

Regulatory Impact Statement

Non-resident seasonal workers' tax rate

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by Inland Revenue and provides an analysis of the tax rate that should be applied to non-resident seasonal workers under the Recognised Seasonal Employer (RSE) scheme.

The RSE scheme allows for the temporary entry of overseas workers to work in the horticulture and viticulture industries in New Zealand. Generally, the rate of tax that currently applies to these workers is a flat rate of 15%. This rate is intended to reflect an average rate of tax faced by the workers on their New Zealand sourced income without the need to apply the marginal tax rate system and file an annual tax return.

The need to review the rate of tax arises as a result of the recent changes to the personal tax rates, particularly from Budget 2010. An analysis of relevant data has led to the policy proposal that the rate be reduced from 15% to 10.5% from 1 April 2011.

The Department of Labour, the Ministry of Foreign Affairs and Trade and the Treasury were consulted on the proposal and are supportive of the change. Officials from Pacific Island nations had previously raised concerns with the Department of Labour requesting that the tax rate for non-resident seasonal workers be reduced. These concerns were taken into account in recommending the revised rate.

Given the time constraints, the horticulture and viticulture industries were not consulted.

The revision of the rate does not impose any significant additional costs on businesses, impair private property rights, restrict market competition, or reduce the incentives on businesses to innovate and invest or override fundamental common law principles.



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STATUS QUO AND PROBLEM DEFINITION

1. The Recognised Seasonal Employer (RSE) scheme was introduced by the Department of Labour in April 2007. The RSE scheme allows for the temporary entry of overseas workers into New Zealand to work in the horticulture and viticulture industries. In 2008, a policy decision was made that a flat rate of tax would apply to workers under this scheme. This was done primarily to minimise compliance costs. It also addresses the fact that non-resident seasonal workers only work part of the tax year and are usually earning low hourly wages and, therefore, setting the flat rate of tax at a rate equal to the lowest marginal rate is an appropriate result.

2. Inland Revenue introduced the NSW (non-resident seasonal worker) tax code in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 to apply to non-resident seasonal workers. The rate of tax that currently applies to this tax code is a flat rate of 15%. The flat rate aims to reflect the average rate of tax faced by non-resident seasonal workers on their New Zealand sourced income. The flat tax rate policy was developed in conjunction with the removal of the legislative requirement for non-resident seasonal workers to file an end-of-year tax return.

3. Some of the non-resident seasonal workers under the RSE scheme are still using the STC (special tax code) code, which was the code used prior to the introduction of the NSW code and which can still be used by the workers until they leave New Zealand. For the purposes of recommending a rate applicable to the NSW tax code, we have assumed that 70% of non-resident seasonal workers are currently using the NSW tax code and that 30% of non-resident seasonal workers are still using the STC tax code.

4. The reduction in personal tax rates was a key element of the Budget 2010 tax package. The 2010 Budget tax reform Regulatory Impact Statement (Tax Reform package for Budget 2010) discussed the importance of shifting the tax mix away from personal taxation towards GST. The NSW tax rate is intended to reflect an average rate of tax faced by non-resident seasonal workers on their New Zealand sourced income. The reduction in personal tax rates in Budget 2010 and previous years has led to a misalignment of the lowest personal tax rate and the rate applicable to non-resident seasonal workers. As a result, the current rate of 15% is no longer the correct rate for the majority of non-resident seasonal workers and this has led to the need to review the rate.

OBJECTIVES

5. In the past, the Government has relied on three key principles when deciding how to treat non-resident seasonal workers. These principles do not form an exclusive list and are just some of the factors that are taken into consideration:

- **Accuracy** - One objective of the NSW tax code is to withhold tax from non-resident seasonal workers at a rate that reflects, as closely as possible, their correct average tax rate. As the NSW rate is a flat rate, there will always be some people who have tax under-withheld and, if the flat rate is set above the lowest personal tax rate, some people will have tax over-withheld. However, the aim is to minimise the amount of tax over-withheld and the tax under-withheld for the largest number of people. If the rate is set at the lowest personal tax rate, given that non-resident seasonal workers are generally on low wages

and only work part of the year, the risk of under-withholding tax for them is perceived to be low, and the risk of over-withholding is nil.

- **Low compliance costs** – One of the key components of the non-resident seasonal workers tax regime is that the workers do not have to file an end of year tax return. This is desirable because often English is the workers' second language and this can make it complex to file a tax return in New Zealand. In addition, the workers are only employed for a part year (seasonal work) and therefore may have left New Zealand by the required filing time and without easy access to the internet, it can be costly and complicated getting in contact with Inland Revenue to confirm details or file a tax return.
- **Similar treatment for New Zealand employees** - Non-resident seasonal workers should not be put in an advantageous position when compared to New Zealand workers. Under the RSE scheme employers can only offer employment opportunities to non-resident seasonal workers if they cannot find New Zealand citizens or residents to perform the same job. Further, a non-resident seasonal worker should face a rate of tax that is approximately equal to what a New Zealand worker in a similar situation would pay.

6. There is no statutory requirement for the rate of tax applicable to the NSW code to be reviewed, however, as noted in paragraph 10 below, if the rate is not changed this will encourage non-resident seasonal workers to file an end-of-year tax return.

OPTIONS

7. There are two options. The first option is to retain the status quo and leave the NSW rate at 15%. The second option is to lower the NSW rate from 15% to 10.5% (which is considered to be the average rate of tax that would otherwise apply under the marginal tax rate system).

8. Reducing the rate of tax that applies to the NSW tax code to 10.5% will cost \$3.8 million per year. This cost was included in the costings for the personal tax rate reductions in Budget 2010.

Discussion of option one

9. If no change was made to the NSW tax code and the status quo was retained non-resident seasonal workers could still be taxed at the correct rate of tax but only if they filed an end-of-year tax return.

10. The large proportion of non-resident seasonal workers who have annual New Zealand income of up to \$14,000 would be subject to a higher rate of tax than appropriate under the progressive tax scale. This would encourage those workers to file an end-of-year tax return. This would be contrary to one of the original drivers of the special tax regime, which was to minimise compliance costs.

11. If the status quo was retained, the small proportion of non-resident seasonal workers who have annual New Zealand income of more than \$14,000 would be taxed closer to their correct rate.

Discussion of option two

12. The proposed new rate of 10.5% was chosen after analysing industry data. The Department of Labour provided a sample of data obtained from employers in the Hawkes Bay, Waikato and the Bay of Plenty. The Department of Labour data relates to 638 workers

under the last two seasons of the RSE scheme and the average annual wage of this sample was \$10,490. Of the Department of Labour data, 80% of the workers had an annual income of less than \$14,000.

13. In addition, data has been extracted from Inland Revenue's database. The Inland Revenue data relates to workers who elected to apply the NSW tax code in the tax year from 1 April 2009 to 31 March 2010. The NSW tax code could only be elected from 1 April 2009. The Inland Revenue sample consisted of 6,655 people with an average annual wage of \$7,638. Of these non-resident seasonal workers, 85% had an annual income of less than \$14,000. The analysis of the Inland Revenue data also supports the proposed new rate of 10.5%.

14. Although the average tax rate of some non-resident seasonal workers will be higher than 10.5%, it is expected that given the nature of seasonal work and the wage rates of the workers, this rate will be closer to the average tax rate faced by these workers.

REGULATORY IMPACT ANALYSIS

15. Analysis of the tax rate that should be applied to non-resident seasonal workers under the RSE scheme, after the Budget 2010 reductions to personal tax rates, shows that the only practicable option is to legislate for a new flat tax rate to apply to non-resident seasonal workers. This outcome supports the original 2008 policy of a flat tax rate for non-resident seasonal workers based on the principles of accuracy, low compliance costs and, comparability of tax treatment, outlined in paragraph 5 above

16. There are no practical non-regulatory options.

CONSULTATION

17. The Department of Labour were consulted and support the proposed change. Inland Revenue originally became aware of workers' discontent with the current NSW rate from Department of Labour intelligence. Following the reductions in personal tax rates, officials from Pacific Island nations had requested that the tax rate for non-resident seasonal workers also be reduced. This request was made at various forums and through different New Zealand government departments. Reasons that were given to the Department of Labour for this request included:

- Most non-resident seasonal workers have no history of paying income tax in their home countries and do not necessarily understand or accept the concept of universal taxation to fund central government services. From a perspective of fairness, it is difficult for the workers to come to terms with the imposition of a tax that is used to fund government services that, in many instances, they are not eligible for (such as health, education, and social services). This is especially the case when personal tax rates in New Zealand are reducing.
- Non-resident seasonal workers are keen to maximise their earnings while they are in New Zealand, and are thus very conscious of the various deductions that are made from their gross earnings (including airfares, food, accommodation, transport and health insurance, as well as PAYE).

18. The Department of Labour also advised Inland Revenue that tax issues and the possibility of reducing tax liability are regularly raised in official and ministerial level discussions with Pacific country representatives.

19. The Ministry of Foreign Affairs and Trade has been informed and are supportive of the proposed 10.5% rate change. Their support is based on their view that, from an equity perspective, non-resident seasonal workers should face a rate of tax that reflects the taxpayer funded services they are likely to receive.

20. The Treasury was also consulted on this proposal and agrees with the decrease to the NSW tax rate from 15% to 10.5%.

21. Given time constraints, members of the horticulture and viticulture industry have not been consulted. From a tax policy perspective this is seen to be acceptable as the change of rate proposed is simply consequential to the tax rate changes. There is no change in policy and the rate change is taxpayer-friendly. We consider that employers will be supportive of the change as employers have stated that non-resident seasonal workers often query them about perceived excessive withholding of tax.

CONCLUSIONS AND RECOMMENDATIONS

22. As a result of the changes to the personal tax rates, there are two options to be considered in regard to the flat tax rate for non-resident seasonal workers. The first is to retain the status quo and the second is to change the rate of tax that applies to the NSW tax code from 15% to 10.5%.

23. Under the first option, the majority of non-resident seasonal workers would have too much tax withheld. However, they would be able to square-up their tax obligations and receive a refund if necessary by filing an end-of-year tax return.

24. Under the second option, the majority of non-resident seasonal workers would be taxed at the correct rate. Some workers would have too little tax withheld. These workers are unlikely to square-up their tax obligations at the end of the year, because this would result in them having to pay additional tax.

25. On balance, we recommend that the second option be adopted.

IMPLEMENTATION

26. Tax is calculated on an annual basis according to the tax year that runs from 1 April to 31 March. As the proposed change to the NSW rate would apply from 1 April 2011, the beginning of a new tax year, there will be no transitional issues arising. For the tax year ending 31 March 2011, workers would have tax withheld at the current rate of 15%. For the tax year ending 31 March 2012, if the legislative change is made, workers would have tax withheld at the rate of 10.5%. Non-resident seasonal workers would retain the ability to file a return.

27. A communications strategy will be developed in conjunction with the Department of Labour for the new tax rate. The primary focus would be on the employers of non-resident seasonal workers. At this stage communications with the Pacific Island Governments have not been fully considered, however opportunities to inform the Pacific Island Governments could be explored.

28. Under the proposed change, compliance costs are reduced for taxpayers as they are more likely to have tax withheld at the correct rate and are less likely to file an end-of-year tax return.

29. However, it should be noted that for the 2010-11 tax year (the year ending 31 March 2011) non-resident seasonal workers are more likely to have tax over-withheld and, therefore, are more likely to file a tax return. This will occur because of the reduction in personal tax rates from Budget 2010 applying from 1 October 2010. Due to the relatively small number of people on the NSW tax rate and the fact that this particular anomaly is only for one year, we consider that it would not be worthwhile implementing measures to reduce compliance costs from 1 October 2010.

30. The legislative amendment changing the rate applicable to the NSW tax code means that all non-resident seasonal workers electing the NSW tax code will, from 1 April 2011, have tax withheld at the new rate of 10.5%.

MONITORING, EVALUATION AND REVIEW

31. If there are significant changes to the personal tax rate scale, or if it is found that the data on which the current review was based was not a representative sample of the industry, this may prompt another review of the NSW tax rate to take place. A review would involve examining the appropriate average tax rate for non-resident seasonal workers based on recent data from the industry, in accordance with the principles of accuracy, low compliance costs and, comparability of tax treatment, outlined in paragraph 5 above.

32. Through regular audits, the Department of Labour will continue to collect and analyse data on RSE workers' wages. In addition, the Department of Labour will continue to engage with Pacific Island Governments on RSE policy matters and discuss any issues or concerns that are raised with Inland Revenue.