

Budget 2012 proposed tax credit changes – transitional rules and the proposed tax exemption for children

Changes to three tax credits – the income under \$9,880 tax credit, the tax credit for childcare and housekeeper expenditure, and the tax credit for the active income of children – have been proposed as part of Budget 2012.

The proposed changes would see the tax credit for the active income of children replaced with a limited tax exemption. This exemption would mean that a school child would not need to declare untaxed income of less than \$2,340. The exemption would not apply to salary or wages, or other income on which tax has already been paid.

The income under \$9,880 tax credit and the tax credit for childcare and housekeeper expenditure are proposed to be repealed. Taxpayers would not be able to claim these credits if they file a tax return at the end of the tax year.

These proposed changes would have effect from the 2012/13 tax year. Taxpayers can still make claims for the year ending 31 March 2012 (the 2011/12 year).

Transitional rules

Two of the tax credits, the income under \$9,880 tax credit and the tax credit for the active income of children, can be claimed during the year through the PAYE system. For the income under \$9,880 credit, this is done by an employee informing their employer of an "ML" or "ML SL" tax code. For the credit for the active income of children, employers can choose to not deduct PAYE from school children employees who are expected to have a total annual income of less than \$2,340.

Because the tax credit changes apply from the current tax year (2012/13), proposed transitional rules have been announced.

Under the proposed rules, an employee on an "ML" or "ML SL" tax code can continue to use that code up until 31 March 2013. After that they will have to use another tax code, such as "M" or "M SL".

For a school child earning less than \$2,340, employers would not be required to deduct PAYE from their pay until 31 March 2013.

These transitional arrangements would mean people on an "ML" or "ML SL" tax code, or children who have not had PAYE deducted, may be able to keep the benefit of these tax credits in the 2012-13 tax year despite their repeal. There would be no requirement for these people to file a tax return or request a personal tax summary solely for having received the credits during the year; however, if they do file a return or request a summary they may be assessed as having tax to pay.

Many people in this situation will not be required to file a return or request a summary at all.

Details of the proposed new tax exemption for children

The proposed new tax exemption has the same eligibility criteria as the tax credit for children. That is, it is available to people who:

- are 14 or under, or
- are 15, 16 or 17 and still attending school*, or
- turned 18 on or after 1 January in the previous tax year and continued to attend school*.

* including schools for people with disabilities, but excluding tertiary institutions.

The exemption would mean that children would not need to pay tax on up to \$2,340 of income which is not taxed at source (such as money for mowing the neighbours' lawns). The exemption would not apply to income on which tax has already been paid, such as salary and wages or interest.

If a child earned more than \$2,340 from income which is not taxed at source, the proposed exemption would not apply to any of the income. The child would have to pay tax on the full amount.

Example of the proposed exemption

Kate is at secondary school and has a part time job at the local retail store earning about \$2,000 a year. Her employer deducts PAYE from her wages each week. Kate also gets paid for the occasional babysitter job for neighbours. She makes around \$300 a year from babysitting. She also earns \$50 in interest on her savings for which Resident Withholding Tax (RWT) is deducted.

Under the previous tax credit for a child's active income, Kate could file a tax return to claim back her PAYE, but not her RWT. The tax credit would also offset the tax payable on her babysitting income. With the new child's income tax exemption, Kate would not be required to file and pay tax on the babysitting income. She would not be able to claim back the PAYE or RWT.
