The Treasury

Budget 2023 Tax Initiatives Information Release

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POLICY AND REGULATORY STEWARDSHIP

TE TAI ŌHANGA
THE TREASURY

Joint Report: Further Advice on Personal Tax Relief

Date:	28 February 2023	**Priority:**	High
Security level:		**Report number:**	IR2023/038 T2023/303

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson) **Minister of Revenue** (Hon David Parker)	**Agree** to the recommendations **Provide** feedback on the attached slide pack and **indicate** which elements should be included in final advice	Wednesday, 1 March 2023

Contact for telephone discussion (if required)

Name	Position	Telephone
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Joint Report: Further Information on Personal Tax Relief Options

Purpose of Report

1. This report provides additional information on possible personal tax relief measures for Budget 2023, and includes slides for possible use at Budget Ministers 3 on 8 March 2023, to further narrow down options. It seeks direction on Ministers' preferred approach, to enable the provision of final policy advice, including detailed analysis of impacts, costings and further information on implementation matters, on 14 March.

Personal tax relief options for Budget 2023

2. We recently provided initial advice on possible personal tax relief measures for Budget 2023 [IR2023-037 / T2023-157 refers]. You indicated a preference for approaches that provide relief at a low level of income, in particular:

- **Approach 1: Tax-free threshold** – this provides a gain to the greatest possible number of taxpayers, and ensures the full gain is achieved at a very low level of income.

- **Approach 2: Raising the $14k threshold** – this provides a greater gain at a level more consistent with earnings from active employment, and is expected to have some positive impacts on work incentives for part-time workers and for those working while receiving main benefits.

3. To support further consideration of the two approaches, you requested the following information around their different distributional and economic impacts.

Characteristics of individuals earning under $14k

4. The previous report noted that a significant proportion of those earning under $14k p.a. (i.e. individuals that would receive a gain from Approach 1 but not 2) are either temporarily on a low income (students) or are supported by someone with a higher income. Table 1 (reproduced from that report) provides a breakdown.

Table 1: Characteristics of individuals with income between $100 and $14,000

Characteristic	Number	% of total	Received main benefit at any time during year
Student	130,000	42%	7,000
Is a dependent child	10,000	3%	N/A
Partner with income >$14,000	102,000	33%	22,000
Single with no children	51,000	16%	14,000
Other	20,000	6%	3,000
Total	313,000	100%	46,000

5. You requested further information on partner income for the group with a partner earning more than $14k p.a. Table 2 provides a breakdown by family taxable income and shows that a significant proportion of the group has relatively high *family* income, with 55% over $70k p.a. and 34% over $100k p.a..

Table 2: Family income bands for individuals earning under $14k p.a. who have partners earning over $14k p.a.

Partner Taxable Income > $14,000	Family taxable income bands	Population	%
Yes	>$14,000	10,000	10%
	>$30,000	18,000	18%
	>$50,000	18,000	18%
	>$70,000	21,000	21%
	>$100,000	35,000	34%
Total		102,000	100%

6. The transfer system is generally a better means to target those on lower incomes as it typically uses family income as a means test. Further analysis of this will be provided as part of our final policy recommendations report.

Impacts for individuals with combined income from main benefits and wages

7. The previous report noted that an increase to the $14k threshold would be more effective at increasing the returns from work for people with combined income from main benefits and wages, whereas a tax-free threshold would have very little or no impact on this.

8. Appendix B provides a more detailed explanation of the different interactions of a tax-free threshold and a change to the $14k threshold with the main benefits interface.

9. In the timeframes we have not been able to run bespoke modelling, but existing data suggests that the share of beneficiaries that have concurrent earnings from employment is relatively low at a given point in time. Data from December 2019 suggests that only 5-10% of people receiving Jobseeker Support had earnings from employment within the same month.

Package options within expected fiscal cost range

10. Policy options for personal tax relief could be based either on a tax-free threshold or a change to the $14k threshold, or a combination thereof. The attached slides (Appendix A) provide some illustrative examples of tax relief packages at a fiscal cost of $2bn, $3bn and $4 bn p.a. This cost range corresponds to indicative revenue ranges available for a tax switch, and so also remains indicative.

11. The examples in the slides are intended to illustrate the range of possible approaches and their different high-level distributional and economic impacts, to support discussions about narrowing down the options for final advice. Other options based on these variables are possible within the cost range.

12. For packages with a fiscal cost over $2bn, there is significant opportunity and rationale for a combination approach. A change to the $48k threshold (which will soon be crossed by full-time workers earning the minimum wage) could also be considered in combination with the other measures as part of this.

13. Final advice, to be provided on 14 March 2023, will include full analysis of the impacts and costs of your preferred policy option, following confirmation of the preferred approach and fiscal parameters. It will also include the Treasury and Inland Revenue recommendation on the tax switch.

14. For the reasons set out in the previous report, the Treasury and Inland Revenue generally consider that a tax-free threshold would not be the best way of meeting your economic and distributional objectives. Both agencies are likely to recommend that changes in the $14k threshold will deliver a progressive tax change focused on lower-income earners, and that changes to either the $48,000 threshold or the 30% rate would help to minimise future impacts of fiscal drag around the steep increase to that rate.

Additional options

15. There are two additional areas on which feedback from Budget Ministers 3 would assist with final design and policy advice.

Providing an accompanying increase to main benefit rates

16. The previous report noted that tax changes do not have a direct impact on net rates for main benefits. Instead, there is a lagged indirect impact, via higher than otherwise wage indexation in the April following the tax change. For the types of tax measures under consideration, the increase from the indirect impact will be smaller than the direct gain for equivalent income from other taxable sources, including wages or New Zealand Superannuation.

17. If the preference is to provide an accompanying increase to main benefit rates, there would be options to do this by 'flowing through' the change (i.e. providing a direct increase equivalent to the tax change), or through a flat dollar increase. A flat dollar amount may be administratively simpler and gives more flexibility around the size of the increase.

18. You may also want to consider the level of any increase in the context of the recently agreed annual adjustment from 1 April 2023.

19. The estimated additional cost of accompanying a tax change with a $10 per week increase to main benefits is around $200 million per annum. The annual value of this would be comparable to a $5,000 tax-free threshold, excluding the indirect impact on rates via indexation. The cost of 'flowing through' the change would depend on the size and type of the tax relief measures, but is likely to be in the same rough relative order of magnitude. The example packages included in the slide pack do <u>not</u> include the cost of an accompanying benefit rate increase.

20. We can provide a slide on this sub-option if you consider it would be useful to support discussions at Budget Ministers 3. If the option of an increase to main benefit rates is to be progressed further, we would need to engage with Ministry of Social Development (MSD) officials.

21. Minister Parker raised a question about changes to the benefit abatement rate regime as an alternative to a possible increase in the main benefit rate. Reforms to the benefit abatement regime could increase incomes for some beneficiaries (those with combined income from main benefits and work) and could improve work incentives for some beneficiaries. However, there would be no simple mechanism to pass on the benefit of a tax-free threshold to the abatement regime without fundamental changes to the tax and welfare interface that we are not able to advise on or deliver in the time available. While changes to benefit abatement settings may be possible, their impacts are

independent of the choice of tax change. They would also have wider interactions across the transfer system and would require urgent engagement with MSD.

Removing or amending the Independent Earner Tax Credit (IETC)

22. The IETC provides a maximum entitlement of $520 per year. In the 2020-21 tax year around $212 million was paid to 493,400 recipients. The fiscal cost of IETC has been reducing by around $10 - $15 million a year due to income growth. There have been no changes to the tax credit since its implementation.

23. The previous report noted that the IETC is now providing a gain at a different level of the income distribution than originally intended and that consideration could be given to its removal or amendment as part of any personal tax system changes.

24. Analysis using the TAWA model for the tax year 2024/2025 suggests 53% of IETC recipients have partners with taxable income. Table 3 summarises the income distribution for this group. It indicates that most have partners earning over $70,000.

Table 3: Partner income for recipients of the IETC who have partners with taxable income (TAWA model outputs for 2024/25 tax year)

Partner income band ($)	Population	Total IETC ($)
Up to $14,000	11,000	$ 4,712,000
$14,001 -$31,000	13,000	$ 5,343,000
$31,001 - $48,000	15,000	$ 6,919,000
$48,001 - $60,000	11,000	$ 5,249,000
$60,001 - $70,000	12,000	$ 5,347,000
$70,001 - $100,000	42,000	$ 19,545,000
$100,001 - $125,000	24,000	$ 11,141,000
$125,001 - $150,000	14,000	$ 6,312,000
Over $150,000	25,000	$ 11,071,000
All	167,000	$ 75,638,000

25. Any options to re-align the IETC to the level of the original income distribution are not expected to significantly improve its effectiveness at meeting possible objectives, such as improving work incentives (in particular, there could be some negative impacts, as abatement thresholds would interact with higher marginal tax rates) or improving income adequacy for families, given it is based on individual income. Options to amend the IETC in this way would also increase the fiscal cost.

26. Officials therefore continue to recommend the best approach is to remove the IETC. This can best be achieved as part of other measures that reduce tax, to help mitigate the impacts on current recipients.

27. Removing the IETC from April 2024 could result in savings of around $139 million in 2024/5, decreasing over the forecast period. Savings could be used to offset some of the fiscal cost of the personal tax relief measures.

28. If the IETC is left unchanged, the fiscal cost is expected to continue reducing as the number of people within the eligible income band decreases due to income growth.

Implementation

29. You have indicated a preference for implementation in September or October 2023. We note that the implementation of a tax-free threshold on 1 September 2023 would of necessity be limited to a 1 September 2023 change for PAYE (which would be reliant

on 3rd parties and software providers being able to update software to support employer changes) while other withholding taxes such as RWT and PIE tax would need to be adjusted at 1 April 2024. Inland Revenue would use a composite rate across the tax year to apply the tax changes as part of the end of year tax calculations. This staggered implementation is likely to result in more people being issued with refunds following their end of year tax assessment.

30. If Ministers prefer increasing the $14k threshold, it is likely that the change could be applied across a range of tax types at the implementation date. This is because private sector organisations would be unlikely to need to make system changes although they would need to deal with customers making tax rate change requests.

31. Phased implementation of any changes that are progressed could support fiscal objectives but may give rise to higher administration costs. If your preferred approach is a combination of changes (e.g. a tax-free threshold and an increase to the $14,000 threshold), these could be phased: for mid-year implementation, changing an existing threshold would be simpler than implementing a tax-free threshold.

32. Removing the IETC would also be considerably more complicated if done as a mid-year change due to the eligibility requirements relating to full-year income. As such, any change to IETC would also be delivered at 1 April.

33. Further information on implementation will be provided as part of the policy recommendations report.

Next steps

34. Subject to your initial feedback, officials can prepare an updated version of the slides to support your discussion of tax options at Budget Ministers 3 on 8 March.

35. Full policy advice will be provided on Ministers' preferred option on 14 March 2023, following confirmation of the fiscal parameters. This will include detailed analysis and advice, including the Treasury's and Inland Revenue's recommendation on options.

36. After discussions at the Joint Ministers meeting on 16 March 2023, draft Cabinet papers and Regulatory Impact Assessments will be provided to you on 17 March. Following final decisions at Budget Ministers 5 on 31 March, Cabinet papers will be finalised for lodging on 5 April.

Recommended Action

We recommend that you:

a **Provide** feedback on the attached slide pack for possible use at Budget Ministers 3 on 8 March 2023 to support discussions on narrowing down options for personal tax changes;

Yes / No

b **Discuss** personal tax options at Budget Ministers 3 and provide feedback to officials on your preferred approach and application date;

Yes / No

c **Indicate** whether, on the basis of the information in this report, the following additional elements should be considered in final advice:

a. Options for an accompanying increase to main benefit rates;

Yes/No

b. Removing the Independent Earner Tax Credit (application date from 1 April 2024);

Yes/No

d **Note** that, following confirmation of your preferred approach, officials will provide you with advice on final policy options and costs, including the Treasury's and Inland Revenue's recommendation, on 14 March 2023 ahead of Budget Ministers 4.

Stephen Bond
Manager
The Treasury

Paul Young
Principal Policy Advisor
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2023

Hon David Parker
Minister of Revenue
/ /2023

Appendix A: Slide Pack: Illustrative Options for Personal Tax Relief

Appendix B: Impact of tax changes on the return from work for people working while also receiving a main benefit

The following analysis looks at the interactions of tax changes costing approximately $2 billion and the main benefit system. We consider a tax-free threshold of $5,000 per annum, and lifting the bottom threshold from $14,000 to $22,000.

The impacts of a tax change for people who have a combination of benefit and wage income vary depending on circumstances, including benefit type and amount of income from wages. Generally, the likelihood of an individual gaining from a tax change increases as they earn more of their income from wages.

The calculations are based on Jobseeker Single 25+ rate of $337.74 per week (after tax, from 1 April 2023) and a minimum wage rate of $22.70 per hour (gross, from 1 April 2023). The gains in the table are annual gains spread evenly across each week of the year[1].

Table 1: Net income gain for three beneficiary scenarios

Income sources:	**Tax-free threshold** (max gain of $10.10 per week, $525 per annum)	**Lift bottom threshold** (max gain of $10.77 per week, $560 per annum)
Scenario 1: Main benefit only	No change	No change
Scenario 2: Main benefit (unabated) plus 5 hours work at the minimum wage ($113.50pw gross)	No change	$3.20 extra per week, $166.40 per annum
Scenario 3: Main benefit (abated) plus 15 hours work at the minimum wage ($340.50pw gross)	$0.79 extra per week, $41.06 per annum	$10.77 extra per week, $560 per annum

Scenario 1: Main benefit only

- The main benefit rate is set net of tax and therefore changes in tax settings won't increase these beneficiaries' incomes. Instead, the changes will reduce the amount of tax paid on the main benefit (i.e., the gross amount decreases), though in practice this does not impact on the client.
- The tax changes will indirectly flow through to future main benefit rates via higher than otherwise wage indexation. This will not happen immediately, but as part of the Annual General Adjustment on 1 April each year.

Scenario 2: Main benefit plus 5 hours of work at the minimum wage

- Under this scenario, beneficiaries would receive the full rate of main benefit. This is because their gross weekly income from wages ($113.50) is below the abatement threshold of $160 per week (this is assessed weekly but is equivalent to $8,320 per annum, gross).
- Gross annual wage income is $5,902 at 5 hours per week.

[1] In practice, people on a benefit will likely be using a secondary tax code on their wage income, which applies a flat rate of tax. This means that unless they are using a tailored code, they will not receive the gains until Inland Revenue finalises their tax assessment for the year. A tailored tax code is a PAYE tax rate worked out to suit individual circumstances. It can be applied to salary and wage income but not to a main benefit. Main benefits must always be taxed as the main source of income.

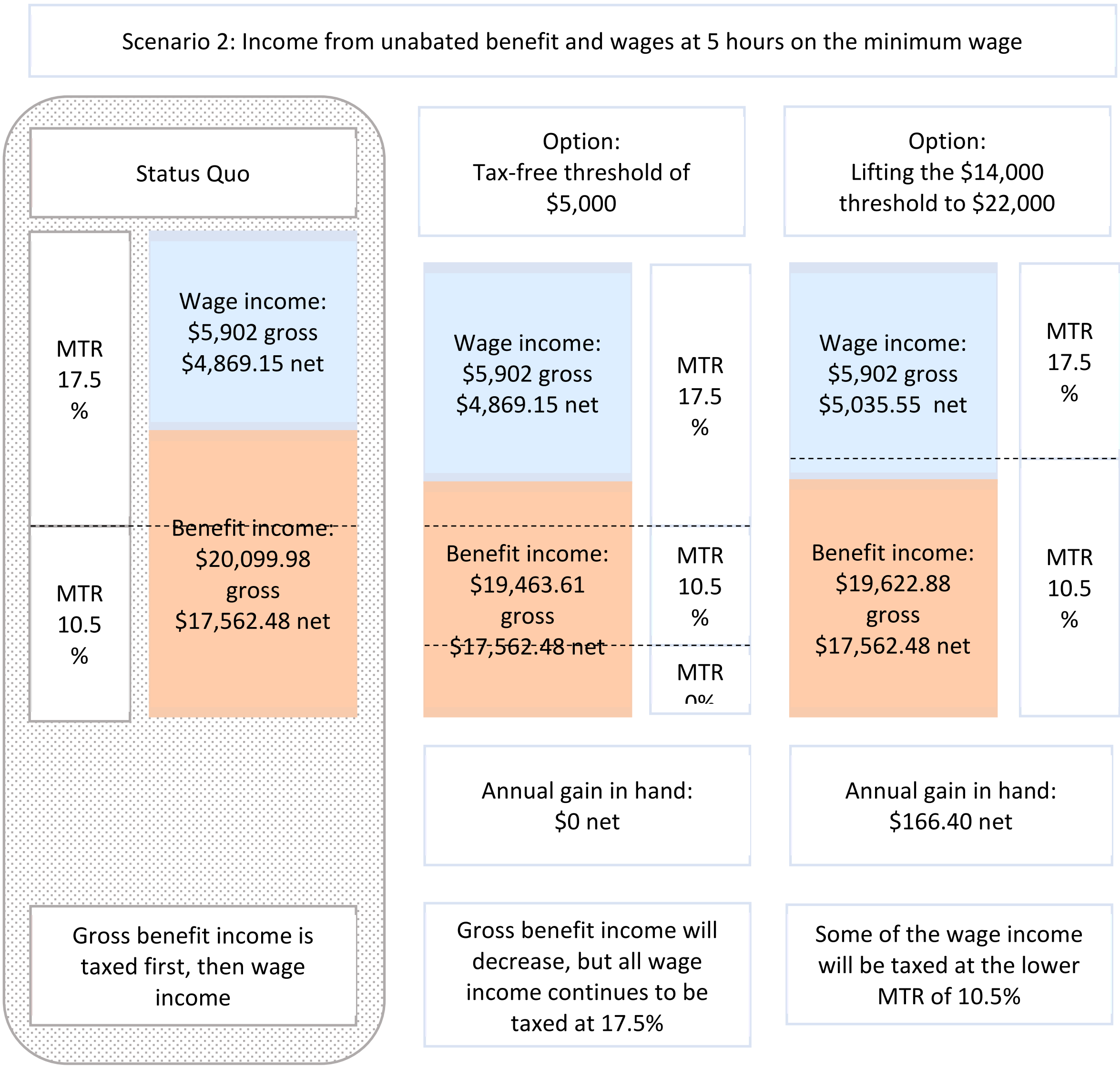
Tax Free Threshold –

- A person working five hours per week at the minimum wage in addition to income from the main benefit would not see any change in their overall take-home income from a $5,000 tax-free threshold. This is because the gross value of their main benefit still exceeds the $5,000 and $14,000 tax thresholds. Any wage income would continue to be taxed at their current 17.5% marginal tax rate.

Lifting the $14,000 threshold –

- A person working five hours per week at the minimum wage in addition to income from the main benefit may see a change in their overall take-home income from an increase to the $14,000 threshold. This will be the case if the new gross amount of the main benefit is below the level of the new bottom threshold. The after-tax income would increase because the wage income between the gross amount of main benefit and the new threshold would be taxed at the lower tax rate.
- The increased take-home pay received from wage income would act as a work incentive. However, this would only apply when the benefit rate is below the level of the new bottom threshold. For example, from 1 April 2023, the Jobseeker Single (20-24 years) will be $17,354.38 p.a. (gross, current tax settings) or $294.18 per week (net), so recipients would have some gain in take-home pay if the bottom threshold were raised to $22,000. In contrast, Sole Parent Support will be $28,612.22 per annum (gross, current tax settings) or $472.79 per week (net), so recipients who earn additional wage income would not immediately gain if the bottom threshold were lifted to $22,000.
- Figure 1 below shows the interaction between taxes and main benefits. This highlights that whether or not a person will gain from tax changes is dependent on the income level at which the tax change is made and the level of benefit income received. The example is based on scenario 2, but the same mechanics apply in scenario 3.

Figure 1: Impact of tax changes for beneficiaries with wage income



Scenario 3: Main benefit (abated) plus 15 hours of work at the minimum wage

- Under this scenario, 15 hours of work would reduce the net main benefit by $126.35 per week ($6,570 per annum). This works the same regardless of tax settings as abatement of the net benefit is calculated based on gross income. As a result of abatement, the gross benefit rate is below $14,000 under the status quo and under the two illustrative tax options.
- Gross annual wage income is $17,706 at 15 hours.

Tax Free Threshold

- Under this scenario, none of the wage income is subject to the tax-free threshold if the person is receiving an abated benefit that is greater than $5,000 gross. However, there is a small increase in take-home income as a slightly higher share of the wage income is taxed at 10.5% instead of 17.5%. This is because the gross benefit is lower than under the status quo as a result of the tax-free threshold.
- For wage income to be subject to the tax-free threshold, it would need to be set at a level higher than the gross abated benefit.

- The tax-free threshold would not provide a work incentive in this scenario.

Lifting the $14,000 threshold –

- Under this scenario, the abated benefit is below $14,000 so the person would see the full increase in their take-home income from the reduction in the marginal tax rate from 17.5% to 10.5% for income between $14,000 and the new threshold.

Appendix C: Caveats and disclaimers (TAWA/IDI/costing assumptions)

1. These results are not official statistics. They have been created for research purposes from the Integrated Data Infrastructure (IDI) which is carefully managed by Stats NZ. For more information about the IDI please visit https://www.stats.govt.nz/integrated-data/. The results are based in part on tax data supplied by Inland Revenue to Stats NZ under the Tax Administration Act 1994 for statistical purposes. Any discussion of data limitations or weaknesses is in the context of using the IDI for statistical purposes, and is not related to the data's ability to support Inland Revenue's core operational requirements.