

An income splitting tax credit for families with children

An officials' issues paper

December 2009

Prepared by the Policy Advice Division of Inland Revenue

First published in December 2009 by the Policy Advice Division of Inland Revenue, PO Box 2198, Wellington 6140.

An income splitting tax credit for families with children – an officials' issues paper.
ISBN 978-0-478-27179-9

CONTENTS

Chapter 1	INTRODUCTION	1
	The consultative process	1
	An income splitting tax credit	2
	Link with Working for Families tax credits	2
	Annual cost	2
	What's in the issues paper	2
	Submissions	4
	How to make a submission	4
Chapter 2	THE POLICY PROCESS TO DATE	5
	Criteria used to assess income splitting	5
	What readers were asked to comment on	7
	What they said	7
	Development of the current proposal	8
Chapter 3	WHO WOULD BE ELIGIBLE	10
	The "whole-year" requirement	10
	Residence	10
	Dependent child	11
	Shared care arrangements	12
	Registration	12
	Submission points	13
Chapter 4	CALCULATION AND PAYMENT OF THE INCOME SPLITTING TAX CREDIT	15
	The information required	15
	How the calculation would be done	16
	Amount of the income splitting tax credit	18
	Payment of the entitlement	19
	Impact of tax credit on other payments and tax credits	19
	Submission points	19

Chapter 1

INTRODUCTION

- 1.1 Couples with children often face a choice between both parents working full-time, employing others to care for their children, and one parent working full-time and the other staying at home to care for the children, possibly on a part-time basis. For most people, financial considerations play a large role in the decision.
- 1.2 Introducing some form of income splitting for tax purposes has been suggested as one way of enabling parents to have greater choice in their work and caring roles. It could help to alleviate the financial constraints on parents being able to stay at home, and give them more choice around their work and home life balance.
- 1.3 UnitedFuture has proposed the introduction of income splitting, which “recognises that the spouse or partner who has chosen to work part-time or has opted out of the paid workforce in order to raise children is making a vital contribution to our society.” Over 300,000 families (around 60 percent of families with a dependent child) could benefit from this additional financial assistance.
- 1.4 In the confidence and supply agreement between National and UnitedFuture, National agreed to support “appropriate income splitting legislation” to First Reading in Parliament. The present consultation is a direct result of that agreement.

The consultative process

- 1.5 This issues paper is the second stage in a process of public consultation on the possible introduction of an income splitting system. It follows on from the April 2008 government discussion document, *Income splitting for families with children*. That discussion document looked at the merits of introducing income splitting as a way of providing additional support to families with children. It also asked whether there were better ways for the government to provide this support than by means of income splitting. A total of 205 submissions were received, with the majority from individuals who supported the introduction of some form of income splitting.

An income splitting tax credit

- 1.6 The approach to income splitting set out in this issues paper would involve an annual tax credit to eligible families, to be calculated by Inland Revenue. For the purposes of calculating the tax credit a couple's combined taxable income would be split equally, and the progressive tax rates would then be applied to each partner's share of the total. The total tax calculated on this notional basis would be compared with the couple's actual combined tax liability and the difference would be paid out by Inland Revenue as an "income splitting tax credit".

Link with Working for Families tax credits

- 1.7 Couples wishing to receive the income splitting tax credit would need to register online through the system used to deliver Working for Families tax credits. Using this existing process would minimise costs for both recipients and Inland Revenue.

Annual cost

- 1.8 We estimate that the income splitting tax credit described in this issues paper would cost in the order of \$450 million a year.
- 1.9 Inland Revenue would incur additional administrative costs in implementing and administering the income splitting tax credit. These would include an initial capital cost in the order of \$2 or \$3 million and annual operating costs averaging in the order of \$3 or \$4 million in the first five years. Increased contacts with taxpayers would represent about half of the operating costs.
- 1.10 An alternative to the 18-year age limit for income splitting would be to limit the tax credit to couples with a dependent child up to the age of six. This would reduce the annual revenue cost to approximately \$230 million and also reduce administration costs.

What's in the issues paper

- 1.11 The main focus of the issues paper is on how an income splitting tax credit might work, the eligibility requirements and the calculation of the proposed tax credit, rather than the arguments for and against introducing such a credit.

How the income splitting tax credit could work

Who would be eligible

A couple would be eligible for the income splitting tax credit if, for the relevant tax year, they are:

- spouses, civil union partners, or de facto partners;
- New Zealand residents; and
- primarily responsible for the day-to-day care of a dependent child or children aged 18 years or under.

Registration

Couples registered for Working for Families assistance would be automatically registered. Other couples who are eligible would need to register online through the system Inland Revenue uses to deliver Working for Families tax credits.

How it would be calculated

Inland Revenue would calculate the income splitting tax credit using the income details from the couple's individual tax returns, or from other sources (such as the employer monthly schedule) if no tax return is required. The couple's combined taxable income would be split on a 50/50 basis. Inland Revenue would carry out the following calculation:

- Step 1:** combine the total taxable incomes of both partners.
Step 2: equally split the total income between the partners.
Step 3: apply the personal tax rates to each income calculated under step 2.
Step 4: calculate the difference, if any, between the tax payable before income splitting and that payable under step 3.

Example

Spouse A's taxable income: \$60,000; tax is \$12,850

Spouse B's taxable income: \$10,000; tax is \$1,250

Taxable income of the couple before income splitting: \$70,000

Tax liability of the couple before income splitting: \$14,100

Step 1: total taxable income for couple: \$70,000

Step 2: spouse A: \$35,000 and spouse B: \$35,000

Step 3: spouse A and B's tax on \$35,000: \$6,160 each or \$12,320 total

Step 4: \$14,100 – \$12,320 = \$1,780

The income splitting tax credit of \$1,780 would be paid to the primary caregiver of the child.

Additional features

The income splitting tax credit would not generally affect, or be affected by, other entitlements or obligations administered by Inland Revenue, such as the payment of provisional tax, the independent earner tax credit, child support, or student loan repayments.

When it would start

The income splitting tax credit would begin in the tax year beginning 1 April 2012.

Submissions

- 1.12 Submissions are welcome on the workability of the proposed approach to income splitting. In particular, we are interested in hearing about any views on the submission points raised at the end of chapters 3 and 4.

How to make a submission

- 1.13 Submissions should be made by 5 February 2010 and addressed to:

Income splitting tax credit
C/- Deputy Commissioner
Policy Advice Division
Inland Revenue Department
P O Box 2198
Wellington 6140

- 1.14 Or email: policy.webmaster@ird.govt.nz with “Income splitting tax credit” in the subject line.
- 1.15 Submissions should include a brief summary of major points and recommendations. They should also indicate whether it would be acceptable for officials from Inland Revenue to contact those making submissions to discuss their submission, if required.
- 1.16 Submissions could be the subject of a request under the Official Information Act 1982, which could result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason, would be determined in accordance with that Act. Accordingly, those making a submission who think that any part of it should be properly withheld under the Act should indicate this clearly.

Chapter 2

THE POLICY PROCESS TO DATE

- 2.1 This chapter summarises the content of the April 2008 government discussion document, *Income splitting for families with children* and the submissions received. Although this issues paper is focused on the details of how an income splitting system would work, it is useful to recap the wider considerations around income splitting because they could influence the final design of the income splitting tax credit.

Criteria used to assess income splitting

- 2.2 The earlier discussion document considered the extent to which income splitting would meet the objective of providing choice to families with children. The document also assessed income splitting against the criteria of fairness, efficiency, simplicity and administrative costs. These criteria are taken into account by government as part of the development of tax policy.

Giving families greater choice

- 2.3 Income splitting was proposed as a way of enabling parents to have greater choices in their work and caring roles. Couples often face a choice between both parents working full-time, often using paid childcare, or one parent staying at home at least part-time to care for a child or children. Income splitting could help to alleviate the financial constraints on a parent's ability to stay at home and give parents more choice around their work and home life balance. On the other hand, the discussion document noted that income splitting might not be the best targeted measure to provide this choice, since the benefit of income splitting rises with primary earner income.
- 2.4 For families with lower incomes, for whom the financial constraints might be greater, income splitting would provide only small amounts of support. For example, a one-earner family receiving \$40,000 would gain only \$1,190 a year from income splitting, while a one-earner family on a single income of \$100,000 would gain \$8,450 a year.

Fairness

- 2.5 The discussion document explored the question of whether introducing income splitting for families with children would lead, at a reasonable fiscal cost, to a fairer outcome for families than is currently the case.
- 2.6 The decision to tax on a family basis by allowing income splitting could increase perceived fairness in some areas at the expense of others. Whether taxing on a family basis is a good thing would depend on the relative weightings given to different goals.

- 2.7 With individual taxation, as at present, a one-earner family would pay more tax than a two-earner family when the two have the same total family income. This might be seen as unfair, particularly when considered in light of the Working for Families package.
- 2.8 Working for Families uses the family, rather than the individual, as its basis for determining the appropriate level of assistance for families. As such, it provides equal support to families in similar circumstances that have the same total family income (and the same number, and age, of children). However, while those families are treated equally for Working for Families purposes, some families would still end up worse off and others better off because income tax liabilities are calculated on an individual basis.
- 2.9 Income splitting for families with children would mean that a couple with a child would pay less tax than a couple without a child even though both had the same combined income. Income splitting could be said to be a way to recognise the contribution of stay-at-home parents, when the current individual system of taxation does not.
- 2.10 On the other hand, family income might not always accurately capture a family's ability to pay tax, and so may not be the fairest means of determining tax liability. It might be considered unfair for different couples with different work arrangements and the same combined income to face different tax burdens. Different work arrangements might result from one partner's ability to earn a high hourly wage. If one partner is not in paid employment he or she would have additional time available for valuable activities at home, such as childcare.
- 2.11 It might be perceived as unfair that the benefit from income splitting increases as primary earner income increases, providing more benefit to couples with higher incomes. This is shown in table 2 in chapter 4.

Efficiency

- 2.12 The discussion document explored whether income splitting would bias people's decisions to produce, consume, work, save and invest. It explained that the introduction of income splitting would lead to a decrease in effective marginal tax rates of some primary earners and an increase in the effective marginal tax rates of some secondary earners.
- 2.13 The lower effective marginal tax rates for primary earners would improve their incentives to work and to invest in their skills and move to better paid jobs. This is likely to boost labour productivity. In contrast, the increased effective marginal tax rates for secondary earners would reduce their work incentives, which could adversely affect their employment prospects and future productivity.

- 2.14 Evidence suggests that once people have been outside the workforce for more than a year their skills might begin to atrophy, resulting, in the long term, in a less productive workforce.¹ This could have an impact on economic growth. Furthermore, empirical evidence suggests that secondary earners, especially women, are more responsive than primary earners to changes in their after-tax incomes.²

Simplicity and administrative costs

- 2.15 The discussion document also noted that income splitting could be complex to implement. Consequently, in designing the details of an income splitting system there should be careful attention to providing a system that is easy to understand and fits with the rest of the tax system.
- 2.16 By implementing income splitting through the existing Working for Families tax credits system, income splitting would likely be relatively simple for people to comply with, and would restrict costs to an extent.

What readers were asked to comment on

- 2.17 The discussion document asked for readers' views on the following detailed policy design questions, if they were in favour of income splitting as the best way to provide additional support for families with children:
- whether family incomes should be split on a 50/50 basis, a 70/30 basis or in some other way;
 - how a “family” should be defined;
 - what restrictions should be placed on the children’s ages for a family to be eligible; and
 - whether income splitting should be optional or compulsory.

What they said

- 2.18 The discussion document attracted 205 submissions from individuals and a variety of organisations, including the Families Commission, the New Zealand Council of Trade Unions and the Child Poverty Action Group.

¹ See, for example, Jaumotte, F., (2003) “Female labour force participation: past trends and main determinants in OECD countries”, OECD Economics Department working papers No. 376; Fagan, C. and Walthery, P. “The role and effectiveness of time policies for reconciliation of care responsibilities”, paper presented to the OECD Conference on Life Risks, Life Course and Social Policy, Paris, 31 May – 1 June 2007.

² See, for example, Blundell, R. and McCurdy, T. (1999) “Labour supply: A review of alternative approaches”, in O Ashenfelter and D Card (eds.), “Handbook of Labour Economics”, Volume 3, North Holland, Amsterdam.

Supporters of income splitting

- 2.19 Ninety percent of those who responded, mostly individuals, were in favour of some form of income splitting. Many of these people argued that income splitting would recognise the contributions of full-time parents to their families and communities, with some arguing that income splitting would strengthen the family unit. Other benefits cited included balancing the assistance to parents in the workforce, reducing incentives to emigrate, and reducing the impact of fiscal drag.

Opponents of income splitting

- 2.20 Those who opposed the income splitting proposal included most of the institutions that made a submission. Their concerns included:

- the inequities and distortions arising from different family structures – some eligible, some not – and no account being taken of family size;
- the potential disruption to family life as primary earners could have an incentive to work longer hours;
- the potential for abuse, with sole parents entering arrangements with higher earners for mutual gain; and
- the fact that the fiscal cost is likely to be transferred to other taxpayers.

- 2.21 Of those who opposed the proposal, three noted that they would prefer that any additional assistance for families be targeted to assist those in need.

Responses to specific questions

- 2.22 Respondents generally supported limiting the eligibility for income splitting to “families” consisting of married couples, civil union partners and de facto couples who have dependent children up to 18 years of age. Most wanted to align the definition of “family” with the definition used for the Working for Families tax credits.

- 2.23 Most considered that income splitting should be optional and that income should be split on a 50/50 basis.

Development of the current proposal

- 2.24 Following the 2009 general election, the National government and UnitedFuture entered into a confidence and supply agreement. The agreement included commitments by National to support the introduction of legislation on income splitting through to its First Reading in Parliament.

- 2.25 Table 1 explains the reasoning behind some of the key features of the proposed income splitting tax credit.

Table 1: Key features of the tax credit

Key feature	Reasons for proposing this feature
The income splitting tax credit would be based on the couple's total income for the year, split 50/50 between the partners.	Supported by 70 percent of submissions. Minimises complexity and avoids disadvantaging any couples, which could occur with any other income splitting ratio such as 30/70.
An eligible couple must consist of either a married couple, civil union partners or de facto partners.	Supported by 60 percent of submissions. Consistent with other legislation dealing with couples, including Working for Families.
An eligible couple must have a child or children aged 18 years of age or under.	Supported by 63 percent of submissions. Consistent with Working for Families and would provide support to all couples with dependent children. Chapter 1 notes the lower cost of an alternative age limit of six years.
The decision to split income for the purposes of receiving the tax credit would be optional.	Supported by 70 percent of submissions. Consistent with the objective of providing choice. No need for compulsion.
The income splitting tax credit would be paid on an annual basis, rather than in periodic payments throughout the tax year.	This would reduce the complexity of the system. A tax credit paid at regular intervals during the year based on estimated income would require an end-of-year square-up and recovery of any overpaid amounts.
An eligible couple and their dependent child must be New Zealand residents for tax and immigration purposes for the whole of the relevant tax year.	This requirement is similar to those for the Working for Families rules. It is also consistent with the objective of assisting New Zealand families and avoids complexities in relation to when and where income was earned.
Couples would register for the tax credit through the system used to deliver Working for Families tax credits.	This would minimise compliance costs for taxpayers and administrative costs for Inland Revenue. In particular, income splitting at source, through employers, would greatly increase compliance and administration costs.
The rules for determining whether a child is dependent would be consistent with similar rules for Working for Families tax credits.	This would make it easier for all involved. There would need to be a good reason to diverge from the established Working for Families rules.
The tax credit would not generally affect or be affected by other obligations and entitlements administered by Inland Revenue.	The objective is to split income for tax purposes only. This would also minimise complexity.

2.26 The government would need to make decisions on the final policy design before the introduction of legislation. The submissions received on this issues paper would help that decision-making.

Chapter 3

WHO WOULD BE ELIGIBLE

- 3.1 This chapter outlines the eligibility criteria for a couple to receive an income splitting tax credit.
- 3.2 In broad terms, a couple would be eligible if, for the relevant tax year, they are:
- spouses, civil union partners, or de facto partners;
 - New Zealand residents; and
 - primarily responsible for the day-to-day care of a dependent child or a child aged 18 years or under.
- 3.3 Eligible couples would need to register online with Inland Revenue for an income splitting tax credit. The registration process would link in with the current system for registering for Working for Families tax credits.

The “whole-year” requirement

- 3.4 To qualify for an income splitting tax credit, the couple, whose combined income would determine the amount of the income splitting tax credit, would need to have been spouses or civil union or de facto partners for the whole of the relevant tax year. This whole-year requirement would reduce the complexity of the system by removing any need for apportionment if the status of a couple’s relationship changed during the tax year.

Residence

- 3.5 For the whole of the relevant tax year, the couple and the dependent child or children being cared for would need to be resident in New Zealand for both immigration and tax purposes. In the case of a dependent child born or adopted during a tax year this requirement would apply from the date of birth or adoption. This requirement is similar to those for receiving Working for Families tax credits.

Dependent child

- 3.6 A dependent child is a child whose care is primarily the responsibility of the couple and is:
- 18 years of age or younger; and
 - financially dependent on the couple.
- 3.7 Children aged 18 would need to be attending secondary school or tertiary education and not be financially independent. Children that the couple support financially and who work more than 30 hours a week, or receive a student allowance, a benefit or other government assistance would not be considered “dependent” for purposes of the tax credit.

Change in status of dependent child

- 3.8 The income splitting tax credit would be reduced in years in which the status of the youngest dependent child changed. This means that the couple would be eligible for an income splitting tax credit up until the end of the calendar year (31 December) in which the child turns 18 or until the child becomes financially independent, whichever is the earlier. Likewise, a couple would become eligible for a tax credit on the day their first dependent child is born or adopted.
- 3.9 Treating children as independent from the end of the calendar year they turn 18 is in line with similar rules for receiving Working for Families tax credits.

Example 1 – a child who turns 18 during the calendar year

Joanna and Paul have a daughter, Sophie, who is 17 when she starts university in February 2013 and is financially dependent on her parents. They will be eligible for an income splitting tax credit (provided they meet the other eligibility criteria) for part of the 2013–14 tax year (which begins on 1 April 2013). Sophie turns 18 in May 2013, so their eligibility will cease at 31 December 2013.

Example 2 – a child who becomes financially independent during the year

Simon and Clare have one child, Robert, aged 16, who begins a full-time job on 5 July 2012 and moves away from home. Simon and Clare will be eligible for an income splitting tax credit for the 2012–13 tax year from 1 April until 5 July, the day Robert started working.

Shared care arrangements

- 3.10 When a shared care arrangement is in place between parents who have separated, both parents (if in new relationships) could be entitled to receive an income splitting tax credit. This entitlement would arise if the shared care arrangement was intended to be in place for four months or more and the child was in both parents' care for at least one-third of the tax year. Over a year, this is at least 122 days a year or five days every fortnight.
- 3.11 The amount of the income splitting tax credit in the case of shared care would be reduced in proportion to the amount of time each parent cares for the child.
- 3.12 This feature of the proposed tax credit links in with the Working for Families rules around shared care arrangements. It relies on the family providing Inland Revenue with the correct information on their shared care arrangement.

Example 3 – when both partners are entitled to an income splitting tax credit in a shared-care arrangement

Andy and Catherine have six-year-old twins and then separate. They will not be entitled to an income splitting tax credit for the tax year in which they separated.

Each then enters into a relationship with another person. For the whole of the following tax year, Andy and Catherine care for the children in alternate weeks. As they each care for their children for at least one-third of the time, they will each be entitled to an income splitting tax credit based on the proportion of the time that they look after the twins (in this case, 50 percent of the time). The calculation of the tax credit when there is a shared-care arrangement is set out in example 5 in chapter 4.

Example 4 – when one partner is entitled to an income splitting tax credit in a shared-care arrangement

Julie and Scott, who have a 10-year-old child, have separated, and each has a new partner. Scott picks up the child from Julie's place at 9am each Saturday morning and drops him back at 7pm on the Sunday evening.

As Scott is not caring for the child for at least one-third of the time, he will not be entitled to an income splitting tax credit.

Registration

- 3.13 Couples would need to be registered for an income splitting tax credit so that Inland Revenue knows who they are and whether they are eligible for the tax credit. Couples would need to provide the following information to Inland Revenue:

- details of both partners or spouses, including IRD numbers and residence details;
 - details of a child in the primary care of the couple, aged 18 years or under during the tax year, and any shared care arrangements; and
 - confirmation that the couple's relationship existed for the entire tax year.
- 3.14 As the income splitting tax credit would build on the rules and systems developed for the Working for Families tax credits, the couple would need to be registered online through the Working for Families system. However, paper forms would be available if a family did not have access to a computer or reliable internet.
- 3.15 A large number of families are currently registered either through Inland Revenue or the Ministry of Social Development for Working for Families. These families would be automatically registered for an income splitting tax credit (but could opt out if they wished). Inland Revenue generally has sufficient information about these couples and their children to assess their eligibility.
- 3.16 Other couples who are eligible for an income splitting tax credit, although not entitled to Working for Families assistance, would need to register online using the system Inland Revenue uses to deliver Working for Families tax credits.
- 3.17 Registration would be permitted up to 18 months after the end of the relevant tax year. Registration would remain in place for the following year, provided that Inland Revenue's information indicates that the couple remains eligible. Couples would be required to notify Inland Revenue of any change that could affect their eligibility, such as the end of their relationship.

Submission points

- 3.18 We welcome submissions on:
- requiring registration for income splitting online through the system used to provide Working for Families tax credits;
 - whether the rules that would be used to determine eligibility for income splitting are appropriate;
 - whether couples should be required to confirm their eligibility for an income splitting tax credit through an annual declaration;
 - whether a couple should be ineligible for the tax credit if they or their child do not meet the residence requirement for the full tax year, or if the couple's marriage, or de facto or civil union relationship does not exist for the full tax year;

- whether a couple with shared care of a child should be eligible for income splitting if they have care of a child for at least one-third of the tax year;
- whether a couple's entitlement to an income splitting tax credit should, as proposed, end at 31 December in the calendar year the child turns 18 or when the child becomes financially independent (whichever occurs earlier); and
- alternative rules for determining a couple's eligibility for an income splitting tax credit.

Chapter 4

CALCULATION AND PAYMENT OF THE INCOME SPLITTING TAX CREDIT

- 4.1 This chapter covers how an income splitting tax credit would be calculated and paid.
- 4.2 The income splitting tax credit would be calculated by Inland Revenue. A couple's eligibility to receive the tax credit would not affect, or be affected by, other entitlements or obligations administered by Inland Revenue, such as child support and student loans. The calculation would be based on the couple's total income for the year, split 50/50 between the partners.

The information required

- 4.3 The income splitting tax credit would be calculated for eligible couples using information provided by the couple in registering for Working for Families and from their personal tax information.
- 4.4 Inland Revenue would need the correct income details of each partner before calculating the income splitting tax credit. This would result in some additional administrative and compliance costs because some couples who would be eligible do not receive a personal tax statement or file a tax return.
- 4.5 If Inland Revenue is aware that a tax return is required from either partner the calculation would not occur until the return has been filed. Otherwise Inland Revenue would calculate the tax credit from around 15 July after the end of the tax year.
- 4.6 The need for Inland Revenue to have the necessary information before calculating the tax credit means that couples would receive their tax credit as a single payment on an annual basis. This would reduce the complexity of the system. A tax credit paid at regular intervals during the year based on estimated income would require an end-of-year square-up and recovery of any overpaid amounts.

How the calculation would be done

4.7 The calculation would consist of the following steps:

Step 1

The taxable incomes of both partners (not the adjusted net income of the family used for Working for Families tax credits) would be combined.

Step 2

The combined taxable income for the couple, as calculated at step 1, would then be divided equally between the partners.

Step 3

Personal tax rates would be applied to each income calculated under step 2 to determine the couple's notional income tax liability for the year.

Step 4

The standard income splitting tax credit would be equal to the difference between the couple's combined tax payable before income splitting, and the tax they would pay if it was calculated on an income splitting basis.

Step 5

Tax year of birth or adoption

In the year that an eligible couple's first dependent child or children are born or adopted, the income splitting tax credit would be calculated according to the following formula:

$$\begin{aligned} & (\text{number of days from date of birth or adoption to 31 March}) \div 365 \\ & \text{multiplied by the amount calculated at step 4} \end{aligned}$$

Reaching 18 years of age

If an eligible couple's youngest dependent child turns 18 before 31 December in the relevant tax year, the income splitting tax credit would be calculated according to the following formula:

$$\begin{aligned} & 275 (\text{number of days from 1 April – 31 December inclusive}) \div 365 = 0.75 \\ & \text{multiplied by the amount calculated at step 4} \end{aligned}$$

Becoming financially independent

If an eligible couple's youngest child has become financially independent during the tax year, the income splitting tax credit would be calculated according to the following formula:

(number of days from 1 April until the date the child becomes financially independent ÷ 365) multiplied by the amount calculated at step 4

Shared-care situations

In a shared-care situation, the amount of the income splitting tax credit would be reduced based on the proportion of time that a couple had a dependent child in their care during the tax year.

Example 5: Calculating the income splitting tax credit in a shared-care arrangement

To return to Andy and Catherine in the earlier example 3 (in chapter 3), the couple separate in December 2012 and each enters into a new relationship in March 2013. Both are entitled to an income splitting tax credit for the 2013-14 tax year as they look after their twins week-on, week-off.

Andy is in full-time employment and earns \$100,000, on which \$27,550 is paid in tax. His new partner is not employed. Catherine's new partner earns \$60,000, on which \$12,850 is paid in tax, but she is not employed.

Splitting Andy's and his new partner's combined taxable income of \$100,000 in half gives \$50,000. Tax on taxable income of \$50,000 is \$9,550. If each were to pay this amount, their combined total would be \$19,100 in tax paid.

The difference between both partners' tax on combined taxable income and the tax they would pay under income splitting is: $\$27,550 - \$19,100 = \$8,450$. As Andy cares for the children only half the time, he and his new partner are entitled to an income splitting tax credit of only half of this amount, which is \$4,225.

As for Catherine and her new partner, splitting their combined taxable income of \$60,000 in half gives \$30,000. Tax on taxable income of \$30,000 is \$5,110. If this was paid by each, they would pay a total of \$10,220 in tax.

The difference between their tax on combined taxable income and the tax they would pay under income splitting is: $\$12,850 - \$10,220 = \$2,630$. As Catherine cares for the twins only half the time, she and her new partner are entitled to an income splitting tax credit of only half this amount, which is \$1,315.

Amount of the income splitting tax credit

4.8 The annual payment to couples with various combinations of primary and secondary earner incomes is set out in table 2. For example, if the primary earner's income is \$40,000 and the secondary earner's is \$10,000, the amount of the income splitting tax credit would be \$340.

Table 2: Income splitting tax credit per couple (per tax year)³

		Secondary earner income (\$000)							
		\$0	\$10	\$20	\$30	\$40	\$50	\$60	\$70
Primary earner income (\$000)	\$0	0							
	\$10	0	0						
	\$20	510	340	0					
	\$30	1,190	340	0	0				
	\$40	1,190	340	0	0	0			
	\$50	1,430	580	240	240	240	0		
	\$60	2,630	1,780	1,440	1,440	960	0	0	
	\$70	3,830	2,980	2,640	2,160	960	0	0	0
	\$80	5,530	4,680	3,860	2,660	1,460	500	500	0
	\$90	7,230	5,900	4,360	3,160	1,960	1,000	500	0
	\$100	8,450	6,400	4,860	3,660	2,460	1,000	500	0
	\$110	8,950	6,900	5,360	4,160	2,460	1,000	500	0
	\$120	9,450	7,400	5,860	4,160	2,460	1,000	500	0
	\$130	9,950	7,900	5,860	4,160	2,460	1,000	500	0
\$140	10,450	7,900	5,860	4,160	2,460	1,000	500	0	

³ The income splitting tax credit amounts calculated in this table are based on the tax rates from 1 April 2009.

Payment of the entitlement

- 4.9 The income splitting tax credit would ordinarily be paid in full into a bank account of the primary caregiver unless the couple chose for each partner to receive half of the tax credit each.
- 4.10 In some cases Inland Revenue might withhold part or all of the tax credit. These could include when:
- the couple has been overpaid social assistance under the Working for Families system;
 - one of the partners has an overdue tax debt or student loan repayment; and
 - one of the partners has a history of non-compliance with tax laws and has not filed a tax return or confirmed their taxable income with Inland Revenue.

Impact of tax credit on other payments and tax credits

- 4.11 The income splitting tax credit would not generally affect, or be affected by, other entitlements or obligations administered by Inland Revenue, such as the independent earner tax credit, child support, or student loan repayments. In particular, provisional tax would continue to be assessed and payable on an individual basis. The effect on recipients of the minimum family tax credit would, however, need to be considered in the detailed design of the credit.

Submission points

- 4.12 We welcome submissions on:
- the process for calculating the income splitting tax credit;
 - using income splitting tax credits to offset Working for Families overpayments or other liabilities, such as tax liabilities;
 - continuing to calculate any provisional tax of each partner on an individual basis, without reference to the income splitting tax credit;
 - the value to couples of the proposed annual income splitting tax credit, compared with a tax credit paid at regular intervals during the year based on estimated income, which would require an end-of-year square-up; and
 - alternative ways of providing for income splitting for couples with dependent children.