

POLICY AND STRATEGY

Tax policy report: Minimum Family Tax Credit – annual review 2019

Date:	24 October 2019	Priority:	High
Security level:	In Confidence	Report number:	IR2019/578

Action sought

	Action sought	Deadline
Minister of Revenue	<p>Agree to recommendations so officials can instruct PCO to begin drafting the regulations</p> <p>Authorise the lodgement of the attached Cabinet paper</p>	<p>7 November 2019</p> <p>Lodge by 10am, 14 November 2019</p>

Contact for telephone discussion (if required)

Name	Position	Telephone
Maraina Hak	Policy Lead	s 9(2)(a)

24 October 2019

Minister of Revenue

Minimum Family Tax Credit – annual review 2019

Executive summary

1. This report sets out the annual review of the Minimum Family Tax Credit (MFTC) and seeks your agreement to increase the MFTC threshold for the 2020/21 tax year.
2. The MFTC tops up the after-tax annual income of recipient families to a threshold level so that the amount of income someone can receive working part-time and receiving an abated benefit never exceeds what they could earn if they worked full-time, moved off-benefit and began to receive in-work support.
3. In the 2017/18 tax year 3,320 families received the MFTC at a fiscal cost of \$12 million. Approximately 90% of MFTC recipients are sole parents, largely as a function of the lower work-hours requirement compared to coupled families.
4. As part of the Working for Families reforms between 2004-2007 it was decided to increase the rate of MFTC and adjust the threshold annually to ensure there is always a financial incentive for beneficiaries to increase their employment by guaranteeing a higher income when working full-time and moving off benefit. Since these changes, the MFTC has been increased every year to reflect relativities between in-work support and main benefits such as the CPI adjustment of benefit rates, minimum wage increases and marginal tax rate changes.
5. In line with current policy, officials recommend that you increase the MFTC threshold from \$26,572 (\$511 per week) to \$27,768 (\$534 per week) for the 2020/21 tax year.
6. Legislation requires the Order in Council to be made by 1 December 2019 for the change to apply from 1 April 2020.
7. A draft Cabinet paper and associated speaking notes have been attached for you to take to the Cabinet Legislation Committee meeting on 19 November. If you agree with the proposed change, the Parliamentary Counsel Office will be instructed to draft the necessary regulations and officials will provide these to you before consideration by Cabinet.

Recommended action

We recommend that you:

- a) **Agree** to increase the level of the Minimum Family Tax Credit for the 2020/21 tax year from \$26,572 to \$27,768 (\$511 to \$534 per week) after tax.

Agreed/Not agreed

- b) **Note** that there are no funding implications from increasing the minimum family tax credit threshold for the 2019/20 tax year, as annual increases are built into existing appropriations.

Noted

- c) **Agree** that the Parliamentary Counsel Office be instructed to draft the necessary regulations to bring into effect the decision in recommendation (a), for consideration by Cabinet.

Agreed/Not agreed

- d) **Note** that if you agree to the issuing of drafting instructions to the Parliamentary Counsel Office, officials will provide you with the Order in Council before the Cabinet Legislation Committee meeting on 19 November.

Noted

- e) **Authorise** the lodgement of the Order in Council and attached Cabinet paper to the Cabinet Legislation Committee for its meeting on 19 November.

Agreed/Not agreed

- f) **Note** there is a legislative requirement under section MF 7 of the Income Tax Act 2007 for the threshold amount to be set via Order in Council by no later than 1 December 2019 if it is to apply from 1 April 2020.

Noted

- g) **Note** that speaking notes have been prepared and are attached for you take to the Cabinet Legislation Committee meeting on 19 November.

Noted

- h) **Agree** to proactively release this Cabinet paper, associated minutes, and key advice papers in whole, in line with the provisions of the Official Information Act 1982, within 30 working days of Cabinet making final decisions.

Agree/Not agreed

- i) **Refer** this report to the Minister of Finance and Minister for Social Development.

Referred

Maraina Hak

Policy Lead
Policy and Strategy

Hon Stuart Nash

Minister of Revenue
24/10/2019

Background

Policy

8. The Minimum Family Tax Credit (MFTC) evolved from the Guaranteed Minimum Family Income (1986-1999) and the Family Tax Credit (1999-2004) and is currently one payment within the system of Working for Families tax credits.
9. To be eligible to receive the MFTC a family must have annual income below the specified threshold amount, not be receiving a main benefit and work for at least 20 hours per week (sole parents) or a combined 30 hours (couples).
10. The payment tops up the after-tax annual income of eligible families to a threshold level, set at \$26,572 for the 2019/2020 tax year. The net threshold remained largely unadjusted between 1990 and 2005, increasing from \$13,936 to \$15,080. However, the purpose of the payment was refined during the Working for Families reforms between 2004-2007 and it was decided to increase the MFTC and adjust its threshold annually from 1 April 2006 onwards.
11. The three key objectives of the Working for Families package were (CAB min (04) 13/4 refers):
 - 11.1 make work pay by supporting families with dependent children, so that they are rewarded for their work effort;
 - 11.2 ensure income adequacy, with a focus on low- and middle-income families with dependent children to address issues of poverty, especially child poverty; and
 - 11.3 achieve a social assistance system that supports people into work, by making sure that people get the assistance they are entitled to, when they should, and with delivery that supports them into, and to remain in, employment.
12. Since these changes, the MFTC has been set annually to a level which resolves an integrity issue within the tax and transfer system whereby the in-work financial assistance provided to someone moving from part- to full-time employment, in addition to their higher market income, was potentially not sufficient to compensate for the amount of benefit income they lost. This means that in the absence of the MFTC someone could have less income in the hand as a result of moving off benefit and into full-time work.
13. The purpose of the MFTC can therefore be summarised as supporting the “make work pay” and “achieve a social assistance system that supports people into work” objectives of the Working for Families package by ensuring there is always a financial incentive for beneficiaries to increase their employment by guaranteeing a higher income when working full-time and moving off benefit.

Effect

14. The annual adjustment of the threshold since 2006 has ensured the MFTC has remained at a value which satisfies its fundamental intention. Despite this, there are significant drawbacks to both the design and operation of the payment.
15. The MFTC is primarily a transitional payment for families that are moving from receiving an MSD administered main benefit (and Winter Energy Payment) onto the Inland Revenue administered In-Work Tax Credit. Eligibility applies over a narrow range of income and approximately 90% of recipients are sole parents, largely as a function of the lower work-hours requirement compared to that for couples.
16. As a result, the MFTC is received by far fewer families than other Working for Families payments. Since 2006 the annual number of recipients has fluctuated between 2,300 and 5,200. In the 2017/18 tax year 3,320 families received the MFTC at a fiscal cost of \$12 million.
17. Officials recommend maintaining the MFTC at a rate which satisfies its primary purpose, in line with the existing Cabinet direction. However, officials advise that the proposed consideration of Working for Families in the medium to long-term work programme of the welfare overhaul provides an opportunity to fundamentally evaluate the purpose, design and effectiveness of the MFTC.

Setting the Minimum Family Tax Credit for the 2020/21 tax year

18. The MFTC considers a range of factors such as the rate of income taxes, main benefits, and the minimum wage to ensure that someone's:

after tax earnings from employment +In-Work Tax Credit +Family Tax Credit +Minimum Family tax Credit	are at least \$1 more than	after tax earnings from employment +net income from an abated benefit +Family Tax credit +Winter Energy Payment
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19. The annual MFTC rate from this calculation is then rounded up to the nearest \$52 so that the weekly value of the credit is a whole dollar amount.
20. We recommend that the MFTC threshold for the 2020/21 tax year should be increased from \$26,572 (\$511 per week) to \$27,768 (\$534 per week). This value considers the wage indexation and higher abatement thresholds for main benefits that are applicable from 1 April 2020 and were announced in Budget 2019.
21. This rate is determined using the tax and welfare settings that will currently apply from 1 April 2020. If any changes to relevant settings occur prior to 1 April 2020 this MFTC threshold may not satisfy the requirement outlined above and another change to the threshold via a legislative amendment would be required to ensure the rate is entirely accurate for its purpose.
22. There is legislative requirement in the Income Tax Act 2007 for an Order in Council that adjusts the rate of MFTC to be made by December 1 for it to apply from 1 April the following year.

Funding implications

23. There are no funding implications associated with this change as annual adjustments to the rate of MFTC are already built into existing appropriations.

Compliance and administration implications

24. There are no compliance cost implications or changes in administration costs associated with increasing the value of the MFTC. Publications and systems will be updated with the new level as part of the Ministry of Social Development and Inland Revenue's existing annual processes.

Consultation

25. The Ministry of Social Development and the Treasury have been consulted during the preparation of this report and agree with its recommendations.

Proactive release considerations

26. Officials recommend that this Cabinet paper, associated minutes, and key advice papers should be proactively released without redaction within 30 working days of Cabinet making final decisions.

Next Steps

27. If you approve of the proposed increase of the MFTC threshold to \$27,768 for the 2020/21 tax year, a draft Cabinet paper has been attached for you to take for consideration at the Cabinet Legislative Committee meeting on 19 November.
28. Pending your agreement, the Parliamentary Counsel Office will be instructed to draft the necessary regulations and officials will provide these to you prior to consideration by Cabinet.
29. Speaking notes have been prepared and are attached for you to take to the Cabinet Legislation Committee meeting on 3 December.