

2013 Tax Expenditure Statement

5 July 2013

ISBN: 978-0-478-40344-2 (Online)

Persistent URL: <http://purl.oclc.org/nzt/b-1469>

URL at 5 July 2013: <http://www.treasury.govt.nz/budget/2013/taxexpenditure>

Introduction

The purpose of this statement is to provide additional transparency around policy-motivated 'expenditures' made through the tax system. Tax expenditures take the form of an exemption, allowance, preferential tax rate, deferral or offset that reduce a tax obligation to achieve a specific policy objective.

This is the fourth successive release of tax expenditure data; 2010 was the first time New Zealand released tax expenditure data since 1984. This voluntary disclosure fills an obvious weakness in our current transparency arrangements by bringing New Zealand's financial reporting closer to OECD best practice standards. As with other disclosures, additional tax expenditure transparency is not intended to be a statement of policy effectiveness or desirability.

Changes from Previous Statements

The 2013 Tax Expenditure Statement incorporates several changes from previous versions. In addition to detailed descriptions of tax expenditures that are usually provided, categorisation of tax expenditures has been introduced in this year's statement as a way to provide further transparency.

Additional quantification of tax expenditures has also been included (see Table 2). Further quantification and assessment of tax expenditures will be undertaken by officials and reported in future statements.

Finally, revisions to tax expenditures since the 2012 tax expenditure statement have been detailed in Table 5.

What is a Tax Expenditure?

Governments can spend in a variety of direct and indirect ways. International public sector accounting standards (IPSAS 23) divide spending into three different categories: direct spending; spending through the tax system; and tax expenditures. Until 2010, The Treasury had not released tax expenditure information in recent years, although information on the first two categories of spending has been routinely released as part of our annual accountability data.

Table 1: Classification of Crown spending under public sector accounting standards

	Definition	Reporting
Direct spending	Traditional spending made as a direct transfer between the Crown and different entities or individuals.	Disclosed in the <i>Crown Financial Statements</i> and annual Budget.
Spending through the tax system	Hybrid transfers that can be taken as a cash payment or via a reduction in tax.	A predictable cash value allows these transfers to be formally appropriated and disclosed in the <i>Crown Financial Statements</i> and annual Budget.
Tax expenditures	Individual features of the tax system that reduce an entity's tax obligation in a way that is designed to give effect to policy other than to raise revenue in the most efficient and economically neutral way.	Tax expenditures are defined in tax legislation, but have not previously been disclosed. The 2010 statement was the first disclosure since 1984.

Tax systems differ from country to country. Thus, there is no current international consensus as to how tax expenditures should be categorised. Treasury released a discussion of how tax expenditure reporting could be categorised to meet New Zealand's objectives in *Treasury Policy Perspectives Paper 09/01*.

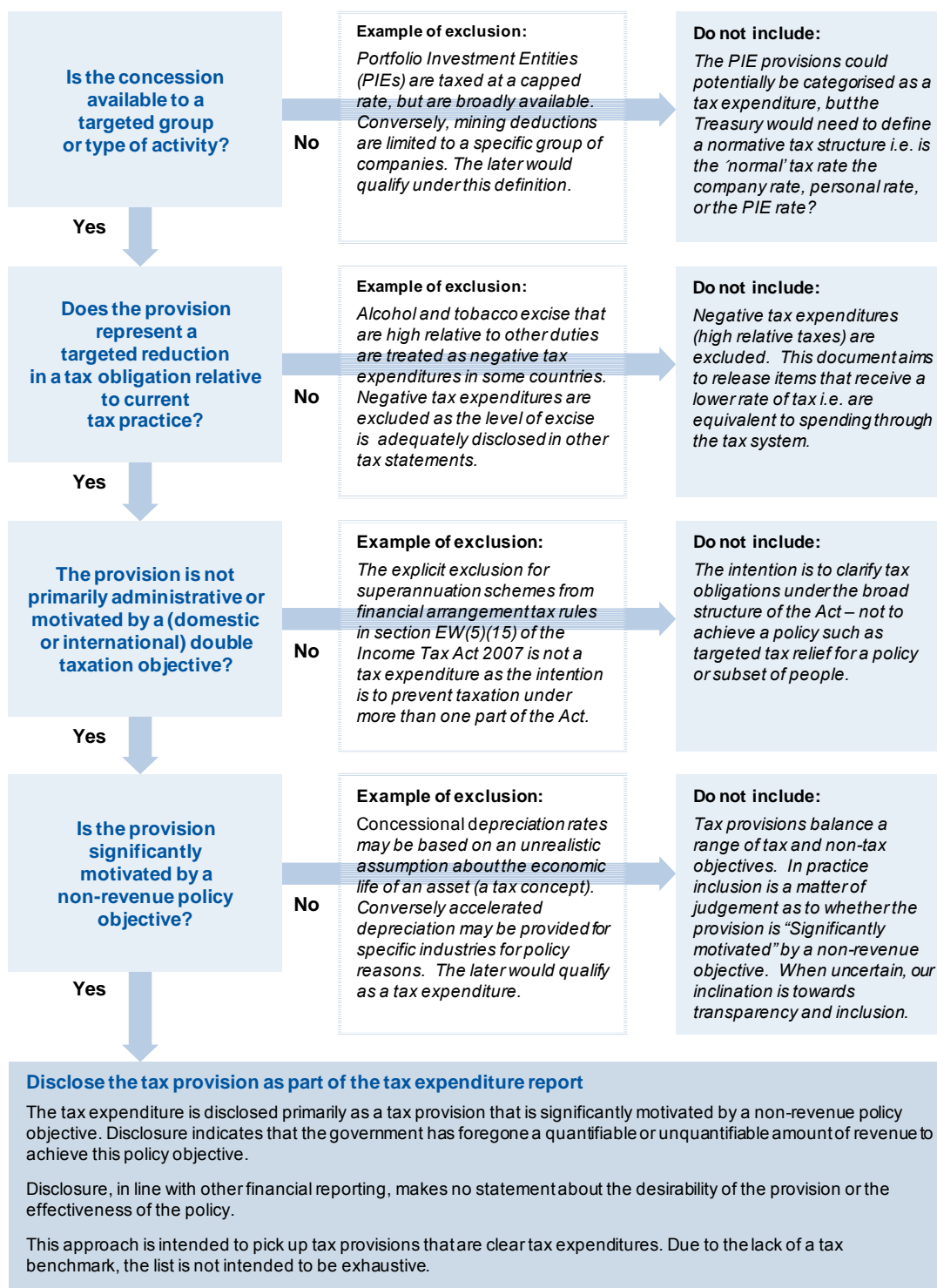
Some countries define tax expenditures indirectly relative to a normative benchmark. This approach allows countries to report a wider set of structural tax expenditures that are generally applicable¹. This document has focused, in the first instance, on a narrow subset of tax expenditures that bear a distinct fiscal cost and represent a clear policy-motivated exemption² to current tax practice. A summary of the guiding criteria is included in figure 1.

¹ For example, Portfolio Investment Entities (PIEs) offer all tax payers the option of relatively 'concessional' tax treatment as a mechanism to encourage portfolio investment. While a non-revenue policy objective suggests that PIEs could be categorised as a tax expenditure, PIEs are excluded from the tax expenditure definition used in this document as PIEs are available to all taxpayers. A benchmark tax system would allow the Treasury to categorise structural features of the tax system such as PIEs, trusts, or progressive personal tax rates. A benchmark tax structure is useful where no clear exemption exists as it would define what constitutes the 'standard' tax treatment. For instance, is the 'standard rate' the company rate, PIE rate, trust rate, or one of the personal tax rates?

² The stated purpose of the Income Tax Act 2007 is to "define, and impose tax on, net income". Tax expenditures are not motivated by a desire to raise revenue in the most efficient manner possible, but instead are significantly motivated by non-revenue policy objectives.

The 2010 Tax Expenditure Statement was a first step towards improved transparency in this area and statements for 2011 and 2012 were also released; this document provides another update. No attempt has been made to identify a normative tax benchmark or to comprehensively analyse tax legislation. Work on identification is ongoing as part of a multi-year work programme. For this reason, this preliminary list should not be taken as an exhaustive or complete list of all current tax expenditures.

Figure 1: Guiding criteria for inclusion in this disclosure document



Current Tax Expenditures

The following sections list tax expenditures drawn from the *Income Tax Act 2007*. Further analysis suggests that the *Goods and Services Tax Act 1985* does not contain any tax expenditures. Appropriated cash payments (spending) made through the tax system, e.g. Working for Families tax credits, have also been included in the final part of the list. Cash payments made through the tax system do not formally meet a tax expenditure definition, but have been included for transparency purposes.

A small sub-section of tax expenditures with readily accessible data has been quantified (refer table 2). The government does not collect data on all tax expenditures as the compliance cost of collecting additional data is, in some instances, considered prohibitive. While work quantifying tax expenditures will continue, many tax expenditures may not be able to be quantified.

Table 2: Quantified tax expenditures and spending through the tax system

Quantified tax expenditures	Value of expenditure 2011/12 (estimated actual)	Value of expenditure 2012/13 (forecast)³
Charitable or other public benefit gifts by a company: deduction	\$27 million	\$30 million
Charitable or other public benefits: tax credit	\$219 million	\$220 million
Child taxpayer credit	\$12 million	-
Housekeeping tax credit	\$15 million	-
Independent earner tax credit	\$210 million	\$210 million
Maori Authorities: donations	\$0.4 million	\$0.5 million
Redundancy tax credit	\$6 million	\$1 million
Tax credit for transitional circumstances	\$7 million	-

Note: measured in March tax years

Appropriated spending through the tax system	Value of expenditure 2011/12 (estimated actual)	Value of expenditure 2012/13 (forecast)
Child tax credit	\$2 million	\$2 million
Family tax credit	\$2,109 million	\$2,099 million
In-work tax credit	\$567 million	\$541 million
KiwiSaver tax credit	\$690 million	\$740 million
Parental tax credit	\$18 million	\$17 million
Minimum Family tax credit	\$11 million	\$12 million

Note: These credits are appropriated and are measured over the financial year.

³ Tax expenditures that have been removed do not have a forecast expenditure value for 2012/13.

Tax Expenditures categorisation

In the tables that follow, tax expenditures as at 1 April 2013 from the Income Tax Act 2007 are categorised by *Type* and *Impact*. Categorisation of tax expenditures has been introduced in this year's statement as a way to provide further transparency.

Notes on Categorisation

According to this statements' new classification, there are three *types* of tax expenditures:

- 1 **Social:** Tax expenditures that are introduced with the purpose of achieving certain social policy objectives. These can be either appropriated spending – such as the *Working for Families* tax credits – or income exemptions or deductions such as the Charities tax credit or the deduction for Maori Authority donations.
- 2 **Business:** Tax expenditures that are aimed at incentivising certain types of business or commercial activities in order to meet explicit or implicit economic policy objectives. Some examples include: income exemption for bodies promoting scientific or industrial research, or the deduction for petroleum mining expenditure.
- 3 **Other:** Tax expenditures that are not expressly introduced to achieve social or business economic policy objectives. An example is the tax exemption for the income of the Governor General.

Tax expenditures are also categorised by their *impact*. That is, whether their effect on the current tax base results from *historic* policy settings, and/or whether they are *permanent*, that is subject to no future reversal, or that they are subject to *timing* changes and they reverse in the future. Detailed definitions of these *impact* categories are as follows:

- 1 **Historic:** Tax expenditures that are no longer available for new claims, but qualifying activity from the past can still affect tax revenues. Some examples include: accelerated depreciation and home ownership savings.
- 2 **Timing:** Tax expenditures that achieve a tax deferral through allowing later recognition of income or earlier deductions that reverse over following years. Some examples include: the mineral mining expenditure deduction and the film industry expenditure deduction.
- 3 **Permanent:** Tax expenditures that reduce the overall amount of tax payable or increase entitlement to Crown expenditure. Some examples include: income exemption for Community Trusts and the Charitable or other public benefit tax credit.

Table 3: Tax Expenditures Included in the Income Tax Act 2007

Tax Expenditure	Sections	Type			Impact		
		Social	Business	Other	Historic	Timing	Permanent
Accelerated depreciation	Sections DO 4-5, 12, DP 3, DZ 17-18, EE 31		✓		✓	✓	
Allowances of the Governor-General	Section CW 16			✓			✓
Bloodstock: accelerated deductions	Sections EC 38-48		✓			✓	
Bodies promoting amateur games and sports: exempt income	Section CW 46	✓					✓
Bodies promoting scientific or industrial research: exempt income	Section CW 49		✓				✓
Certain income derived by transitional residents: exempt income	Sections CW 27 and HR 8			✓			✓
Charitable or other public benefit gifts by a company: deduction	Section DB 41	✓					✓
Charitable or other public benefit gifts by an individual: tax credit	Subpart LD	✓					✓
Charities: exempt income	Sections CW 41-43	✓					✓
Community trusts: exempt income	Section CW 52	✓					✓
Credits for savings in special home ownership accounts	Section LZ 9	✓			✓		✓
Farming business expenditure: accelerated deductions	Section DO 1-3, DO 10		✓			✓	✓
Film industry expenditure: accelerated deductions	Section DS 1-4		✓			✓	
Forestry encouragement grant: accelerated deductions	Section DP 5		✓		✓	✓	
Forestry expenditure: accelerated deductions	Section DP 1		✓			✓	
Friendly societies: exempt income	Section CW 44	✓					✓
Fringe benefit tax: partial exclusion for charities	Section CX 25	✓					✓
Funeral Trusts: exempt income	Section CW 45	✓					✓
Herd improvement	Section CW 51		✓				✓

Tax Expenditure	Sections	Type			Impact		
		Social	Business	Other	Historic	Timing	Permanent
bodies: exempt income							
Income equalisation schemes: deduction	<i>Subpart EH</i>		✓			✓	
Income for military or police service in operational area: exempt income	<i>Section CW 23-24</i>			✓			✓
Income from conducting gaming-machine gambling: exempt income	<i>Section CW 48</i>			✓			✓
Independent earner: tax credit	<i>Section LC 13</i>	✓					✓
Interest on home vendor mortgages: tax credit	<i>Sections LZ 6-8</i>	✓			✓		✓
Jurors' and witnesses' fees: exempt income	<i>Section CW 26</i>	✓					✓
Local and regional promotional bodies: exempt income	<i>Section CW 40</i>	✓					✓
Maori Authorities: deduction	<i>Section DV 12</i>	✓					✓
Mineral mining expenditure: accelerated deduction	<i>Section DU</i>		✓			✓	
Payments of interest post-war credits: exempt income	<i>Section CW 5</i>	✓					✓
Payments of interest on farm mortgages: exempt income	<i>Section CW 6</i>		✓				✓
Petroleum mining expenditure: accelerated deduction	<i>Subpart DT, sections EJ 12-20</i>		✓			✓	
Scholarships and bursaries: exempt income	<i>Section CW 36</i>	✓					✓
TAB and racing clubs: exempt income	<i>Section CW 47</i>		✓				✓
Veterinary services bodies: exempt income	<i>Section CW 50</i>		✓				✓

Table 4: Approved Appropriated Spending Made through the Tax System

Tax Expenditure	Sections	Type			Impact		
		Social	Business	Other	Historic	Timing	Permanent
Child tax credit	<i>Section MZ 2</i>	✓			✓		✓
Family tax credits	<i>Section MD 3</i>	✓					✓
In-work tax credits	<i>Section MD 10</i>	✓					✓
KiwiSaver tax credits	<i>Section MK 1-8</i>	✓					✓
Parental tax credits	<i>Section MD 12</i>	✓					✓
Minimum family tax credit	<i>Section ME 1</i>	✓					✓

Table 5: Revisions to tax expenditures since the 2012 Tax Expenditure Statement

Tax Expenditure	Sections	Comments
Bloodstock	<i>Sections EC 38-48</i>	Added – More analysis confirms this is a tax expenditure.
Child taxpayer credit	<i>Section LC 3</i>	Removed - Does not apply from the 2012/13 income year
Forestry encouragement grant	<i>Section DP 5</i>	Added separately - Previously recorded as part of forestry expenditure.
Fringe benefit tax – partial exclusion for charities	<i>Section CX 25</i>	Added – More analysis confirms this is a tax expenditure.
Housekeeping/carer: tax credit	<i>Section LC 6</i>	Removed - Does not apply from the 2012/13 income year
KiwiSaver superannuation contribution tax exemption	<i>Section RD 65</i>	Removed - Does not apply for pay periods commencing after 1 April 2012
New Zealand companies operating in Niue	<i>Section CW 59</i>	Removed - Not a tax expenditure as Niue based companies use our companies register because they do not have one.
Non-profit organisations - deduction	<i>Section DV 8</i>	Removed – Not considered to be a tax expenditure because it is in place for compliance reasons.
Redundancy tax credit	<i>Section ML 2</i>	Removed - Does not apply for redundancies after 1 October 2011
Tax credit for transitional circumstances	<i>Section LC 4</i>	Removed - Does not apply from the 2012/13 income year
GST – Financial services exemption	<i>Sections 14(1) and 11</i>	Removed – Not considered to be a tax expenditure because it is in place for compliance reasons.
GST – Supply of fine metal exemption	<i>Sections 14(1) and 11</i>	Removed – These provisions are not tax expenditures as the supply of fine metal is more akin to a supply of currency and this recognises that.
GST – various residential exempt supplies	<i>Various</i>	Removed – Not considered to be tax expenditures because the underlying asset is taxed when created which is a substantial offset.

Tax Expenditures Included in the Income Tax Act 2007⁴

Accelerated depreciation: accelerated deductions

Sections DO 4-5, 12, DP 3, DZ 17-18, EE 31

The ability to depreciate capital items faster than their economic life reduces income by a greater amount in earlier years (deferring tax payments). This covers both primary sector amortisation and fixed asset depreciation.

Allowances of the Governor-General

Section CW 16

Allowances and benefits received by the Governor-General and former Governors-General under the *Governor-General Act 2010* are exempt from tax.

Bloodstock: accelerated deductions

Sections EC 38-48

Both the timing and rate of write downs are accelerated when compared with an economic approach.

Bodies promoting amateur games and sports: exempt income

Section CW 46

Income derived by a club, society or association is exempt income, providing it is established to promote an amateur game or sport and no funds are used for private pecuniary profit.

Bodies promoting scientific or industrial research: exempt income

Section CW 49

Income derived by a society or association established mainly to promote or encourage scientific or industrial research is exempt income, providing the society or association is approved by the Royal Society of New Zealand and no funds are used for private pecuniary profit.

Certain income derived by transitional residents: exempt income

Sections CW 27 and HR 8

New tax residents (both immigrants and returning New Zealanders) can gain a temporary tax exemption for up to four years on most foreign-sourced income.

Charitable or other public benefit gifts by a company: deduction

Section DB 41

A company is allowed a deduction for a charitable or other public benefit gift when made to a society, institution, association, organisation, trust, or fund described in section LD(3)(2) or listed in schedule 32 of the *Income Tax Act 2007*. This applies to cash donations only and is limited by net income.

⁴ This list has mainly been sourced from the following sections of the Act: Section D (Deductions); Section C (Income); Section L (Tax credits and other credits); and Section M (Tax credits paid in cash).

Charitable or other public benefits: tax credit

Subpart LD

An individual who makes a charitable or other public benefit gift is, under certain conditions, allowed a refundable tax credit. This applies to cash donations only and is limited by taxable income.

Charities: exempt income

Sections CW 41-43

Business, non-business and charitable bequests are exempt income for registered charitable entities. The exemption does not apply to business income to the extent that the charity carries out its charitable purposes outside New Zealand.

Community trusts: exempt income

Section CW 52

Income derived by the trustee of a community trust is exempt income.

Credits for savings in special home ownership accounts: tax credit

Section LZ 9

An increase in savings in a special home ownership account can attract a credit.

Farming business expenditure: accelerated deductions

Sections DO 1-3 and DO 10

Certain deductions granted for improvements and enhancements to land for farming can be expensed rather than treated as capital and amortised, e.g. fencing.

Film industry expenditure: accelerated deductions

Section DS 1-4

Expenditure incurred acquiring film rights or film production expenditure can be expensed over a specified time frame.

Forest encouragement grant: accelerated deductions

Section DP 5

Forestry expenditure incurred by a person who derives a forestry encouragement grant that is not grant related is immediately deductible.

Forestry expenditure: accelerated deductions

Section DP 1

Expenditures associated with forestry (e.g. planting or tending costs) can be expensed rather than capitalised against harvest proceeds.

Friendly societies: exempt income

Section CW 44

Specified income derived by a friendly society is treated as exempt income.

Fringe benefit tax and charities: partial exemption

Section CX 25

Generally fringe benefits provided to employees not involved in a charities' business are exempt FBT.

Funeral Trusts: exempt income

Section CW 45

Interest or a dividend derived by a trustee in a funeral trust is exempt income.

Herd improvement bodies: exempt income

Section CW 51

Income derived by a herd improvement association, or society established mainly to promote an improvement in New Zealand dairy cattle, is exempt income, providing no funds are used for private pecuniary profit.

Income equalisation schemes: income deferral

Subpart EH

Persons working in forestry, fishing, or farming entities may reduce their taxable income in a year by depositing taxable income with Inland Revenue. The schemes allow taxable income to be transferred between years thereby smoothing taxable income.

Income for military or police service in operational area: exempt income

Section CW 23-24

Specified income derived by members of the New Zealand Defence Force (or the police) serving in an operational area can be treated as exempt income.

Income from conducting gaming-machine gambling: exempt income

Section CW 48

Gross gambling proceeds from gaming-machine gambling are exempt income if the person complies with the *Gambling Act 2003*. Note that turnover is separately taxed.

Independent earner tax credit: tax credit

Section LC 13

Individuals whose income is between \$24,000 and \$44,000, and who are not receiving certain forms of income, are entitled to a tax credit of \$520. This credit abates once annual income rises above \$44,000.

Interest on home vendor mortgages: tax credit

Section LZ 6-8

A tax credit may be available for interest from a home vendor mortgage.

Jurors' and witnesses' fees: exempt income

Section CW 26

Fees paid by the Crown to jurors and its witnesses, other than expert witnesses, are exempt income.

Local and regional promotional bodies: exempt income

Section CW 40

The income derived by a charitable association or society is exempt income, if it is primarily established for beautification purposes.

Maori Authorities: deduction

Section DV 12

A Māori authority is allowed a deduction for a donation that it makes to a Māori association as defined in the *Māori Community Development Act 1962*. It is also allowed a deduction for charitable or other public benefit gifts. This deduction applies to cash donations only and is limited by net income.

Mineral mining expenditure: accelerated deductions

Subpart DU

Specified mineral mining companies can deduct expenditure, including capital expenditure, in advance of when a deduction should be allowed. Government is currently reviewing these rules.

Payments of interest post-war credits: exempt income

Section CW 5

Interest derived by a person under section 2 of the *Income Tax (Repayment of Post-War Credits) Act 1959* of the United Kingdom Parliament is exempt income.

Payments of interest on farm mortgages: exempt income

Section CW 6

50 percent of the interest that an individual derives from a mortgage securing a loan made by a seller of a farm is exempt income, if the Rural Banking and Finance Corporation of New Zealand approves the mortgage.

Petroleum mining expenditure: accelerated deductions

Subpart DT, and sections EJ 12-20

Petroleum exploration expenditure is deductible as incurred. Development expenditure is written off over an accelerated seven-year period.

Scholarships and bursaries: exempt income

Section CW 36

Any scholarship or bursary payment for attendance at an educational institution is exempt income, except for a basic grant or an independent circumstances grant under the *Education Act 1989*.

TAB and racing clubs: exempt income

Section CW 47

Income derived by the New Zealand Racing Board, New Zealand Thoroughbred Racing, Harness Racing New Zealand and the New Zealand Greyhound Racing Association is exempt income. Note that betting turnover is separately taxed.

Veterinary services bodies: exempt income

Section CW 50

Income derived by a veterinary association, club or society established mainly to promote efficient veterinary services in New Zealand is exempt income, providing no funds are used for private pecuniary profit.

Approved Appropriated Spending Included in the Income Tax Act 2007

Child tax credit

Section MZ 2

Families with a pre-existing entitlement dating from before 31 March 2006 are able to claim a tax credit for dependent children. Additional access to this tax credit is no longer available.

Family tax credits

Section MD 3

Families are entitled to an income tested tax credit or cash payment for children aged 18 years or younger.

In-work tax credits

Section MD 10

Families with children 18 years or younger that work the required number of hours per week are entitled to an income tested in-work tax credit.

KiwiSaver tax credits

Sections MK 1-8

The savings of participants in the KiwiSaver scheme are entitled to a tax credit.

Parental tax credits

Section MD 12

A tax credit may, under certain conditions, be paid to families with a newborn baby for the first 56 days (eight weeks) after the baby is born.

Minimum family tax credit

Section ME 1

A tax credit may be available to ensure that the annual income (after tax) of a family with dependent children 18 or younger does not fall below \$22,724.