

2016 Tax Expenditure Statement

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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 voluntary disclosure improves our transparency arrangements by bringing New Zealand's financial reporting closer to OECD best practice standards. This statement is not intended to be a statement of policy effectiveness or desirability.

Changes from Previous Statements

The 2016 Tax Expenditure Statement is very similar to last year's statement. In this year's statement there is the addition of several income tax expenditures, and removal of one credit, that are detailed in table 5. For quantified expenditures, a greater number of previous years are reported in table 2, and a brief explanation of how they are calculated is provided in the *Quantification Methods* section on page 14.

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.

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*.

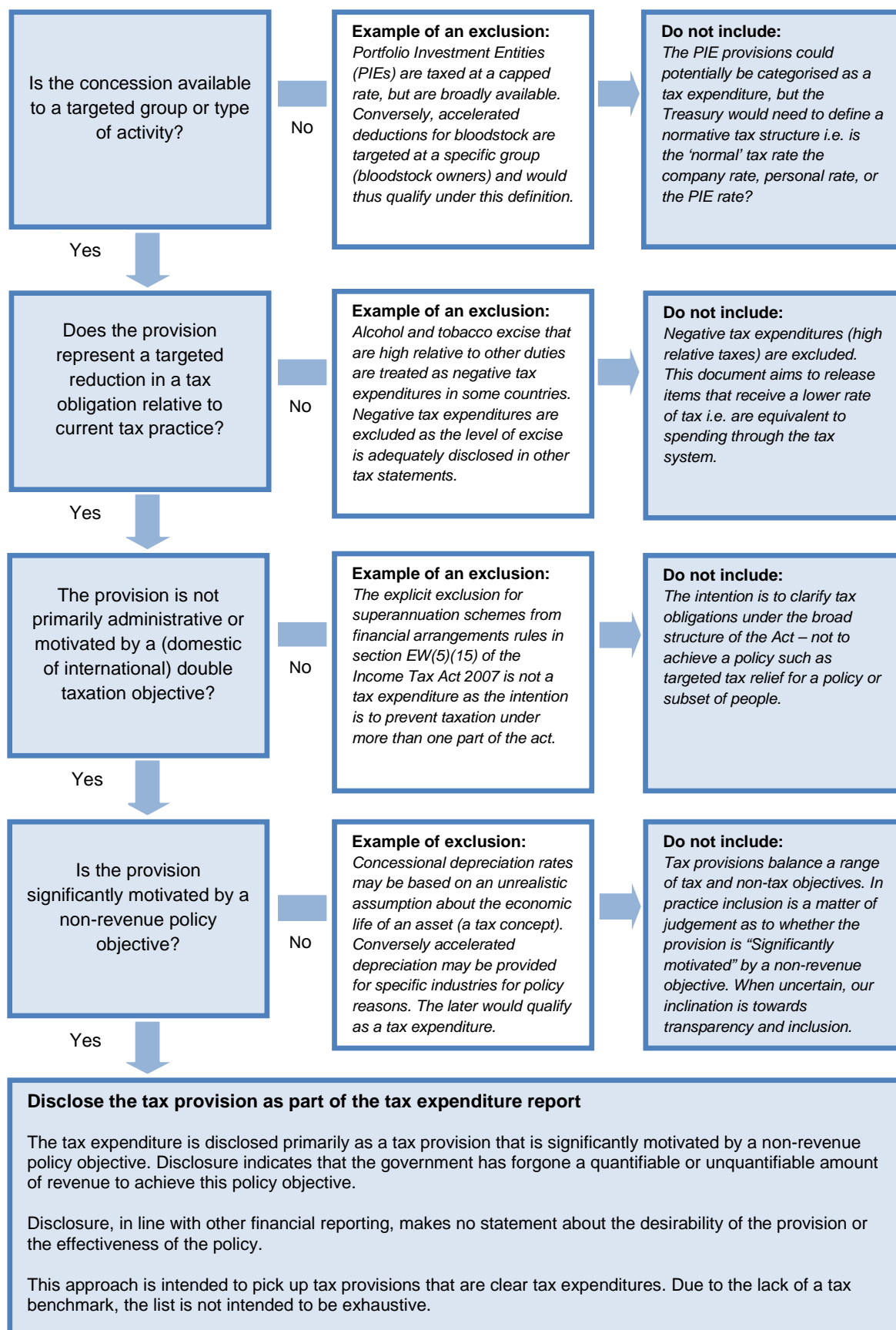
Some countries define tax expenditures indirectly relative to a normative benchmark. This approach allows countries to report a wider set of structural tax expenditures that are generally applicable¹. This document has focused, in the first instance, on a narrow subset of tax expenditures that bear a 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.

No attempt has been made to identify a normative tax benchmark or to comprehensively analyse tax legislation.

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.

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*, as at 1 April 2016. Current 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, eg, 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 and administration costs of collecting additional data exceed the value that data might provide.

Table 2: Quantified Tax Expenditures and Spending through the Tax System

Quantified tax expenditures	Value of expenditure 2010/11 (actual)	Value of expenditure 2011/12 (actual)	Value of expenditure 2012/13		Value of expenditure 2013/14		Value of expenditure 2014/15		Value of expenditure 2015/16 (forecast)
			As at April 2016	Estimated Actual	As at April 2016	Estimated Actual	As at April 2016	Estimated Actual	
Charitable or other public benefit gifts by a company: deduction	30	22	20	20	17	17	15	15	15
Charitable or other public benefits: tax credit	210	235	223	226	231	238	230	247	247
Independent earner tax credit	218	220	217	220	214	220	199	220	220
Māori Authorities: donations	0.8	0.5	0.7	0.7	0.9	0.9	2.2	2.2	0.9

Note: measured in \$000,000s over March tax years. Italicised values may be incomplete. See the appendix for further information on quantification methods.

Appropriated spending through the tax system	Value of expenditure 2010/11 (actual)	Value of expenditure 2011/12 (actual)	Value of expenditure 2012/13 (actual)	Value of expenditure 2013/14 (actual)	Value of expenditure 2014/15 (actual)	Value of expenditure 2015/16 (forecast)
Child tax credit	2.8	2	1.7	1.8	1.3	1.1
Family tax credit	2178	2109	2060	2015	2006	1824
In-work tax credit	585	567	545	533	511	522
KiwiSaver tax credit	1041	689	723	804	855	701
Parental tax credit	19	18	17	18	21	31
Minimum Family tax credit	10	11	12	14	16	14

Note: These credits are appropriated and are measured in \$000,000s over financial years.

Tax Expenditures Categorisation

In the tables that follow, tax expenditures and appropriated spending are categorised by *Type* and *Impact*.

Notes on Categorisation

In this statement 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 Māori 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 allowances 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 facilitate *timing* changes which 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 **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.
- 3 **Timing:** Tax expenditures that achieve a tax deferral through allowing later recognition of income or earlier deductions that reverse over following years. An example is the film industry expenditure deduction.

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

Tax Expenditure	Sections	Comment	Type			Impact		
			Social	Business	Other	Historic	Timing	Permanent
Accelerated depreciation	<i>Sections DO 4-5, 12, DP 3, DZ 17-18, EE 31</i>	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.		✓		✓	✓	
Accommodation allowances: <ul style="list-style-type: none"> Defence Force Ministers of religion Canterbury rebuild 	<i>Section CD 1D</i> <i>Section CE 1E</i> <i>Section CZ 29</i>	Generally the provision of long term accommodation forms part of an employee's income. The Canterbury rebuild exemption completely expires on 31 March 2019, the other two are permanent.			✓			✓
Allowances of the Governor-General	<i>Section CW 16</i>	Allowances and benefits received by the Governor-General and former Governor-Generals under the <i>Governor-General Act 2010</i> are exempt from tax.			✓			✓
Bloodstock: accelerated deductions	<i>Sections EC 38-48</i>	Both the timing and rate of write downs are accelerated when compared with an economic approach.		✓			✓	
Bodies promoting amateur games and sports: exempt income	<i>Section CW 46</i>	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	<i>Section CW 49</i>	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	<i>Sections CW 27 and HR 8</i>	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	<i>Section DB 41</i>	A company is allowed a deduction for a charitable or other public benefit gift of cash when made to an entity described in section LD(3)(2) or listed in schedule 32 of the <i>Income Tax Act 2007</i> . This deduction is limited by net income.	✓					✓

Tax Expenditure	Sections	Comment	Type			Impact		
			Social	Business	Other	Historic	Timing	Permanent
Charitable or other public benefit gifts by an individual: tax credit	<i>Subpart LD</i>	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 deregistration	<i>Section HR 12</i>	Charities that predominately provide community housing are exempt from section HR 12 (tax on deregistration of charities) in qualifying circumstances.	✓					✓
Charities: exempt income	<i>Sections CW 41-43</i>	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 housing	<i>Section CW 42B</i>	Income derived by community housing entities is exempt income.	✓					✓
Community trusts: exempt income	<i>Section CW 52</i>	Income derived by the trustee of a community trust is exempt income.	✓					✓
Credits for savings in special home ownership accounts	<i>Section LZ 9</i>	An increase in savings in a special home ownership account can attract a credit.	✓			✓		✓
Employee share schemes	<i>Sections DC 12-15, CE 2</i>	Employers who run a qualifying share scheme are entitled to a notional deduction for interest, employees of such employers are able to take any gains tax free.		✓				✓
Farming business expenditure: accelerated deductions	<i>Sections DO 1-3, DO 10</i>	Certain deductions granted for improvements and enhancements to land for farming can be expensed rather than treated as capital and amortised, eg, fencing.		✓			✓	✓
Film industry expenditure: accelerated deductions	<i>Section DS 1-4</i>	Expenditure incurred acquiring film rights or film production expenditure can be expensed over a specified time frame.		✓			✓	
Forestry encouragement grant: accelerated deductions	<i>Section DP 5</i>	Forestry expenditure incurred by a person who derives a forestry encouragement grant that is not grant related is immediately deductible.		✓		✓	✓	
Forestry expenditure: accelerated deductions	<i>Section DP 1</i>	Expenditures associated with forestry (eg, planting or tending costs) can be expensed rather than capitalised against harvest proceeds.		✓			✓	
Friendly societies: exempt income	<i>Section CW 44</i>	Specified income derived by a friendly society is treated as exempt income.	✓					✓

Tax Expenditure	Sections	Comment	Type			Impact		
			Social	Business	Other	Historic	Timing	Permanent
Fringe benefit tax: partial exclusion for charities	<i>Section CX 25</i>	Generally fringe benefits provided to employees not involved in a charities' business are exempt FBT.	✓					✓
Funeral Trusts: exempt income	<i>Section CW 45</i>	Interest or a dividend derived by a trustee in a funeral trust is exempt income.	✓					✓
Herd improvement bodies: exempt income	<i>Section CW 51</i>	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: deduction	<i>Subpart EH</i>	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	<i>Sections CW 23-24</i>	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	<i>Section CW 48</i>	Gross gambling proceeds from gaming-machine gambling are exempt income if the person complies with the <i>Gambling Act 2003</i> . Note that turnover is separately taxed.			✓			✓
Independent earner: tax credit	<i>Section LC 13</i>	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	<i>Sections LZ 6-8</i>	A tax credit may be available for interest from a home vendor mortgage.	✓			✓		✓
Jurors' and witnesses' fees: exempt income	<i>Section CW 26</i>	Fees paid by the Crown to jurors and its witnesses, other than expert witnesses, are exempt income.	✓					✓
Local and regional promotional bodies: exempt income	<i>Section CW 40</i>	The income derived by a charitable association or society is exempt income, if it is primarily established for beautification purposes.	✓					✓

Tax Expenditure	Sections	Comment	Type			Impact		
			Social	Business	Other	Historic	Timing	Permanent
Māori Authorities: deduction	<i>Section DV 12</i>	A Māori authority is allowed a deduction for a cash donation that it makes to a Māori association as defined in the <i>Māori Community Development Act 1962</i> . It is also allowed a deduction for charitable or other public benefit cash gifts. This deduction is limited by net income.	✓					✓
Non-resident oil rig and seismic vessel operator - tax exemption	<i>Section CW 57</i>	Income derived by non-resident operators of oil rigs and seismic vessels is exempt from taxation.		✓				✓
Payments of interest post-war credits: exempt income	<i>Section CW 5</i>	Interest derived by a person under section 2 of the <i>Income Tax (Repayment of Post-War Credits) Act 1959</i> of the United Kingdom Parliament is exempt income.	✓					✓
Payments of interest on farm mortgages: exempt income	<i>Section CW 6</i>	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 deduction	<i>Subpart DT, sections EJ 12-20</i>	Petroleum exploration expenditure is deductible as incurred. Development expenditure is written off over an accelerated seven-year period.		✓			✓	
Plain clothes allowances	<i>Section CW 17CC</i>	In very limited circumstances a plain clothes allowance paid to an employee who is also provided with a uniform can be tax exempt.			✓			✓
Research and Development – cashing out tax losses	<i>Subpart MX</i>	In qualifying circumstances a company that conducts research and development and incurs tax losses may cash out the tax value of the research and development part of the tax losses. This is repayable against future profits, or in certain other circumstances.		✓			✓	
Scholarships and bursaries: exempt income	<i>Section CW 36</i>	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 <i>Education Act 1989</i> .	✓					✓
TAB and racing clubs: exempt income	<i>Section CW 47</i>	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.		✓				✓

Tax Expenditure	Sections	Comment	Type			Impact		
			Social	Business	Other	Historic	Timing	Permanent
Te Urewera Board	<i>Section CW 40B and the Te Urewera Act 2014</i>	The Board's income (generally from concessions) is exempt from tax so long as it is applied for the purposes set out in the Te Urewera Act 2014.			✓			✓
Veterinary services bodies: exempt income	<i>Section CW 50</i>	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.		✓				✓

Table 4: Approved Appropriated Spending Made through the Tax System

Tax Expenditure	Sections	Comment	Type			Impact		
			Social	Business	Other	Historic	Timing	Permanent
Child tax credit	<i>Section MZ 2</i>	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 credit	<i>Section MD 3</i>	Families are entitled to an income tested tax credit or cash payment for children aged 18 years or younger.	✓					✓
In-work tax credit	<i>Section MD 10</i>	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	<i>Section MK 1-8</i>	The savings of participants in the KiwiSaver scheme are entitled to a tax credit.	✓					✓
Parental tax credit	<i>Section MD 12</i>	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	<i>Section ME 1</i>	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 \$22,776.	✓					✓

Table 5: Revisions to Tax Expenditures since the 2015 Tax Expenditure Statement

Tax Expenditure	Sections	Comments
Charities deregistration	<i>Section HR 12</i>	As amended by the Taxation (Annual Rates 2015–16, Research and Development, and Remedial Matters) Act 2016.
Community housing	<i>Section CW 42B</i>	Added by the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 and further amended by the Taxation (Annual Rates 2015–16, Research and Development, and Remedial Matters) Act 2016.
Employee share schemes	<i>Sections DC 12-15, CE 2</i>	Further analysis shows that qualifying share schemes are or can be tax expenditures.
Research and Development – cashing out tax losses	<i>Subpart MX</i>	Added by the Taxation (Annual Rates 2015–16, Research and Development, and Remedial Matters) Act 2016.

Quantification Methods

This section provides further information on the methods used to obtain those expenditures listed in table 2.

Quantified Tax Expenditures

Charitable or other public benefit gifts by a company: deduction

This item is sourced from the Income Tax return for companies (IR4). The values returned are the amount of donations made; the tax expenditure associated with these donations are the amount of donations multiplied by the company tax rate prevailing for the tax year in which the donations are returned.

Analysis of filing patterns in the previous two years suggests that claims for donation-related deductions are generally available by April the following year, and additional claims for a deduction are not large. Consequently, data for 2014/15 uses the claims information available at the end of April 2016.

The forecast for 2015/16 is, in the absence of better information, held at the same level as for 2014/15.

Charitable or other public benefits: tax credit

This item is sourced from the tax credit claim form (IR526) and from Employer Monthly Schedules for payroll giving.

Analysis of filing patterns for the IR526 return suggests that over 90 percent of claims for tax credits in the 2014/15 year will be received by April 2016. Consequently, for the estimated actual figure for 2014/15 we have assumed a small scale up on the credits received by April.

The forecast for 2015/16 is, in the absence of better information, held at the same level as the 2014/15 estimate.

The (small) payroll giving component of the donations reported in this expenditure are available within 20 days of the end of the month in which the donation was made, and actual data is used for the 2014/15 year. The forecast for 2015/16 is held at the same level as for 2014/15.

Independent earner tax credit

The Independent Earner Tax Credit (IETC) can be claimed at year end, or during the year through the PAYE system. For the year-end claims, the amount is compiled directly from IR3 tax returns or personal tax summaries. For the PAYE claims of people who do not square up at year end, the amount of IETC claimed is imputed monthly from the PAYE earnings of people who have selected 'ME' tax codes for their PAYE. This monthly imputation annualises the earnings of that particular month, and imputes entitlement on the basis of these monthly earnings, not on the basis of the annual earnings.

The final step in quantification of IETC for any given return period is an estimate for late claims. Not all claims are made within a year of their entitlement, and back periods can continue to grow as late claims are made through the square-up process. From past experience, over \$20 million of additional claims can be made in second and subsequent years.

Maori Authorities: donations

This item is sourced from the Income Tax return for Maori authorities (IR8). The values returned are the amount of donations made; the tax expenditure associated with these donations is the amount of donations multiplied by the Maori authority tax rate for the tax year in which the donations are returned.

Analysis of filing patterns in the previous two years suggests that claims for donation-related deductions are generally available by April the following year, and additional claims for a deduction are not large. Consequently, data for 2014/15 uses the claims information available at April 2016.

The 2015/16 year is estimated to be similar to 2013/14.

Appropriated spending through the tax system

Child tax credit, Family tax credit, In-work tax credit, Parental tax credit, and Minimum Family tax credit

Historical values for these Working for Families tax credits are provided by Inland Revenue's Crown Accounting team, based on actual expenditure on these credits. These items are also formally forecast as part of the preparation of the Government's Budget process, and the values reported in the Tax Expenditure statement are taken from these forecasts.

KiwiSaver tax credit

The KiwiSaver tax credit reflects the combined expenditure on (historically) Kickstart, Member Tax Credit and interest payments made by Inland Revenue relating to the period when contributions to members' scheme providers are held by Inland Revenue.

Historical values for these tax credits are provided by Inland Revenue's Crown Accounting team, based on actual expenditure on these credits. This item is also formally forecast as part of the preparation of the Government's Budget process, and the values reported in the Tax Expenditure statement are taken from these forecasts.