $60,000	33%
$60,001 - $70,000	36%
$70,001 and above	39%

41. However, the old PAYE rates would apply until 30 September 2008 and the new PAYE rates would apply from 1 October 2008, so for most wage and salary earners the cash flow benefits of the reduced tax rates would be felt from 1 October 2008.

PAYE Rates

42. PAYE rates would be adjusted from the start dates, including from 1 October 2008 if that date is chosen.

Resident Withholding Tax (RWT) and Portfolio Investment Entity (PIE) Tax Rates

43. Changing the personal tax rates implies it may be appropriate to adjust the PIE tax rates and the RWT rates to reflect the new tax scale. However, given the complexity of systems changes that may be required, I recommend that these decisions be deferred to give officials time to consult with the savings and banking industries after announcement of the tax rate changes. This means the earliest PIE and RWT tax rate changes could be made is 1 April 2009 if this is feasible for banks and managed funds. The practical issues regarding the PIE rates are likely to be much more complex than the RWT rates so it is possible that the RWT changes could happen fairly quickly while the PIE rate changes may take more time.

44. The PIE tax is a final tax so the fact that the PIE rate may be different from the personal tax rate will not result in an increase in tax return filings. However, the fact that the PIE rate may be different from the personal marginal tax rate means that a PIE investor may be somewhat better off or somewhat worse off for investing in a PIE than investing directly. However, because of the usual way the PIE tax rate is determined this already happens now and, in the vast majority of cases, the PIE investor will be the same or better off than the direct investor.

45. The RWT rate is not a final tax but is a payment towards satisfaction of tax liability. Currently, the RWT rate matches the individual marginal tax rates so if the taxpayer chooses the RWT rate that matches their actual tax rate, they pay the right amount of tax and they do not have to file a tax return (unless they are required for another reason). A delay in aligning the 19.5% RWT rate to the 21% marginal tax rate means there may be some taxpayers who will not have enough RWT withheld and, if they earn more than $200 of interest, they will have to file a tax return to make up the shortfall. Taxpayers on the 12.5% personal tax rate would also be overwithheld and would have to file a tax return to obtain a refund.

Fringe Benefit Tax Rate

46. The multi-rate fringe benefit tax rate would be changed to reflect the new personal tax rate scale, including using the 2008-09 blended tax rate scale if a 1 October 2008 start date is chosen.

Maori Authority Tax Rate

47. The 19.5% Maori Authority tax rate would no longer equate with a personal tax rate. However, I recommend the 19.5% tax rate for Maori Authorities continue while officials consider what the appropriate tax rate should be and report back to me and the Minister of Revenue.

Other Consequential Issues

48. Other consequential changes include:

- Adjusting the provisional tax safe-harbour amount to reflect the lower rates;
- Changing the ACC attendant care withholding rate from 15% to 12.5%;
- The minimum family tax credit will be reviewed later this year and implications of the new tax rate schedule for it will be considered at that time; and
- Secondary tax codes, specified superannuation contribution withholding tax (SSCWT), extra pay amounts, fund withdrawal tax, retirement scheme contributions tax, and the child rebate will be amended as necessary to reflect the new rate schedule.

Administrative Costs

49. The changes have administrative implications for Inland Revenue which differ according to the start date. Some administrative implications are expected irrespective of the start date, such as updating and reprinting publications and responding to enquiries from taxpayers about the changes, but there is significantly more administrative work required for a 1 October 2008 start date. As a result, if Inland Revenue is to deliver this package from 1 October 2008 the current legislative work programme may need to be adjusted. Work to understand these impacts is underway and it is expected that final decisions on any changes to the work programme will be made in late May (should a 1 October 2008 implementation date be pursued).

50. If this package is implemented from 1 October 2008 Inland Revenue will require additional administrative funding mainly as a result of systems changes to

calculate composite tax rates for the 2008/09 tax year and to accommodate the increased filing requirements for individuals. Inland Revenue have estimated the total cost of implementing the changes by 1 October 2008 to be $0.617m in 2007/08, $5.653m in 2008/09, $1.370m in 2009/10, $1.390m in 2010/11 and $0.384m in 2011/12 and outyears. The Treasury supports Inland Revenue seeking this funding, should delegated Ministers decide on a 1 October 2008 start date.

51. If this package is implemented from 1 April 2009 Inland Revenue will require additional administrative funding mainly due to a limited set of systems changes and a limited increase in filing requirements. Inland Revenue have estimated the total cost of implementing the changes by 1 April 2009 to be $0.482m in 2007/08, $1.074m in 2008/09, $1.210m in 2009/10, $1.230m in 2010/11 and $0.224m in 2011/12 and outyears. The Treasury supports Inland Revenue seeking this funding, should delegated Ministers decide on a 1 April 2009 start date.

Delegated Authority

52. Final economic and fiscal forecasts from Treasury will not be available until the end of April. It would be prudent to wait for this information before taking final decisions on the design and implementation dates. I am seeking a delegated authority from the Cabinet Business Committee for the Prime Minister, myself and the Associate Minister of Finance (Hon Mallard) to take final decisions on the design of the tax package and its implementation date once the final economic and fiscal information is available. We will report back to Cabinet on these decisions prior to the Budget.

Consultation

53. Treasury has discussed implementation and administrative issues with Inland Revenue.

Financial Implications

54. The table below presents the net operating balance impact of this package (based on a 1 April 2009 implementation date). The total reduction in personal tax revenue is shown in the subtotal line (i.e. the tax package would reduce taxes by approximately $5 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 bond holdings by the Debt Management Office will be reduced, there will be a cost in terms of reduced interest revenue.

Table 9: Financial Implications

($ million)	2008/09	2009/10	2010/11	2011/12
Total revenue reduction	605	2,694	3,930	5,214
adjustment in gross NZS appropriations	-4	10	65	10
adjustment in gross benefit appropriations	46	188	207	219
Subtotal	563	2,496	3,658	4,985
less tax 'clawback'	96	427	625	852
add reduction in investment income	41	139	197	259
Net Operating Balance Impact	**508**	**2,208**	**3,229**	**4,392**

Legislative Implications

55. I will be introducing a Bill on Budget day under urgency.

Other Implications

56. There are no Treaty of Waitangi, human rights, gender or disability implications. A Regulatory Impact Analysis is not required.

Recommendations

I recommend that the Cabinet Business Committee:

1. **note** that in the last four Budgets we have reduced taxes totalling $4.5 billion per annum in line with our ongoing economic and social priorities;

2. **note** that changes to personal tax rates and thresholds are consistent with our equity and growth objectives;

3. **note** that our current effective tax rate structure is:

Current *effective* rates of personal tax
15% to $9,500
21% to $38,000
33% to $60,000
39% over $60,000

4. **agree** to remove the Low Income Rebate (retrospectively from 1 April 2008 if a 1 October 2008 start date is chosen) and introduce the following statutory rates and thresholds over the next three years:

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

5. **note** that there are two main options for implementing the first phase of the tax package – 1 October 2008 or 1 April 2009;

6. **agree** that the income tax rates and thresholds to be confirmed for the 2008/09 tax year reflect the composite personal income tax rates that would apply for this year if a 1 October 2008 start date is chosen.

7. **note** that the design of the proposed tax package is consistent with the four tests of:
   - not requiring borrowing to fund it;
   - not requiring cuts to public services;
   - not exacerbating inflationary pressures in the economy;
   - not leading to greater inequality in our society;

8. **note** that this fiscal cost of these changes are:

($ million)	**2008/09**	**2009/10**	**2010/11**	**2011/12**
Total revenue reduction	605	2,694	3,930	5,214
adjustment in gross NZS appropriations	-4	10	65	10
adjustment in gross benefit appropriations	46	188	207	219
Subtotal	563	2,496	3,658	4,985
less tax 'clawback'	96	427	625	852
add reduction in investment income	41	139	197	259
Net Operating Balance Impact	**508**	**2,208**	**3,229**	**4,392**

9. **note** that these tax changes will not flow through to beneficiaries as net rates of income-tested benefits are set in legislation, but the tax changes will flow through to those on New Zealand Superannuation and Veterans' Pension as their gross rates of payment are set in legislation;

10. **invite** the Minister for Social Development to report back to Cabinet after Budget day to seek agreement to the necessary appropriation changes for income-tested benefits, New Zealand Superannuation and the Veterans' Pension as a result of this package;

11. **note** that Treasury has factored these benefit and pension changes into the Budget Economic and Fiscal Update;

Consequential changes to other parts of the tax system

Composite Rates

12. **agree** that if a 1 October 2008 start date is chosen, composite income tax rates are adopted for the 2008-09 income year which would reflect a blended average of the 2007-08 income year rates and the 2009-10 income year rates which would be:

Income Range	Tax Rate
$0 - $9,500	13.75%
$9,501 - $15,000	16.75%
$15,001 - $38,000	21%
$38,001 - $40,000	27%
$40,001 - $60,000	33%
$60,001 - $70,000	36%
$70,001 and above	39%

PAYE rates

13. **agree** that PAYE withholding rates are adjusted downwards from the date the tax cuts begin (including from 1 October 2008 if that is the intended start date for the tax rate reductions);

Fringe benefit tax (FBT)

14. **agree** that the rates and thresholds that apply for the FBT square-up calculation be adjusted to reflect the tax cut package;

15. **agree** that if a 1 October 2008 start date is chosen composite FBT rates be used for the transitional year which correspond to the personal tax rates under the composite rates table;

Resident Withholding Tax (RWT) and Portfolio Investment Entity (PIE) Tax Rates

16. **agree** that the current PIE tax rates and RWT rates apply pending consultation between officials and managed funds and banks following announcement of the tax rate changes.

Provisional tax

17. **agree** that from the 2009-10 income year:

    - the standard uplift that would otherwise apply to calculate provisional tax instalments should be reduced as if the tax cut had applied to the whole of the previous tax year;
    - a similar approach would be used for taxpayers using the GST ratio method to pay provisional tax; and
    - a similar approach would also apply to the 2010-11 and 2011-12 income years;

18. **agree** that if a 1 October 2008 start date is chosen, the figure on which provisional tax instalments are based should be reduced by the dollar amount of the maximum tax cut that a person earning $70,000 would receive as if the 2008-09 blended tax rate scale applied to the prior income year on which the uplift amount is determined;

ACC attendant care

19. **agree** to change the amount of tax withheld by ACC on attendant care payments to 12.5% to reflect the new bottom income tax rate from the start date of the tax rate cuts;

Maori Authority

20. **note** the Maori Authority tax rate will continue to be 19.5% and officials will report to me and the Minister of Revenue on implications for the Maori Authority tax rate from the personal tax rate changes later this year;

Minimum Family Tax Credit

21. **note** the Minimum Family Tax Credit will be reviewed later this year and implications from the change in the personal tax rates will be considered in that review;

Other consequential changes

22. **agree** to amend Income Tax Act provisions relating to secondary tax codes, specified superannuation contribution withholding tax (SSCWT), extra pay amounts, fund withdrawal tax, retirement scheme contribution tax and the child rebate to reflect the new personal tax rate structure;

23. **agree** to other amendments to the Income Tax Act of a mechanical nature that are necessary to reflect the new personal tax rate structure;

Delegated Authority

24. **note** that Treasury will finalise their economic and fiscal forecasts in late April and that it would be prudent to wait until these are finalised before taking a final decision on the design of the tax package and its implementation date;

25. **delegate** authority to the Prime Minister, the Minister of Finance and the Associate Minister of Finance (Hon Mallard) to take final decisions on the design of the tax package and its implementation date once Treasury has finalised their economic and fiscal forecasts in late April;

26. **invite** the Prime Minister, the Minister of Finance and the Associate Minister of Finance (Hon Mallard) to report back to Cabinet before Budget day on final decisions;

27. **agree** 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;

Administration costs

If the tax package is implemented from 1 October 2008:

28. **approve** the following changes in appropriations to implement the Budget 2008 tax package from 1 October 2008, with a corresponding impact on the operating balance and debt:

	$m - increase/(decrease)				
	2007/08	**2008/09**	**2009/10**	**2010/11**	**2011/12& Outyears**
Departmental Output Expenses (General):					
Services to Inform the Public About Entitlements and Meeting Obligations (funded by Revenue Crown)	0.338	2.693	0.644	0.680	0.230
Services to Process Obligations and Entitlements (funded by Revenue Crown)	0.145	1.795	0.430	0.454	0.154
Net Asset Schedule of Inland Revenue:					
Capital Injection	0.134	1.075	0.296	0.256	-
Total Operating	**0.483**	**4.488**	**1.074**	**1.134**	**0.384**
Total Capital	**0.134**	**1.075**	**0.296**	**0.256**	**-**

If the tax package is implemented from 1 April 2009:

29. **approve** the following changes in appropriations to implement the Budget 2008 tax package from 1 April 2009, with a corresponding impact on the operating balance and debt:

	$m - increase/(decrease)				
	2007/08	**2008/09**	**2009/10**	**2010/11**	**2011/12& Outyears**
Departmental Output Expenses (General):					
Services to Inform the Public About Entitlements and Meeting Obligations (funded by Revenue Crown)	0.305	0.388	0.548	0.584	0.134
Services to Process Obligations and Entitlements (funded by Revenue Crown)	0.131	0.258	0.366	0.390	0.090
Net Asset Schedule of Inland Revenue:					
Capital Injection	0.046	0.428	0.296	0.256	0
Total Operating	**0.436**	**0.646**	**0.914**	**0.974**	**0.224**
Total Capital	**0.046**	**0.428**	**0.296**	**0.256**	**-**

30. **agree** that the proposed changes to appropriations and projected balances of net assets for 2007/08 above in recommendations 30 and 31 be included in the 2007/08 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply.

Legislation

31. **note** that I intend to introduce a Bill on Budget day under urgency to legislate the package;

32. **direct** Inland Revenue to draft the necessary Bill for introduction on 22 May 2008.

Hon Dr Michael Cullen
Minister of Finance