Regulatory Impact Statement

Providing additional financial assistance to working families with newborns

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue. It summarises the analysis of options to increase financial assistance to families of newborns through the Parental Tax Credit element of the Working for Families (WFF) scheme. These are scheduled to be announced in Budget 2014, as part of a wider package of financial support measures for such families.

Ministers wanted to explore various options to increase the amount of financial assistance to families during the first year of a child's life, as part of a wider Government objective of improving life outcomes for children. Ministers were interested in changes to support lower and middle income families, while minimising any impact on work incentives.

Officials from the Treasury, the Ministry of Business Innovation and Employment (MBIE), the Ministry of Social Development (MSD) and Inland Revenue first presented Ministers with a broad set of options covering various family situations. These options were narrowed following further discussion to those that could feasibly be considered (from a policy, fiscal and operational perspective) for inclusion in the 2014 Budget.

As directed by Ministers, Inland Revenue's analysis then focused on options using the existing Parental Tax Credit element of the WFF scheme. Options involving the paid parental leave system and provision for beneficiary families were considered by MBIE and MSD respectively, and are not further addressed in this RIS.

The RIS does not analyse the efficacy of providing financial support to families in improving life outcomes for children, nor does it analyse other (non-financial) options.

A key constraint in the process was the need for Budget secrecy, which made consultation on options impossible. Further constraints related to the timeframe for analysis. The timeframe for providing advice was often short, especially given number of potential options under consideration and the introduction of new options late in the process.

The policy options discussed in this RIS affect areas that the government has stated require a strong case before regulation is considered, because the options analysed alter incentives to work for beneficiary and working families. Officials consider that regulation is appropriate as it is the only means to achieve the desired objectives.

There are no other significant constraints, caveats and uncertainties concerning the regulatory analysis undertaken. The proposed option does not impose additional costs on businesses, impair private property rights, restrict market competition, reduce the incentives on businesses to innovate and invest, or override fundamental common law principles.

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STATUS QUO AND PROBLEM DEFINITION

Current components of financial support for families with newborns

1. The primary financial support currently provided by the Government for families with newborns is either paid parental leave (PPL) or the Parental Tax Credit (PTC) element of the Working for Families (WFF) system. The key features of these are:

Paid Parental Leave (PPL)	Parental Tax Credit (PTC)
• PPL payments up to a maximum of $488.17 per week before tax.	• PTC maximum of $1,200 per child ($150 p/w).
• Payments generally made fortnightly, in period immediately preceding and following birth.	• Either paid as a lump sum after the end of the tax year of birth, or in regular instalment payments over 8 weeks (from date of application).
• Employees with at least six months' continuous service with the same employer entitled to up to 14 weeks of employment protected PPL payments.	• Eligibility based on status of the primary caregiver - usually the mother - for the 56 days (8 weeks) following birth.
• Self-employed entitled to up to 14 weeks of PPL payments, but no employment protection.	• Cannot be claimed if receiving either PPL, or a social assistance payment through the benefits system.[1]

2. Taxpayers who are eligible for both PPL and PTC can choose which to claim, based on whatever is most advantageous to them. In most cases PPL will deliver more financial support, and for women who are employed PPL has the additional advantage of employment protection, facilitating a smooth re-entry into the workforce after birth.

3. The number of live births registered in New Zealand in the year to March 2012 was 60,860. The table below summarises the number of PPL and PTC recipients in relation to these births:

Payment	Recipients no. (end Mar 2012)	As % of live births	Spending in the 2011/12 (Actual)	Total funding in 2013/14 (main estimates)
Paid Parental Leave	25,900	42%	$157.6 m	$176.0 m
Parental Tax Credit	15,500	25%	$18.9 m	$15.0 m

Note: a small number of people can claim the paid parental leave on the adoption of a child aged under six years old.
Source: IR and Budget Documents

4. Of the remaining 33% of births, approximately 25% are beneficiaries[1], who do not qualify for either PTC or PPL. The rest are largely non-working mothers from higher incomes who do not qualify for either PTC or PPL payment. There are also a small number of families who do not claim either payment, even if they do qualify.

[1] There is no other specific payment for beneficiaries on the birth of a newborn, although some parents may receive the Sole Parent Support payment.

Current components of Working for Families (WFF)

5. To receive WFF payments a person must be at least 16 years of age and also meet residency requirements. The amount of payments depend on the number of dependent children aged 18 or younger that are being cared for; the age of the child being cared for; the total family income; where the family income comes from; and any shared care arrangements.

6. The WFF scheme has four main components:

Type of credit	Paid for
Family Tax Credit (FTC)	Payment for each dependent child aged 18 or younger
In-Work Tax Credit (IWTC)	Payment for families who are in paid work
Minimum Family Tax Credit (MFTC)	Payment made to working families with dependent children aged 18 or younger, so they have a minimum post-tax income each week
Parental Tax Credit (PTC)	Payment on birth of a new child

7. The FTC and IWTC are currently abated at 21.25 cents in the dollar when annual family income exceeds $36,350. The PTC is also abated at 21.25 cents in the dollar; however the amount of the abatement is calculated against 56 days of annualised income, rather than a full year's worth of income; this creates an *effective* PTC abatement rate of 3.26 cents. The MFTC is abated dollar for dollar until a family's income reaches $21,216 after tax.

8. FTC amounts are adjusted for inflation when the Consumer Price Index (CPI) movement cumulatively reaches 5%. MFTC amounts are reviewed each year to ensure incentives to move from benefit into work are maintained. IWTC and PTC amounts are reviewed every three years.

Problem definition

9. The rationale for the proposed package of increased financial support for families of newborns in Budget 2014 draws on national and international evidence that:

- poverty is one of the greatest risks to children's health and development
- the forming of close early bonds between parent and child, breastfeeding in the first six months, and reducing parental stress especially in the early years is good for children in the short- and longer-term
- there are generally extra demands on the family budget and reduced family income in the first year of a newborn's life, and
- the labour supply of parents is relatively inelastic around the time a baby is born.

10. In the light of this, Ministers directed officials to look at options using the PTC element of the existing WFF scheme, to increase the financial support available to lower and middle income working families at the time a child is born. The problem considered in this analysis is how to increase the financial support provided to families with newborns through the PTC and how to best target additional PTC payments to lower and middle income families.

OBJECTIVES

11. The PTC proposals were assessed against Ministers' specific objectives for the Budget 2014 package of financial support for families with new-borns, namely to:

- increase the amount of financial support available (the primary objective)
- target this additional support to the period around the birth of a new child
- target this additional support to lower and middle income families
- minimise any impacts on work incentives.[2]

12. The level of administration and implementation costs and efforts were considered for each option; only options that could feasibly be implemented from an operational perspective by 1 April 2015 were pursued in any detail.

REGULATORY IMPACT ANALYSIS

13. In November 2013, a number of options were first presented to the Ministers of Finance, Labour and Revenue, and the Minister for Social Development, dealing with increasing the financial support for families with newborns as a whole. Following this, joint Ministers narrowed these potential options to a series of discrete options to take to Cabinet for Budget 2014.

14. This analysis summarises Inland Revenue officials' advice on the development of the options considered by joint Ministers from February 2014 involving the WFF scheme; options involving the PPL scheme, or beneficiary families are being considered by other agencies and do not form part of this analysis.

15. The WFF scheme has three main parameters or levers that are able to be changed without structurally altering the scheme: (i) the amount of each tax credit[3]; (ii) the abatement rate; (iii) the abatement threshold, being the family income level at which WFF tax credits start to abate.

16. The analysis below considers two options for changes to the PTC, using the first two of these levers. The abatement threshold (iii) for PTC is the same as that for the FTC and IWTC, so changes to this would have increased WFF payments for all families, not just families with newborns. Creating separate thresholds for PTC would have led to a multiple number of thresholds depending on the numbers and ages of dependent children; this would have required significant restructuring of the entire WFF support package for all families, and was therefore not considered feasible.

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[2] As noted at paragraph 11, new parents have a relatively inelastic labour supply. New parents, particularly mothers, do not readily respond to incentives to increase working hours. Therefore, unlike with other discussions of work incentives and the tax-benefit interface, the 'work incentive' impacts here are primarily concerned with maintaining a margin between PPL and PTC. Paid employment is a critical plank of the government's strategy to address poverty, so incentives that would encourage women to switch from PPL to a PTC payment would run counter to this.

[3] Indexation can be another lever, to ensure that thresholds or rates are adjusted in line with inflation, or wage levels. In the context of this analysis, inflation adjustment is considered as part of lever (i).

17. A high-level assessment of the relevance of the tax credit amount lever and the abatement lever showed; given the nature of the PTC design, no critical trade-offs between the objectives were identified in completing this analysis.

Lever/Objective	Primary objective		Secondary objectives	
	Increase amount of financial support	**Minimise impacts on work incentives**	**Target period around birth**	**Target lower and middle-income families**
Status Quo	No			
Credit amount lever (i)	Yes	Yes	Yes	No
Abatement rate lever (ii)	No	Yes	No	Yes
Credit amount (i) and abatement rate (ii) levers	Yes	Yes	Yes	Yes

18. Because the overarching objective was to increase the amount of payments made to families with newborns, the status quo (no changes to the PTC) and adjustments to the abatement rate (ii) were not separately analysed as it would not deliver this objective. Two options were taken forward for further analysis; option 1 considered the use of the credit amount lever only, while option 2 considered the use of both the credit amount and abatement rate levers. The status quo provided the baseline against which these options were measured.

19. Throughout this RIS we refer to lower, middle and high income families. For the purposes of this analysis only, these family groups are defined as:

- Lower income: Income under the current abatement threshold of $36,350
- Middle income: Income above the current abatement threshold of $36,350, but below the threshold for the current top personal tax rate of $70,000.
- Higher income: Income above the top personal tax rate threshold of $70,000.

20. These family groups have been defined according to administrative thresholds and are not intended to be seen as a definitive view of what it means to be a lower, middle or higher income family. They are illustrative only. Different family circumstances, special demands on the family budget, or larger numbers of children will mean some families on "middle" or even "higher" incomes may have limited means.

Option 1 Increase the tax credit amount

21. This option would increase the PTC amount to $220 per week; eligibility and payment periods of either 8 or 10 weeks were considered for this initial analysis.

Increase the amount of financial support available

22. Increasing the amount of PTC will increase the amount of financial support paid out to all families who receive PTC.

23. There is no single optimum level of payment, because the costs of a newborn will vary between families; the PTC is simply a contribution towards those costs. The existing PTC amount ($150 per week) has not been increased since it was introduced in October 1999. If it is assumed that the relative level of support the PTC provided in 1999 is an appropriate target, and that the costs of a newborn have increased in line with general inflation, an increase of

$220 per week is a starting point. This is based on the current forecast of CPI inflation between October 1999 and April 2015 (46.3%).

Minimise the impacts on work incentives

24. Because parents can choose to claim either PPL or PTC, the maintenance of some margin between the newborn payment and PPL is necessary to maintain incentives for women to remain attached to the workforce. The 'minimum' PPL payment is around $142.50 before tax, which equates to a pre-tax total of $2,280.[4] To minimise workforce impacts, any maximum PTC payment should be less than this.

25. Taken together, the analysis in paragraphs 23 and 24 indicate a range for the maximum PTC amount of between $220 and $285 per week, based on the current 8 weeks of payment (i.e. $1,760 to $2,280 PTC in total).

26. Ministers indicated a preference for a weekly PTC amount of $220, and so this weekly figure is used for the remainder of this analysis.

Targeting the period around birth

27. PTC entitlement is calculated on the status (eligibility) of the primary caregiver for the 56 days following the birth of the child, i.e. to be eligible the caregiver must not be in receipt of a welfare benefit on any given day. The PTC is paid pro-rata if the caregiver is only eligible for part of that period.

28. For any given total payment a longer eligibility period means a lower daily rate of entitlement build up. In this sense, the shorter the eligibility period the greater the payment is targeted around the birth. On the other hand, alignment with related policies, such as PPL (paid for 16 or 18 weeks) could reflect the time when mothers are not working as they need to recover and/or breastfeed. There is no conclusive evidence on the optimum eligibility period.

29. The other aspect of timing is the timing of the payments themselves. There is no single optimum payment period; for any given total a shorter payment period means a higher weekly/monthly rate.

30. At present the PTC can be received either as a lump sum after the end of the tax year of birth, or in instalment payments over 8 weeks.[5] A series of regular instalments in the first few weeks of a child's life will tend to be used as an income replacement measure, and to meet additional one-off expenditures associated with the newborn in the earliest weeks. Spreading payment over a longer timeframe might better reflect the time when mothers are not working, as discussed in paragraph 28.

31. However the amount to be paid overall must be factored in; for example a maximum total amount of $2,200 spread over the first 6 months of a child's life amounts to $84 per week; this is less beneficial as an income replacement measure, or in meeting additional expenditure, than doubling the weekly amount and paying it over a shorter 3 month period.

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[4] This is based on a woman who works 10 hours a week, the minimum number of hours required for eligibility, at the minimum wage of $14.25 (effective from 1 April 2014), and received PPL for the full 16 weeks (as proposed under the PPL changes being developed by MBIE, to come into effect on 1 April 2015).

[5] This 8 week payment period depends on the date the PTC application is made, and so could be any 8 week period within the first 5 months after birth.

32. Ministers were initially interested in exploring eligibility periods of either 8 or 10 weeks, so both weekly periods were used in this analysis.

Targeting lower and middle-income families

33. The amount of the PTC does not influence the income thresholds from which the PTC entitlement starts to be abated, as illustrated in Table 2 but it does influence the point of full abatement.[6] This is because, although the PTC is abated at 21.25 cents in the dollar, the amount of the abatement is calculated against 56 days of annualised income, rather than a full year's worth of income; this creates an *effective* PTC abatement rate of 3.26 cents[7]. Or put another way, because the PTC abates last, from the point at which the PTC abatement starts, approximately $36,000 further income is required before the PTC is fully abated away

Table 2: Income abatement thresholds for current and proposed PTC rates

	Number of children			
	1	2	3	4
PTC paid at $150/week for 8 weeks (abatement rate 3.26 cents)				
Maximum payment up to this income level	73,724	89,494	105,263	124,703
Payments fully abated at this income level	110,531	126,300	142,070	161,510
PTC paid at $220/week for 8 weeks (abatement rate 3.26 cents)				
Maximum payment up to this income level	73,724	89,494	105,263	124,703
Payments fully abated at this income level	127,712	143,482	159,251	178,691
PTC paid at $220/week for 10 weeks (abatement rate 4.075 cents)				
Maximum payment up to this income level	73,724	89,494	105,263	124,703
Payments fully abated at this income level	127,712	143,482	159,251	178,691

34. Increasing the amount of PTC to $220 per week, over either 8 or 10 weeks will bring in more higher-income families into the PTC net, i.e. 2-children families with incomes between $126,300 and $143,482 will now also receive some PTC, because the higher PTC amount will take longer to abate. Put another way, from the point at which the PTC abatement starts, around $54,000 of further income is required before this higher PTC amount is fully abated away.

35. An estimated 300 more higher-income families would be brought into the PTC net at a PTC rate of $220 per week over 8 or 10 weeks. This option does not affect the PTC entitlements of lower and middle income families, but to the extent that it extends the PTC to more higher-income families it does not meet the objective to target lower and middle income families.

[6] Table 2 assumes that all of the children are aged under 12. If some of the children are older, then the FTC amount would be higher, and so the maximum level of income at which the PTC is fully abated would be higher, as PTC only begins to abate at the point at which all of the other WFFTCs that the family is entitled to have been fully abated. The table only shows the thresholds for families with up to 4 children; additional children in the family would increase the level of FTC, and so increase the abatement threshold.

[7] Simply changing the amount of weeks the eligibility period, although increasing the total amount of PTC received, does not change the income thresholds for abatement cut-off purposes. The additional weeks of eligibility simply increase the number of weeks of income against which the PTC is abated, i.e. a 10 week eligibility period simply increases the *effective* abatement rate to 4.075 cents.

Option 2 Increase the PTC amount and adjust the abatement rate

36. The option would increase the PTC amount to $220 per week over either 8 or 10 weeks, and change the abatement formula so that the *effective* abatement rate is 21.25 cents. The analysis of the amount of financial support available, targeting the period around birth and workforce incentives are the same as set out for option 1.

Targeting lower and middle-income families

37. Currently, because the PTC is only paid out in respect of the eight week period following birth, the abatement formula only considers 8 week's worth of annual income in determining the PTC abatement. This is in contrast to other WFF tax credits that are paid throughout the year and therefore abated against a full year's income.

38. Option 2 would adjust the abatement rate rules for PTC, so that fewer higher-income families would be pulled into the net, but with no impact on the income levels to which families would receive the maximum PTC amount (so lower and middle income families would be unaffected). For consistency with the rest of the WFF credits, this option was to achieve an *effective* PTC abatement rate of 21.25 cents

Table 3: Income abatement thresholds various PTC amounts, if an *effective* 21.25 cent abatement rate applied

	Number of children			
	1	2	3	4
PTC paid at $220/week for 8 weeks = $1,760				
Maximum payment up to this income level	73,724	89,494	105,263	124,703
Payments fully abated at this income level	82,006	97,776	113,545	132,985
PTC paid at $220/week for 10 weeks = $2,200				
Maximum payment up to this income level	73,724	89,494	105,263	124,703
Payments fully abated at this income level	84,077	99,847	115,616	135,056

39. Such a change would means that approximately 400 higher-income families who would currently qualify for at least some of the PTC payment will no longer qualify; in addition the 300 higher income families who would otherwise become entitled to the increased PTC without this abatement change (see paragraph 35), will remain outside the PTC net.

40. There are two ways the PTC abatement rate can be *effectively* increased:

i. Increase the 21.25 cents rate that nominally applies (only for PTC, not the other credits)
ii. Increase the proportion of the annual income against which the PTC is actually abated.

41. The 21.25 cents nominal abatement rate is linked to the other WFF credits, so approach (i) was rejected as this would require having different nominal abatement rate for each credit. This would mean that any changes to abatement rates in future would have to be adjusted separately for each tax credit; this is a significant IT change, and is also likely to be more complex to explain to WFF customers. For these reasons, approach (ii) would be officials' preferred mechanism.

42. This change would apply only in respect of PTC claims for children born on or after the implementation date (1 April 2015). Therefore it would not impact on any higher-income families eligible for, or in receipt of the PTC, before that date.

CONSULTATION

43. The need for Budget secrecy meant that no consultation was possible on these options, outside of the agencies developing this Budget initiative – namely the Department of the Prime Minister and Cabinet, the Treasury, the Ministry of Social Development and the Ministry of Business, Innovation and Employment.

44. There will be no opportunity for post-announcement consultation. This is because the proposals are to be included in a bill to be introduced and passed on Budget day. This is because the proposed implementation date of 1 April 2015 necessitates the legislation being in place before November 2014 at the latest, to allow sufficient time for Inland Revenues systems, processes and guidance to be finalised.

CONCLUSIONS AND RECOMMENDATIONS

45. The options considered by officials, and discussed in the preceding sections are all broadly consistent with the stated objectives of Budget 2014, namely to provide financial additional support to working families. The PTC options are also fully consistent with the objectives of WFF scheme.

	Extent to which delivers objectives (relative ranking *within* each objective)				
	Primary objective		**Secondary objectives**		
Summary of Option	**Increase amount of financial support**	**Minimise impacts on work incentives**	**Target period around birth**	**Target lower and middle-income families**	**Totals**
Option 1a: 8 weeks PTC at $220 per week	3	3	4	1	**11**
Option 1a: 10 weeks PTC at $220 per week	4	4	3	1	**12**
Option 2a: 8 weeks PTC at $220 per week; adjust abatement formula for full year's income	1	3	4	4	**12**
Option 2b: 10 weeks PTC at $220 per week; adjust abatement formula for full year's income	2	4	3	4	**13**

Scale: Does not achieve objective or achieves objective to lesser extent 1 2 3 4 Achieves objective to greater extent

46. On balance, option 2b is preferred. It delivers the highest overall increase to lower and middle income families (as defined at paragraph 19), and reduces the number of higher-income families receiving the PTC, thus rebalancing WFF expenditure.

Fiscal costs

47. Final decisions around the maximum payment parameters also need to take into account the Crown's broader fiscal position and the current economic conditions; these could not be modelled in the current analysis. The fiscal costs of each of the preferred option (2b) are is estimated at:

$M	2014/15	2015/16	2016/17	2017/18
Costs of existing PTC scheme (8 weeks at $150/week)	**$15**	**$14**	**$13**	**$12**
10 weeks PTC at $220 per week, plus adjustments to abatement thresholds	$3.25	$13	$13	$13

IMPLEMENTATION

48. The PTC changes proposed under either option are to be implemented on 1 April 2015. Implementation employs the existing WFFTC framework and processes.

49. Both options will require changes to the existing PTC calculations within Inland Revenue's WFF system, which will include testing the IT coding for the new PTC payment to ensure the payments are correctly and accurately calculated and made for recipients. Under either option, the WFF system will need to be able to deal with paying out at two PTC rates/periods in the transitional year (i.e. the 15/16 tax year). Although PTC is only one element of WFF, each component of the payment system needs to be tested to ensure there is no impact to the wider WFF population (approximately 602,000 people).

50. Changes to the PTC will be incorporated as part of Inland Revenue's annual WFF application cycle. This includes updating any forms, threshold tables and calculators, as well as updating customer guidance and providing staff information about the changes. Part of this process also involves communicating to families any changes to WFF eligibility and amounts. The WFF/PTC application process and information requested from parents of newborns will not change. There will be no additional compliance costs for affected families.

51. Inland Revenue has prepared a high-level impact analysis costings analysis for the proposed changes to PTC. Additional funding to make these changes will be sought as part of Budget 2014. Inland Revenue is confident that it can deliver the changes for both options within the timeframe, on the basis of its current work programme.

52. There is always a potential risk that any change, addition or reprioritisation of Inland Revenue's work programme within the next few months could impact (delay) the implementation of these PTC changes; this will need to be managed through discussion with relevant Ministers on the comparative trade-offs.

MONITORING, EVALUATION AND REVIEW

53. There is a statutory requirement under the Income Tax Act 2007 for the Minister of Revenue and the Minister for Social Development and Employment to review the amount of the PTC every three years. The next statutory review is due in June 2017, and will review the rate of PTC against changes in inflation, the level of the other WFF tax credits, and the interface of the PTC rate with the paid parental leave rates.

54. There are other no plans to specifically and separately monitor, evaluate or review the proposed PTC changes for Budget 2014. The post-implementation phase of the generic tax policy process will help to identify any remedial issues that arise post-Budget. Any issues identified in this way would be recommended for addition to the Government's tax policy work programme, as necessary.