TE TAI ŌHANGA
THE TREASURY

Reference: 20210590

18 January 2022

[redacted]

Dear [redacted]

Thank you for your Official Information Act request, transferred to the Treasury from Inland Revenue on 10 December 2021. You requested the following:

Joint Report Tax Policy Scorecard Review

Information being released

Please find enclosed the following document:

Item	Date	Document Description	Decision
1.	12 November 2021	Tax Policy Report T2021/1273 IR2021/551: Tax Policy Scorecard Review	Release in part

I have decided to release the relevant parts of the document listed above, subject to information being withheld under the following sections of the Official Information Act:

- names and contact details of officials, under section 9(2)(g)(ii) – to maintain the effective conduct of public affairs through protecting Ministers, members of government organisations, officers and employees from improper pressure or harassment, and
- direct dial phone numbers of officials, under section 9(2)(k) – to prevent the disclosure of information for improper gain or improper advantage.

Direct dial phone numbers of officials have been redacted under section 9(2)(k) in order to reduce the possibility of staff being exposed to phishing and other scams. This is because information released under the OIA may end up in the public domain, for example, on websites including Treasury's website.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

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https://treasury.govt.nz

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Stephen Bond
Manager, Tax Strategy

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

TE TAI ŌHANGA
THE TREASURY

Tax Policy Report: Tax Policy Scorecard Review

Date:	12 November 2021	**Report No:**	T2021/1273, IR2021/551
		File Number:	SH-13-5-8

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Agree** to the proposed changes to clarify the purpose and management of the Tax Policy Scorecard.	none
Minister of Revenue (Hon David Parker)	**Agree** to the proposed changes to clarify the purpose and management of the Tax Policy Scorecard.	none

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
James Adams	Graduate Analyst, the Treasury	N/A	s9(2)(g)(ii)	✓
Stephen Bond	Manager (acting), the Treasury	s9(2)(k)		
Sam Rowe	Policy Lead (acting), Inland Revenue			

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Tax Policy Report: Tax Policy Scorecard Review

Executive Summary

This report clarifies how the direct fiscal impacts of tax changes should be managed through the Tax Policy Scorecard.

What is the Scorecard?
The Scorecard is a memorandum account that allows the fiscal impacts of tax policy changes to be offset against one another, rather than being managed through Budget allowances or the between-Budget contingency. Both revenue-positive and revenue-negative initiatives can be charged against the Scorecard, with the proviso that the Scorecard balance must remain positive.

Issues with the current approach
The Tax Policy Scorecard generally works well. It makes it easier to progress small tax policy changes, which are important for the fair and effective functioning of the tax system. It also encourages officials to advance a tax policy work programme that is approximately fiscally neutral over time.

However, there has been a lack of clarity as to which tax policy changes can be managed through the Scorecard. There have also been some issues managing the Scorecard's balance, although it has not become negative. There have been many small, revenue-negative items charged to it, whereas there have been fewer, larger, revenue-positive items. This has caused the balance to rise unpredictably and then fall over time. Alongside the uncertainty as to the Scorecard's scope, the sometimes fairly limited balance has impeded efforts to prioritise the most high-value tax policy changes.

Improving the management of the Scorecard
Officials recommend that the Scorecard should be the default funding mechanism for managing the direct fiscal impacts of non-structural tax policy changes that improve the tax system. Changes that represent a significant departure from existing settings (such as a decision to, for instance, introduce a new personal income tax rate), departmental or social policy funding, or the impact of policies that use the tax system to advance non-tax objectives should be excluded.

Officials also propose to cap the Scorecard balance at $200m over the forecast period and to retain the rule that the balance may not fall below zero. Officials will aim for the Scorecard balance to be broadly revenue-neutral over time.

Role clarity and reporting
Officials recommend reinstating an earlier practice of reporting to Ministers on the Scorecard balance and possible tax policy changes that could be managed through it. This would improve transparency and encourage effective prioritisation.

Inland Revenue will continue to be primarily responsible for developing tax policy proposals and identifying their fiscal impacts. With the exception of changes with a fiscal impact greater than $10 million each year, other significant fiscal or economic effects, or core Government priorities, the Treasury's role is to provide limited comments on the policy, providing second-opinion advice to Ministers, and ensuring that the fiscal impacts are treated appropriately. The two agencies will continue to advise jointly on more significant tax policy changes.

We will seek your approval to add the revenue effect of a particular policy item to the scorecard when we report to you on that policy item.

Recommended Action

We recommend that you:

a **agree** the Scorecard should be the default mechanism for managing the direct fiscal impacts of tax policy changes that improve the tax system, excluding structural changes, social policy, and departmental spending;

Agree/disagree

b **agree** that the Tax Policy Scorecard should be broadly revenue-neutral over time, and its balance should not fall below zero nor exceed $200 million;

Agree/disagree

c **agree** that Inland Revenue and the Treasury will report approximately 2-3 times each year on the Scorecard's balance, the likely effect on the balance of upcoming changes, which changes officials have prioritised, and why;

Agree/disagree

d **note** that officials will also report on the Scorecard's balance as part of the development of the Tax Policy Work Programme, and will continue to seek Ministerial agreement to all tax policy changes and their fiscal impact, whether or not they are managed through the Scorecard.

Noted.

Stephen Bond
Acting Manager
The Treasury

Emma Grigg
Policy Director
Inland Revenue

Hon Grant Robertson
Minister of Finance

Hon David Parker
Minister of Revenue

Tax Policy Report: Tax Policy Scorecard Review

Purpose of Report

1. This report clarifies the purpose and scope of the Tax Policy Scorecard. It also seeks your agreement to officials' recommended approach to managing the fiscal impact of tax policy changes. If you agree, this will:
   - ensure that tax policy initiatives are appropriately prioritised, both in relation to other tax policies and general spending;
   - protect the fairness and functioning of the tax system; and
   - provide certainty as to the responsibilities of Inland Revenue and the Treasury in managing the Scorecard.

Context

Why is there a Scorecard?

2. The Scorecard was introduced in 2009 as part of an effort to manage the aggregate cost of the Tax Policy Work Programme. Officials and Ministers recognised the importance of continuing to maintain and improve the tax system, which is achieved by passing a large number of small, remedial amendments to tax laws each year.

3. Prior to its introduction, savings from revenue-positive items were returned to the Crown, while revenue-negative items were charged against the between-Budget contingency, managed through the Budget allowance, or pre-committed against the next year's Budget. While this approach gave Ministers the opportunity to trade tax policy initiatives off against other priorities, it came with difficulties:
   - Because revenue raised from small tax policy changes was returned to the centre while revenue forgone was charged against allowances, it was more difficult for Ministers to progress a balanced tax stewardship programme;
   - Assessing minor policy changes through the Budget process was administratively costly, while relying on out-of-cycle funding undermined the use of allowances; and
   - Tax legislation timeframes were poorly aligned with Budget decision-making points.

4. The Scorecard was intended to be the default mechanism to account for the revenue impacts of (at least) remedial tax policy changes. Officials have been unable to locate the paper originally establishing the Tax Policy Scorecard, and recollections of its original purpose vary. However, the only available report on the Scorecard's scope indicates that it should be used to manage the revenue impacts of "non-structural" tax policies.

5. Structural tax changes were excluded on the basis that some changes should be traded-off against a wider set of competing Government priorities. This could be achieved through the Budget process or implementing the change out-of-cycle. Expenditure items (i.e. items that impact appropriations) were also excluded.

The Scorecard is a principled departure from the Fiscal Management Approach (FMA)

6. The centrepiece of the Fiscal Management Approach (FMA) is that spending decisions are made through the annual Budget process. This allows options for new spending to be traded-off against one another, producing a package of initiatives that best achieves the Government's objectives.

7. The Scorecard is a departure from this approach. Because it effectively pre-commits revenue gains from various tax measures to fund subsequent tax expenditures, it arguably lowers the Government's ability to allocate resources across priority areas. It also lowers the overall level of transparency associated with fiscal decision making. In this way, fiscal flexibility is traded-off for a higher degree of certainty that coherence-enhancing tax policy will be progressed.[1]

8. However, the Scorecard generally works well, and so officials recommend that it should be retained. In particular, it enables tax officials to develop, assess and implement a programme of non-structural tax changes, which is important for maintaining the functioning and fairness of the tax system.

Issues with the current approach

9. The Scorecard was intended to be the default mechanism to account for *at least* the revenue impacts of remedial tax policy initiatives (i.e. small 'fixes' to tax law). In practice, it has also been used to account for tax changes of various fiscal sizes, from very small to more than $100 million over the forecast period.

10. Additionally, the process for trading these initiatives off against one another has been inconsistent over time. Alongside uncertainty as to the Scorecard's scope and balance, this impeded efforts to prioritise the highest value-for-money tax changes.

11. Further, some initial processes that were supposed to govern the Scorecard's management have fallen away, such as quarterly reporting to Ministers. These factors have resulted in the usefulness of the Scorecard as a funding mechanism fluctuating over time.

12. Officials therefore see several interconnected issues that should be addressed:

    - **Scope:** Ministers and officials should be clear which tax policy changes can be managed through the Scorecard;
    - **Sustainability:** the Scorecard's balance should enable high-value tax policy changes to be advanced, protecting the fairness and functioning of the tax system, while not undermining the Government's wider fiscal management objectives;
    - **Prioritisation:** items on the Tax Policy Work Programme should be prioritised with funding sources in mind from the outset;
    - **Role clarity and transparency:** Inland Revenue and the Treasury's roles in managing the Scorecard should be clear, and Ministers should have sufficient opportunities to influence the management of the Scorecard.

[1] That said, the Between Budget Contingency and the option to pre-commit expenditure against future Budget allowances also reduce the Government's ability to allocate resources transparently and efficiently through the annual Budget.

13. Whatever decisions are made to address these issues, tax policy decisions that are within the scope of the Scorecard could still be funded through the Budget process, as pre-commitments, or through the between-Budget contingency. As a result, none of the proposals in this paper limit Ministerial freedom; they only seek to improve the default settings.

The Scorecard's scope

14. The first issue is which tax policy changes should be managed through the Scorecard. Officials recommend that the Scorecard should be limited to:

- managing the direct fiscal impacts…
- of tax policy changes that improve the tax system…
- excluding structural changes, social policy, and departmental spending.

The Scorecard should primarily – but not exclusively – be used to manage the revenue impacts of tax policy changes

15. At present, only revenue impacts – that is, the fiscal impact of changes in tax revenue – are managed through the Scorecard. By contrast, changes to appropriations are not accounted for though the Scorecard. But, because the Scorecard operates akin to an allowance, it could be used to fund appropriation impacts, too.

16. Officials consider that the Scorecard should primarily be used to account for revenue impacts, as these are what makes tax policy distinctive from other policy areas. However, in limited circumstances, officials recommend that non-revenue impacts (i.e. changes to appropriations) should be accounted for through the Scorecard, especially in preference to managing the revenue and non-revenue impacts separately where both are the direct result of a single change. This would represent a change from existing practice.

17. For instance, changes to Use Of Money Interest (UOMI) tend to affect the impairment of tax debt, and impairment is appropriated. It would make it more difficult to progress policy changes in this area if the revenue impact of UOMI changes were managed through the Scorecard while the non-revenue impacts were accounted for elsewhere (such as through the BBC or a pre-commitment against the next year's Budget allowance).

18. This would be a moderate expansion of the Scorecard's scope. However, officials consider that any risk associated with the change can be managed through the other restrictions set out in this report, including that only direct fiscal impacts should be accounted for through the Scorecard, and that departmental and social policy funding should be specifically excluded.

Tax changes made for non-tax reasons should be treated separately

19. Second, only the fiscal impact of changes intended to improve the tax system itself should be managed though the Scorecard. This is not as redundant as it sounds. In some instances, tax policy is changed to advance the Government's wider objectives. A tax exemption might be provided to support a specific taxpayer or to promote a particular activity, for example.

20. Officials recommend that the cost of such exemptions should ideally be assessed against alternative means of achieving the Government's objectives in the relevant area. The alternative to this limitation would be deeply undesirable: it would make it easier to use the tax system to advance these non-tax goals than to achieve these

goals by other means, and it could undermine tax officials' ability to advance a coherent programme of tax changes intended to improve the fair and efficient collection of tax revenue.

Structural tax change should also be excluded

21. Finally, by 'non-structural,' we mean tax policies that are not a significant departure from existing tax settings (see **Box 1** below for examples). This includes, but is not limited to, items in the remedial work programme. The 'non-structural' criterion is broadly consistent with existing practice.

Box 1. Examples of structural and non-structural tax policy

A structural tax policy change is any change that represents a significant departure from existing tax policy settings. For example:

- Denial of interest deductions for residential property owners
- The introduction of the 39% tax rate
- Tax loss carry-forward

A non-structural tax policy is therefore a change that does not represent a significant departure from existing tax policy settings. For example:

- Preventing local authorities from converting unused imputation credits into tax losses (policy change to align rules with the policy intent).
- Allowing deductions for donated trading stock.

22. The 'non-structural' test is broader than possible alternative approaches, such as re-scoping the Scorecard to only fund either remedial items or ad hoc, time sensitive items. One downside is that it allows for more hypothecation of tax revenue, reducing the opportunities to compare tax policy changes and other policy changes through a consistent process.

23. That said, re-scoping the Scorecard to deal with only remedial or time-sensitive items substantially reduce its usefulness as a funding option. It would increase the demand on other funding sources, such as Budget allowances or the between-Budget contingency. It would also likely impede the efficient and timely maintenance of the tax system. For these reasons, officials consider that the structural / non-structural distinction strikes an appropriate balance between maintaining the tax system and managing the Crown's finances consistently.

24. Changes that do not meet these criteria – those that relate to social policy or departmental funding, would not improve the tax system, or would amount to a structural change – will continue to be managed through the Budget process or out-of-cycle funding, as appropriate.

Funding the Scorecard

Several other rules should apply to the Scorecard

25. The Scorecard's scope influences which processes are the most appropriate for funding it. Officials' preferred approach is that the Scorecard becomes the default mechanism to account for eligible tax policies, it would remain a memorandum account, and its balance would be subject to both a cap and a floor.

26. Making the Scorecard the default mechanism for items that meet the three criteria above increases funding predictability. Although Ministers will continue to have final say over which allowance a revenue-negative item is charged to and whether savings from revenue-positive items are returned to the centre, choosing not to manage revenue-positive changes through the Scorecard will significantly compromise its usefulness.

27. Officials further recommend that the Scorecard remain a memorandum account. Imposing a cap on the Scorecard's balance of $200 million (with excess funding being returned to the centre) and confirming a floor of $0 would also ensure the non-structural work programme is broadly revenue-neutral over time. This mitigates some of the risk associated with reduced fiscal flexibility.

These proposals have some risks, but are preferable to the alternative

28. There are two main downsides to these proposals. As described above, the non-structural work programme would remain separate from the Budget process, and so non-structural tax policy changes would not be directly traded-off against other priorities.

29. Second, because it is self-funding, revenue-positive items must be progressed to pay for revenue-negative items – even if they do not provide the most benefit to the tax system.

30. However, introducing a cap mitigates the hypothecation risk, and regular reporting on the Scorecard's balance will help to ensure the work programme does not become unbalanced.

31. Officials also considered funding the Scorecard through each year's Budget. Funding would be sought each year to advance tax policy changes, and any excess funds would be returned to the centre. This option is more transparent and would allow Ministers to directly weigh tax system maintenance against their other priorities. However, it is likely to reduce the quantity and timeliness of non-structural tax policy changes. Over time, this would reduce the fair and efficient functioning of the tax system.

Prioritisation and role clarity

Further reporting to Ministers would encourage better management of the Scorecard

32. Currently, the Minister of Revenue and the Minister of Finance must agree to the Tax Policy Work Programme ("TPWP"), and this will continue. Officials also propose to use the development of the TPWP to assess how the fiscal impacts of expected tax policy changes could be managed. This would include estimating what effect the TPWP would likely have on the Scorecard's balance and identifying which items should be managed outside of the Scorecard.

33. Once established, however, Ministers are updated only intermittently on the TPWP's status and the fiscal impact of policy changes. It was originally anticipated that the Treasury and Inland Revenue would report quarterly to Ministers on the Scorecard balance and any upcoming items, but the practice has fallen away. However, this has meant that Scorecard management has tended to operate on a 'first come, first served' basis. Officials therefore recommend reinstating some form of reporting, both in the interests of transparency to Ministers and to motivate effective prioritisation efforts.

34. If the reporting is too burdensome, it is unlikely to last. However, reports should:

- specify the Scorecard's current balance;
- anticipate how future items might affect the balance;
- explain which items officials have prioritised and why.

35. Initially, officials recommend reporting with each Omnibus Tax Bill and when reporting on the work programme generally, which will occur approximately every nine months. That would result 2-3 reports each year. These reports would be written by Inland Revenue and the Treasury.

36. This change would complement existing reporting mechanisms. Ministers will continue to authorise each tax policy change (and whether its fiscal effect is charged to the scorecard):
    - The Minister of Revenue authorises tax policy changes that have no fiscal impact and are insufficiently significant to be referred to Cabinet;
    - The Minister of Revenue and Minister of Finance jointly authorise tax policy changes that do have a fiscal impact and are insufficiently significant to be referred to Cabinet; and
    - The most significant tax policy changes are decided by Cabinet.

37. Further, ahead of each Omnibus Tax Bill, the Minister of Revenue's approval will be sought to include completed policies in the Bill.

Inland Revenue and the Treasury have different but complementary roles

38. When prioritising which tax policy changes to design, assess and implement, officials should consider from the outset their likely fiscal cost and how they could be funded.[2]

39. As agreed between Inland Revenue and the Treasury, the two agencies jointly advise the government on all tax policies that may have a fiscal impact greater than $10 million per year, those that have other significant economic impacts or which are core Government priorities.

40. For all other tax policy work, Inland Revenue is generally responsible for developing proposals and identifying their fiscal consequences. The Treasury's role is to provide limited comments on the policy, providing second-opinion advice to Ministers (if necessary), and making sure that the fiscal impacts are treated appropriately – for instance, ensuring consistency with the decisions taken in this report. The Treasury will also keep a definitive record of the Scorecard's balance and the items that have been managed through it.

41. In this way, clarifying the role and processes of the scorecard will allow the Treasury to more effectively prioritise its own resources towards high-value advice on tax policy and fiscal management, as well as avoiding duplication of effort and resource on small tax policy changes across both Treasury and IR. Officials are investigating other process improvements that will similarly improve the prioritisation of resources by Inland Revenue and the Treasury.

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[2] There are limitations as fiscal costings require finalised policy design, so this is just intended to be high level at the planning end of the policy project.