Regulatory Impact Statement: Personal income tax relief

Coversheet

Purpose of Document	
Decision sought:	Agree to progress the personal income tax changes in the Budget 2024 Cabinet Paper.
Advising agencies:	The Treasury, Inland Revenue
Proposing Ministers:	Minister of Finance (Hon Nicola Willis)
Date finalised:	24 April 2024

Problem Definition

When prices and incomes rise from generalised inflation and wage growth, but nominal income tax thresholds remain unchanged, individuals end up paying a larger proportion of their income in tax. Over time, this may result in the amount of tax being paid at different income levels not aligning with the Government's intentions.

Executive Summary

The desired amount of tax paid at different income levels is a judgement for ministers to make and will depend on their goals for progressivity in the personal income tax (PIT) system, revenue needs, and economic goals.

Both the National Party and the ACT Party announced plans for PIT relief during the 2023 general election, with relatively similar objectives of compensating for fiscal drag, increasing the financial return to work, and increasing after-tax incomes. The ACT party also had the goal of flattening and simplifying the personal income tax system by reducing the number of tax rates and thresholds. In the National-ACT coalition agreement, a commitment was made to:

"Ensure the concepts of ACT's income tax policy are considered as a pathway to delivering National's promised tax relief, subject to no earner being worse off than they would be under National's plan."

Given the commitments made by parties in the coalition Government during the 2023 election and the compressed timeframe for decisions, officials focused on the plans put forward by the National and ACT parties during the election and variations on these plans. The income tax changes proposed by National and ACT are set out in the table below.

Marginal rate	Current thresholds	National policy	ACT policy (final)
10.5%	$0-14,000	$0-$15,600	n/a
17.5%	$14,001 - $48,000	$15,601 - $53,500	$0 - $60,000
30%	$48,001 - $70,000	$53,501 - $78,100	$60,001 - $180,000
33%	$70,001 - $180,000	$78,101 - $180,000	$180,001 +
39%	$180,001 +	$180,001 +	n/a

The ACT plan would be phased in over several years, with the final settings in the table being implemented from 1 April 2026. This would be combined with a Low- and Middle-

Income Tax Credit ("the tax offset"), which would be paid out at time of taxation to compensate for a higher bottom tax rate. The National plan would be effective from 1 July 2024 and also includes lifting the abatement threshold of the Independent Earner Tax Credit (IETC) from $48,000 to $70,000.

Officials also considered two variations on the ACT plan that make less significant changes to the thresholds and rates, as well as an alternative to the ACT plan that can be achieved at a lower fiscal cost while still achieving the objective of simplifying the personal income tax system by reducing the number of tax rates and thresholds. Three cost-saving variations on the National plan were also considered.

Officials judge that the National plan effectively addresses the policy problem of fiscal drag while having minimal negative consequences on other policy objectives. The plan does involve a significant fiscal cost. The ACT plan delivers larger efficiency gains but at a much larger fiscal cost, while also producing significant administrative effort by introducing a new tax offset. Officials therefore support the broad approach of the National plan, with the following further recommendations:

i. consider cost-saving alternatives to the plan to support a return to surplus,
ii. delay implementation to 1 October 2024 to reduce the fiscal cost, minimise administrative demands for Inland Revenue and ensure all taxpayers receive the benefit of the tax changes on time,
iii. do not proceed with the proposed IETC expansion. The longstanding view of officials has been that the objective of improving work incentives could be achieved more effectively by removing the IETC and making other changes to tax and transfer settings for the same fiscal cost. See T2017/164: Removing the Independent Earner Tax Credit[1] for further discussion of the IETC, and
iv. prevent the tax changes flowing through to student allowances. Alignment with the benefit system is a principle of the student support system, and since main benefits will not increase from the tax changes, the same approach should be taken for student allowance.

The Cabinet Paper recommends progressing the National plan, with an implementation date of 31 July 2024. This involves a large reduction in Crown revenue over the forecast period, estimated at $10.3 billion. This cost could be reduced by around $1 - 2 billion through the cost-saving variations suggested by officials.

The reduction in Crown revenue corresponds to an equivalent increase in the disposable income of taxpayers, owing to the reduction in tax levied on personal income. This may result in small efficiency benefits to the wider economy.

The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that CIPA requirements do not apply to this proposal as it not expected to result in any significant, direct emissions impacts.

[1] https://www.treasury.govt.nz/sites/default/files/2017-11/b17-3659148.pdf

Limitations and Constraints on Analysis

Given the commitments made by parties in the coalition Government during the 2023 election and the compressed timeframe for decisions, officials focused on the policies proposed by the National and ACT parties and modifications to these.

Officials consulted with private sector software providers and payroll service providers to understand the timeframes needed to make PIT changes. Broader consultation, including with Māori stakeholders, was limited owing to the Budget sensitive nature of the policy advice. However, the 2023 general election provided sufficient public engagement on the broad approach to tax relief proposed by the National and ACT parties. Previous public engagement by the Tax Working Group in 2018 revealed support for adjusting PIT thresholds in line with inflation, on the grounds that this would increase progressivity and compensate for the impacts of fiscal drag, which was viewed by some as an unprincipled and untransparent tax increase.

Distributional impacts of the policy options were assessed using the Treasury's Tax and Welfare Analysis (TAWA) model. Modelling results are based on survey data and cannot capture the actual situation of every household in New Zealand, meaning there are likely to be impacts from the package that are not reflected in the modelling outputs provided to ministers. The estimated fiscal costs also involve some uncertainty but can be used as a guide for decision making.

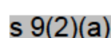
This regulatory impact statement focuses on changes to PIT thresholds and the IETC. Other policy changes for Budget 2024 that relate to household incomes, including Working for Families and the FamilyBoost policy, are covered in separate regulatory impact statements.

Responsible Manager

Tim Hampton

Director, Economic System

The Treasury



24 April 2024

Quality Assurance

Reviewing Agency:	The Treasury, Inland Revenue
Panel Assessment & Comment:	*The Quality Assurance reviewers at Treasury and Inland Revenue have reviewed 'Regulatory Impact Statement: Personal income tax relief' and consider that the information and analysis summarised in it partially meets the quality assurance criteria of the Regulatory Impact Statement framework.* *The RIS applies a comprehensive tax policy framework to assess the options considered for these personal income tax changes, against the Government's stated objectives for the package. This includes*

	presentation of a range of quantitative analysis of the key fiscal and distributional elements of the package. *The key reason the assurance panel considers this RIS does not fully meet the RIS criteria is the absence of public consultation on the specific proposals/options beyond discussions with private sector software providers and payroll service providers. Although the pre-election policies of all the parties forming the current Government included tax cuts, the specific proposals that are the subject of this RIS have not been formally consulted on. However, the Panel does acknowledge the limitations associated with the Budget-sensitive nature of these proposals.*

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. New Zealand's progressive personal income tax (PIT) system means individuals pay higher marginal tax rates as their incomes rise above certain income thresholds. When prices and incomes rise from generalised inflation and wage growth, but nominal income tax thresholds remain unchanged, individuals end up paying a larger proportion of their income in tax.
2. The structure of the PIT system was most recently changed in 2021, with the introduction of a 39% rate for income over $180,000. All other rates and thresholds have been in place since 1 October 2010. Personal incomes have risen since that time, leading to higher average tax rates on personal income. The current rates and thresholds are shown in Table 1.

Table 1: Current personal income tax rates

For each dollar of income	Tax rate
Up to $14,000	10.5%
Over $14,000 and up to $48,000	17.5%
Over $48,000 and up to $70,000	30%
Over $70,000 and up to $180,000	33%
Over $180,000	39%

3. This phenomenon of rising incomes and fixed tax thresholds, known as "fiscal drag", increases the amount of PIT revenue collected and has been a significant means by which governments have addressed growing fiscal pressures since 2010.
4. Since 1 October 2010 (the last time personal income tax thresholds were adjusted) the most significant impact from fiscal drag has been on individuals whose incomes had just crossed the $48,000 threshold at the time (assuming their incomes have continued to grow in line with average wage growth). This is because of the steep increase in their marginal tax rate from 17.5% to 30%.
5. The median full-time wage and salary worker earned $48,024 in the year ended June 2011 and paid $7,427 in personal income tax. In the year ended June 2023, the median full-time wage and salary worker earned $73,417 and paid $15,148 in personal income tax. Owing to the effect of fiscal drag, their average tax rate (the total tax paid per dollar of income) increased by 5.1 percentage points from 15.5% to 20.6% between 2011 - 2023. Their marginal tax rate also increased from 30% to 33%.
6. To completely offset the impact of fiscal drag for the median earner, personal income tax thresholds would have to be lifted by the same proportion that the median wage has increased, i.e., by 53%. This would substantially reduce the revenue collected by the personal income tax system and would likely not be a fiscally sustainable option.
7. If adjustments to PIT thresholds are not made, fiscal drag is projected to continue in the future as incomes continue to grow. In the 2024 Half Year Economic and Fiscal Update, average wages were forecast to increase by 16.6% between 2024 and 2028.
8. As more earners move into the higher tax brackets, there is a broad flattening in the taxation of incomes and the progressivity of the PIT system decreases. With the increase in the minimum wage to $23.15 per hour from 1 April 2024, a minimum-wage earner working 40 hours per week will earn $48,284 per year. This means that under

current settings, all full-time earners will have a marginal tax rate (the rate they pay on an additional dollar of income) of 30% or more and the most progressive stages of the personal tax system will be below the level of the full-time minimum wage.

9. Similar impacts can be seen for tax credits that have fixed income thresholds where credits start to abate. The Independent Earner Tax Credit (IETC) was introduced in 2009 to provide a targeted tax reduction of up to $520 per year to earners between $24,000 and $48,000 who do not receive other transfer payments. The IETC abates at a rate of 13 cents for every dollar earned over $44,000 and fully abates at $48,000. These abatement thresholds have not been adjusted in the 15 years since the IETC was introduced, meaning the target population has changed significantly.

10. For example, a full-time worker on the minimum wage in 2009 earned around $26,000 and would have received the full IETC payment assuming they met other eligibility requirements. In 2024, an individual working 40 hours per week on the minimum wage would earn just over the income limit of $48,000 and would not receive the IETC.

What is the policy problem or opportunity?

11. As described above, fiscal drag has the potential to erode the progressivity of the personal income tax system and has other impacts that may not align with Government objectives:

    - The increase in annual tax liability from fiscal drag is uneven across income levels, with the greatest impact occurring as the $48,000 income threshold is crossed. Full-time minimum wage earners will therefore be heavily affected in coming years.
    - The average rate of tax on total personal income increases over time, reducing economic efficiency as people's decisions are more heavily impacted by tax.
    - The increase in tax from fiscal drag is arguably less transparent than explicit changes to tax settings and may engender less public debate.
    - When inflation exceeds wage growth, people's tax burden increases even as their ability to pay for goods and services decreases.

12. The desired level of progressivity in the PIT system is a judgement for ministers to make. Any decision to address fiscal drag by adjusting PIT thresholds will also depend on the revenue needs of the Government and their economic goals.

What objectives are sought in relation to the policy problem?

13. In the National-ACT coalition agreement, a commitment was made to:

    > "Ensure the concepts of ACT's income tax policy are considered as a pathway to delivering National's promised tax relief, subject to no earner being worse off than they would be under National's plan."

14. Both the National Party and the ACT Party announced plans for PIT relief during the 2023 general election, with the stated objectives as summarised in Table 2.

15. The New Zealand First Party also campaigned on tax relief in response to fiscal drag, and a commitment was made in the National-New Zealand First coalition agreement to, "by or before 2026, assess the impact inflation has had on the average tax rates faced by income earners."

Table 2: Objectives for PIT relief

National Party objectives	ACT Party objectives
compensate for the impact of fiscal drag on average tax rates	encourage work, saving and investment (including by reducing the top tax rate)
increase after-tax incomes, particularly for middle-income New Zealanders	flatten and simplify the personal income tax system by reducing the number of tax rates and thresholds
ensure there is a greater financial return from work	

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

16. Officials use the principles in Table 3 to assess the impact of tax policy changes. These principles broadly encapsulate the objectives described in Table 2 (e.g., the objective of encouraging work, saving and investment is included in the principle of efficiency and productivity). The weight given to each principle (priorities and trade-offs) is a value judgement for ministers to make.

17. In particular, trade-offs must be made between the first three principles. For example, using tax to redistribute income from higher earners to lower earners will likely have negative impacts on economic efficiency, while targeting efficiency gains by reducing tax rates would have a negative impact on fiscal sustainability. It is unlikely that all three objectives could be targeted with the same policy.

Table 3: Principles used to assess tax policy changes

Principle	Key considerations for ministers
Fiscal impact / sustainability	Reductions in tax revenue have a price tag. Revenue changes may also compromise long-term fiscal sustainability.
Efficiency and productivity	Reducing tax rates can reduce distortions to personal income decisions and could enhance incentives to work, save, and invest in human capital.
Distributional impacts / equity	While tax relief may target a specific group, changes will impact across the entire taxpayer distribution including earner types, ethnicities, households, etc.
Integrity	Changes to tax rates and marginal tax rates can impact perceptions of fairness in the tax system and taxpayers' willingness to comply.
Macroeconomic impacts	Impacts of options could be considered in the context of the macroeconomic environment, e.g., capacity constraints and inflation.
Administrative / compliance costs	Officials favour options that minimise administration and compliance costs for software providers, employers, and earners.

What scope will options be considered within?

18. Both the National Party and the ACT Party announced plans for PIT relief during the 2023 general election. The income tax changes proposed by National and ACT are set out in Table 4 below. Given the commitment made in the National-ACT coalition agreement (see paragraph 13), officials focused on the proposals put forward by these two parties.

    a. The ACT manifesto plan would be phased in over several years, with the final settings in the table being implemented from 1 April 2026. This would be combined with a Low- and Middle-Income Tax Credit ("the tax offset"), which would be paid out at time of taxation to compensate for a higher bottom tax rate.

    b. The National manifesto plan would be effective from 1 July 2024 and also includes lifting the abatement threshold of the IETC from $48,000 to $70,000.

Table 4: National and ACT Party personal income tax policies

Marginal rate	Current thresholds	National policy	ACT policy (final)
10.5%	$0-14,000	$0-$15,600	n/a
17.5%	$14,001 - $48,000	$15,601 - $53,500	$0 - $60,000
30%	$48,001 - $70,000	$53,501 - $78,100	$60,001 - $180,000
33%	$70,001 - $180,000	$78,101 - $180,000	$180,001 +
39%	$180,001 +	$180,001 +	n/a

19. Given the commitments made by parties in the coalition Government during the 2023 election and the compressed timeframe for decisions, officials focused on the policies in Table 4 and modifications to these.

What options are being considered?

Option One – *Status Quo*

20. The status quo PIT thresholds are set out below.

Marginal rate	Upper threshold
10.5%	$14,000
17.5%	$48,000
30.0%	$70,000
33.0%	$180,000
39.0%	-

Option Two – *National manifesto plan*

21. The uplifted thresholds announced by the National Party during the 2023 general election are set out below. The National plan also includes lifting the abatement threshold of the IETC from $44,000 to $66,000.

Marginal rate	Upper threshold
10.5%	$15,600
17.5%	$53,500
30.0%	$78,100
33.0%	$180,000
39.0%	-

Option Three – *ACT manifesto plan*

22. The phased threshold changes announced by the ACT party during the 2023 general election are set out below. The plan also includes a tax offset to compensate for a higher bottom tax rate. The changes are phased in as follows:

    i. From 1 April 2024, the 10.5% marginal rate is removed and the threshold for the 17.5% rate is lifted to $60,000

    ii. From 1 April 2025, the 33% marginal rate is removed

    iii. From 1 April 2026, the 39% marginal rate is reduced to 33%.

<table>
<tr><th>Upper threshold</th><th>Status quo</th><th>2024/25</th><th>2025/26</th><th>2026/27</th><th>2027/28</th></tr>
<tr><td>$14,000</td><td>10.5%</td><td colspan="4" rowspan="3">17.5%</td></tr>
<tr><td>$48,000</td><td>17.5%</td></tr>
<tr><td>$60,000</td><td rowspan="2">30%</td></tr>
<tr><td>$70,000</td><td>30%</td><td colspan="3" rowspan="2">30%</td></tr>
<tr><td>$180,000</td><td>33%</td><td>33%</td></tr>
<tr><td>+</td><td>39%</td><td colspan="2">39%</td><td colspan="2">33%</td></tr>
</table>

23. After the ACT-National coalition agreement made a commitment to no earner being worse off than they would be under National's plan, two variations on the ACT plan were considered at the request of ministers:

    a. Retain the 2024/25 settings in the ACT plan, without any further changes in subsequent years.

    b. Retain the 2024/25 settings in the ACT plan for the first two years, and then remove the 33% rate in 2026/27 (but retain the 39% rate).

24. These options included a tax offset with the following parameters:

    i. Phase in at 10 cents for every dollar earned between $1000 and $11,000 up to a maximum offset of $1,000.

    ii. Abate at 10 cents for every dollar earned between $48,000 and $58,000.

Option Four – *Alternative option to simplify the tax system ("Alternative plan")*

25. Officials developed an alternative plan to achieve the objective of simplifying the tax system by reducing the number of tax rates and thresholds, but that could be achieved at a lower fiscal cost. This plan was developed by officials as an illustration of what could be achieved within these parameters.

26. The alternative plan combines the first two thresholds under a 14.5% rate and the next two thresholds under a 32.5% rate, leaving three tax thresholds overall. This option retains the 39% top tax rate and does not include a tax offset or extension to the IETC.

Marginal rate	Upper threshold
14.5%	$53,500
32.5%	$180,000
39.0%	+

Option Five – *Cost-saving alternatives to National plan*

27. Officials developed three alternative cost-saving options to the National plan, as set out below. These options all retain the basic approach of the National plan but make relatively small adjustments to different aspects of it.

	Option 2 *National plan PIT threshold changes*	**Option 5a** *National plan but retain bottom threshold*	**Option 5b** *National plan but 10% less for each threshold*	**Option 5c** *National plan but 50% less for $70,000 threshold*
10.5% rate	$15,600	**$14,000**	**$15,400**	$15,600
17.5% rate	$53,500	$53,500	**$53,000**	$53,500
30% rate	$78,100	$78,100	**$77,300**	**$74,000**
33% rate	$180,000	$180,000	$180,000	$180,000

28. Further to these alternatives, additional savings could be achieved by:
    a. delaying implementation of the plan to 1 October 2024 (from 1 July 2024)
    b. scaling the IETC expansion (i.e., a smaller increase to the threshold)
    c. retaining the current settings for the IETC (i.e., no increase to the threshold)

How do the options compare to the status quo/counterfactual?

	Option 2 ***National plan***	**Option 3** ***ACT plan***	**Option 4** ***Alt plan***	**Option 5a** ***Cost-saving***	**Option 5b** ***Cost-saving***	**Option 5c** ***Cost-saving***
Fiscal impact/ sustainability	- -	- - -	- -	-	-	-
Efficiency and productivity	+	+ +	+	+	+	+
Distributional impacts/equity	*na*	*na*	*na*	*na*	*na*	*na*
Integrity	+	+	0	+	+	+
Macroeconomic impacts	0	0	0	0	0	0
Administrative/ compliance costs	0	- -	-	0	0	0
Overall assessment	+	-	0	+	+	+

29. **Fiscal impact:** All options significantly reduce tax revenue over the forecast period (OFP). This policy analysis was prepared in the context of the Government's intention to fund this package from within Budget 2024 allowances, which was advised by the Treasury in its Briefing to the Incoming Minister of Finance in 2023 and is consistent with the objective of fiscal sustainability. Therefore, these packages would be considered fiscally sustainable when looked at in the wider context of the Budget decisions they are being taken in – as long as they are not so costly that it would no longer be possible to fund within allowances. However, the Treasury has advised the Government to reduce the cost of Budget 2024, and where possible to support a return to surplus. Whilst all the plans would therefore be viewed as fiscally sustainable in theory, there was a difference in cost, which may impact the feasibility of funding some of the plans within Budget 2024 allowances, and consistency with the goal of returning to surplus:

    - Option 3 has the largest impact of at least $15 billion OFP ($6.1 billion in 2027/28).
    - Option 2 and Option 4 have impacts of around $10-11 billion OFP ($2.8 billion in 2027/28).
    - Options 5a, 5b and 5c have the smallest impact of around $8-9 billion OFP ($2.2 - $2.3 billion in 2027/28).
    - The two variations on Option 3 cost around $6 billion (3a) and $12 billion (3b) OFP, and $1.8 billion (3a) and $5.0 billion (3b) in 2027/28.

30. **Efficiency:** Personal income tax has a negative impact on economic efficiency to the extent that it affects people's income earning decisions (in other words, distorting behaviour). All options would be expected to have positive impacts on efficiency by reducing the amount of tax levied on personal income, thereby decreasing distortions to work, investment and savings decisions. The removal of the 39% rate in Option 3 would have a relatively larger impact per dollar of fiscal cost, but the limited population affected would mitigate the aggregate benefits.

    For those already in work, the decision to work more or fewer hours can be influenced by effective marginal tax rates (EMTR – the fraction of each additional dollar earned that is lost to tax and reduced transfers). Changes that significantly reduce effective marginal tax rates would be expected to enhance incentives to work additional hours and may also encourage workers to increase their wage prospects by upskilling. This could have positive implications for overall labour supply and the productive capacity of the economy. Other factors will also contribute to a person's decision to work, however, so it is uncertain whether they will respond to increased incentives, and we have not formally modelled the impact of the options on overall labour supply. Annex 1 contains analysis of the impact of the options on EMTRs.

    The expansion of the IETC will have opposing impacts on financial returns from work. While it will increase overall returns for earners between $44,000 - $70,000, it will also have a negative impact on marginal returns for earners between $66,000 - $70,000, which may reduce their incentive to work additional hours. It is therefore likely that this objective could be achieved more effectively by removing the IETC and making other changes to tax and transfer settings for the same fiscal cost.

31. **Distributional impacts:** Each option has different distributional impacts, with Options 3 and 4 being more targeted to reducing tax for higher-income earners, and Options 2 and 5 being more targeted to middle-income earners and those impacted by fiscal drag. As the desirability of a particular income distribution is a judgement for ministers, officials do not comment on whether an option is preferable regarding distributional impacts. Annex 2 contains analysis of the distributional impacts of the options.

Option 2 is most directly targeted towards addressing fiscal drag, as it makes proportional increases to all of the PIT thresholds that were in place in 2010, thus achieving the exact opposite effect as fiscal drag. The PIT threshold adjustments in Option 2 would reduce the annual tax liability of someone earning the 2023 median full-time wage ($73,417) by $902, reducing their average tax rate by 1.2 percentage points to 19.4%. This compensates for around one quarter of the average tax rate increase from fiscal drag since 2011. The expansion of the IETC would not benefit these earners as they will earn above the new threshold.

Fully compensating for the accumulated fiscal drag since 2011 would therefore require an adjustment to PIT thresholds around four times larger than the adjustments in Option 2, which would likely increase the cost by a similar proportion. This would not be a fiscally sustainable option without substantial changes to government spending and/or revenue in other areas.

Adjustments to personal income tax thresholds will have flow-on impacts to other components of the tax and transfer system:

a. New Zealand Superannuation rates will increase due to both the direct impact of the PIT threshold adjustments and the indirect impact of being tied to the net average wage.

b. Student allowances will *increase* as the rates are set gross in legislation.

c. Main benefits will be *unaffected* by the tax changes as the rates are set net of tax in legislation.

32. **Integrity:** The revenue-raising capability of the personal income tax system depends on taxpayer compliance, which may be influenced by people's perceptions of the fairness of the tax system. To the extent adjustments to tax thresholds in response to fiscal drag improve perceptions of fairness, we would expect some small positive impacts on compliance from Options 2 and 5. Option 3 would also be expected to improve integrity by reducing the gap between the company tax rate and the top personal tax rate, thereby reducing incentives for tax avoidance.

33. **Macroeconomic impacts:** Treasury modelling shows that tax relief funded through an increase in government debt is expected to put some upward pressure on inflation and therefore interest rates. However, if tax relief is funded through an equivalent decrease in government spending, then the overall effect is a slight decrease in modelled interest rates. This is because the "fiscal multiplier" for tax relief is assumed to be lower than for government spending, meaning the decrease in government spending more than offsets the increase in spending by recipients of tax relief. To the extent that tax relief is funded within Budget 2024 operating allowances, a slight decrease in inflation pressures and therefore slightly lower interest rates would be expected.

34. **Administrative and compliance costs:** Options 2 and 5 are relatively simple changes to the PIT system and would have minimal impacts on administrative and compliance costs. However, implementation in the middle of the tax year would place one-off costs on Inland Revenue, employers and third-party payroll providers. Option 4 would be more complex owing to the changes in marginal tax rates.

Option 3 would be the most complex change owing to the introduction of the tax offset (a tax credit paid out at the time of taxation); effectively compensating for the higher bottom marginal tax rate. Introducing the offset would create substantial costs for private and public sector payroll providers and Inland Revenue. For taxpayers, the offset would likely lead to more end-of-year tax bills and place additional burden on those who have more than one source of income and the income from the secondary source occurs in the abatement zone for the tax offset. Those with a second job would

have to apply for tailored tax codes each year as the abatement zone is not reflected in the secondary tax codes.

35. **Other government commitments:** The ACT-National Coalition Agreement made a commitment to no earner being worse off than they would be under National's plan (Option 2). Option 3 – the ACT manifesto plan – did not meet this test, even with the use of a tax offset to compensate for the higher bottom tax rate. Variations on this plan – Options 3a and 3b – were developed in order to meet this test, but the use of the tax offset in these plans was considered to be a complex change that contradicted the aim of simplifying the tax system. Options 4, 5a, 5b and 5c also did not meet this test, although to a lesser degree than Option 3.

    In general, it would not be possible to deliver greater tax relief at some parts of the income spectrum compared to Option 2, while also ensuring no earner is worse off, without increasing the fiscal cost compared to Option 2.

36. **Overall assessment:** Options 2 and 5 are considered to be positive changes overall. They go some way to addressing the impacts of fiscal drag and have minimal negative consequences apart from the large fiscal cost. Insofar as ministers are willing to trade off the fiscal cost to meet their other objectives and can manage the cost within Budget allowances, officials support these options.

    Option 4 may also be supported if ministers were more focused on the goal of flattening the PIT system by reducing the number of thresholds and rates, noting that some low-income households would be made significantly worse off. However, officials do not support Option 3 as it would create significant additional compliance costs and it is unlikely that the fiscal cost could be managed within Budget allowances without making large sacrifices to other Government priorities.

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

37. Option 2 effectively addresses the policy problem of fiscal drag while having minimal negative consequences on other policy objectives, except for the large fiscal cost. The cost could be reduced through the alternatives in Option 5. Option 3 delivers larger efficiency gains but at a much larger fiscal cost, while also producing significant administrative effort and causing some earners to be worse off than under Option 2. **Officials therefore support the broad approach in Option 2 (the National manifesto plan)**, with the following further recommendations:

    a. consider cost-saving alternatives (Option 5) to support a return to surplus,

    b. delay implementation to 1 October 2024 to reduce the fiscal cost, minimise administrative demands for Inland Revenue and ensure all taxpayers receive the benefit of the tax changes on time,

    c. do not proceed with the proposed IETC expansion. The longstanding view of officials has been that the objective of improving work incentives could be achieved more effectively by removing the IETC and making other changes to tax and transfer settings for the same fiscal cost. See T2017/164: Removing the Independent Earner Tax Credit[2] for further discussion of the IETC, and

    d. prevent the tax changes flowing through to student allowances. Alignment with the benefit system is a principle of the student support system, and since main benefits will not increase from the tax changes, the same approach should be taken for student allowance.

[2] https://www.treasury.govt.nz/sites/default/files/2017-11/b17-3659148.pdf

What are the marginal costs and benefits of the option?

Groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Crown	Large reduction in Crown revenue over the forecast period.	$10.3 billion OFP	*Large reduction in revenue:* High *Broadly similar to forecast:* Medium
Inland Revenue and third-party payroll providers	Changes to PIT thresholds creates a small, one-off administrative cost for Inland Revenue and third-party payroll providers. Changes made within 3 months of announcement may create additional costs if some employers fail to make the changes on time.	Administrative costs to Inland Revenue and the Ministry of Social Development estimated at 15.4 million OFP. Costs to third parties is uncertain.	Medium
Part-year benefit recipients	Modelling shows 9,000 households will have a small reduction in income due to an unintended interaction with the personal income tax threshold adjustments and the way part-year benefit payments are calculated.	9,000 households have their income reduced by $1 per week on average compared to the status quo.	Medium
Total monetised costs	Main cost is reduction in Crown revenue over the forecast period. Forecast by Treasury using *Budget Economic and Fiscal Update 2024* forecasts. Forecasts of revenue are uncertain, but the evidence base for PIT revenue forecasts is relatively strong.	$10.3 billion reduction in Crown Revenue + $15.4 million administrative costs to Inland Revenue and the Ministry of Social Development	Medium
Non-monetised costs	Small costs to third-party payroll providers.	Low	Medium
Additional benefits of the preferred option compared to taking no action			
Taxpayers	Greater disposable income owing to reduction in tax levied on personal income.	$10.3 billion OFP	Medium
Wider economy	Small efficiency benefits from reductions in personal income tax.	Uncertain	Low
Total monetised benefits	Individual taxpayers receive the benefit of greater disposable income, equal to revenue lost by the Crown.	$10.3 billion OFP	Medium
Non-monetised benefits	Small efficiency benefits to wider economy.	Low	Low

Te Tiriti o Waitangi: Budget sensitivity did not allow for engagement with Māori stakeholders, meaning the extent to which Māori had a role in the design of the policy was limited. Analysis of distributional impacts for Māori has also been limited owing to short timeframes for advice. Available analysis of the option suggests average gains for Māori are relatively similar to other population groups, though a smaller proportion of Māori gain compared to the overall population (see Annex 2). By providing tax relief, the option is expected to have positive impacts on Māori wellbeing and building Māori capability.

Section 3: Delivering an option

How will the new arrangements be implemented?

38. Inland Revenue will continue to be responsible for the ongoing operation and enforcement of the tax system. The proposed changes will require amendments to Inland Revenue's tax administration system START and changes to Inland Revenue's customer facing content. While the changes to the START system can be made later, the changes to customer facing content will need to be made by 30 May so that the content can be made available as soon as the changes have been legislated. This will allow third parties to work on the system changes that they need to make to implement the proposed changes.

39. Inland Revenue will also need to contact significant groups such as payroll software providers and payroll service providers as soon as possible after the changes are announced to help ensure that there are no delays in beginning to implement the changes. Inland Revenue will have a communications plan in place that will go live after the changes have been legislated. This will include messaging to payroll software providers, payroll service providers, employers and individuals.

40. If the changes come into effect on 31 July 2024 and are only announced on 30 May 2024 it is likely that some employers will not be able to make the changes in time and will incorrectly calculate the income tax to be deducted from their employees pay. This can be corrected in later pay runs by the employer or can be corrected as part of the end of year tax assessment process that Inland Revenue runs.

Consequential tax impacts

41. Several other taxes have rates that are based on the personal income tax rates. Changes to the personal income tax rates and thresholds will therefore require further legislative amendments to these other tax types. Affected tax types include:

- Resident Withholding Tax (RWT).
- Portfolio Investment Entity (PIE) tax.
- Fringe Benefit Tax (FBT).
- Employer Superannuation Contribution Tax (ESCT).
- Retirement Scheme Contribution Tax (RSCT).

42. The applicable rates and thresholds of these tax types would also need to shift to align with the proposed PIT changes. For example, under the National plan, the ESCT thresholds will also change as in Table 5 below:

Table 5: Change to ESCT thresholds resulting from personal income tax changes

Tax Rate	Status quo	New thresholds
10.5%	$0 - $16,800	0 - $18,720
17.5%	$16,801 - $57,600	$18,721 - $64,200
30.0%	$57,601 - $84,000	$64,201 - $93,720
33.0%	$84,001 - $216,000	$93,721 - $216,000
39.0%	$216,001 +	$216,001 +

43. The changes to RWT will also be made on 31 July 2024. The changes are increasing the income thresholds for the various personal tax rates, but they are not changing the rates themselves. While payers of resident withholding income will need to update their information on RWT and some recipients may need to adjust their selected RWT rates, there should be no changes to the actual withholding system that RWT payers use. In addition, if people are using the incorrect RWT rate, any under or overpayment can be corrected as part of the end of year tax assessment process that Inland Revenue runs.

44. The other consequential tax types including), PIE tax, FBT, ESCT and RSCT will be adjusted from the beginning of the next tax year (1 April 2025). This will allow more time to make the changes and reduce the complexity of the changes. This will in turn reduce compliance costs for employers. The trade-off for this is that investors and employees will receive the benefit of the changes from a later date, and this will be a permanent difference.

Third parties

45. Third parties such as payroll software providers and payroll service providers will need to make changes to their systems and their software to implement the personal income tax changes. Officials consulted with private sector software providers and payroll service providers to understand the timeframes needed to make changes. The time required is dependent on the level of complexity of the changes.

46. Ideally, payroll software providers would be given 3 months' notice of upcoming changes. This is based on a timeframe of 6 weeks to complete and test the changes before providing the software to their clients 6 weeks before the implementation date. This is because clients need to load information for pay runs into their system before they make the payments. Some pay information can be input as much as a month before the pay run and as such the new software would need to be in place for this information to be processed correctly.

47. Shortening this timeframe to 2 months would likely mean clients would receive the software 2 weeks before implementation, instead of 6 weeks. This would likely mean some employees would have their tax calculated under status quo thresholds for a payment after the implementation date. However, this could be corrected in subsequent pay periods, or the difference picked up in the end of year tax assessment process.

48. Similarly, payroll service providers would ideally be given 3 months' notice of upcoming changes to the Pay as You Earn (PAYE) rules. Shortening this timeframe to 2 will increase the likelihood of errors. However, these could be corrected in subsequent pay periods, or the difference picked up in the end of year tax assessment process.

49. Some public sector organisations with specific payment challenges will need longer to implement the changes due to the special characteristics of the payments they make (i.e., this is not relevant to their standard departmental payroll functions). These include the payments made by the Ministry of Social Development (benefits, allowances and pension systems); Accident Compensation Corporation (compensation system) and the Ministry of Health (doctors and nurses payroll systems).

50. The identified organisations make payments that are subject to PAYE to a significant number of beneficiaries, superannuitants, compensation claimants and the health workforce. If they are unable to update their payment systems in time, incorrect

amounts of tax will be deducted, and the recipients (other than beneficiaries) will be likely to receive less of their payments than they are entitled to.

51. These organisations could be given advance notice, prior to Budget Day, on a Budget Secret basis, or errors could be addressed by Inland Revenue during the end of year tax assessment process. The Ministry of Social Development have provided initial indications that approximately three months lead in time (from the Cabinet decision) will be required for it to progress the necessary IT, legislative and operational changes in time; the Accident Compensation Corporation would need 8-13 weeks; and Health New Zealand would need approximately 4 months.

Implementation date

52. In 2010 (the last time thresholds were increased), 1 October was the date chosen in order to allow sufficient time for implementation as detailed. Officials have recommended the same date is chosen for these changes. A shorter delivery window is possible, but brings a higher likelihood of increased errors, which in turn will create an increased workload for Inland Revenue during the end of year tax assessment process.

53. The Cabinet Paper recommends progressing the PIT changes from 31 July 2024. With the changes being announced on Budget Day (30 May), this will allow approximately two months for third parties such as payroll software providers and payroll service providers to implement the changes. As noted above, these third parties would ideally be given 3 months' notice of upcoming changes.

54. Despite this shortened timeframe, we would generally expect most employers to be able to pay their employees under the updated tax scales from 31 July. There are likely to be some exceptions and some incorrect calculations, but these are able to be corrected in subsequent pay runs or as part of the end of year tax assessment process completed by Inland Revenue.

Legislative change

55. The tax changes will be included in Budget night legislation.

How will the new arrangements be monitored, evaluated, and reviewed?

56. Inland Revenue will continue to monitor the tax system in a range of ways to maintain the integrity of the tax system. Inland Revenue also regularly reports to the Government on the amount of tax being collected. It is not anticipated that any additional monitoring, evaluation or review above that which already occurs will be required as a result of the proposed changes.

Annex 1: Impact of Option 2 on effective marginal tax rates

Treasury modelling can estimate the distribution of EMTRs for the New Zealand population. Table 6 shows the number and characteristics of people who we estimate will experience a change in EMTRs from Option 2 in the year ending 31 March 2027. This analysis was only completed for Option 2 as this was the main option being considered at this stage in the advice process. It is important to note that not all people with income within the income tax ranges in Table 6 would experience the impacts shown – it will be dependent on their receipt of any benefits or tax credits, as well as the design of the final tax package.

The personal income tax threshold changes and extending the income range of the Independent Earner Tax Credit reduce EMTRs for 335,000 people (positive impact on work incentives) and increase EMTRs for 85,000 people (negative impact on work incentives).

Adding the proposed family-based tax credit changes (the In-Work Tax Credit and FamilyBoost) increases the EMTRs for a further 45,000 people (negative impact on work incentives). These people are in coupled families with children, and are spread across the first 4 income tax bands ($0 to $180,000). Modelling did not indicate an increase in EMTRs for sole parents.

These tax credits increase people's EMTRs because of the way the credits abate as incomes grow. Although people's income is increased by the credits, their EMTR also increases as they cross the abatement threshold and their payment reduces with each extra dollar of income. This negatively impacts their incentive to work. The proposed changes impact abatement in different ways:

a. The increase to the In-Work Tax Credit by $25 per week means the payment will take longer to abate to zero, as the abatement rate is constant. This means some people whose payment would otherwise have fully abated will now receive an abating payment.

b. As FamilyBoost is a new credit, people who receive it and whose family income is within the abatement range ($140,000 to $180,000) will have an increased EMTR because of the abatement of the credit.

Table 6: Impact of Option 2 on effective marginal tax rates

Reason for change	Taxable incomes between:	Work incentive	Threshold changes + IETC threshold to $70,000	Threshold changes + IETC threshold to $70,000 + family-based tax credits
PIT rate change from 17.5% to 10.5%	$14,000 - $15,600	Reduced EMTR, **increased** work incentive	35,000 people	35,000 people
Those who are eligible for IETC and no longer in abatement zone. Abatement rate of 13%	$44,000 - $48,000	Reduced EMTR, **increased** work incentive	45,000 people	45,000 people
PIT rate change from 30% to 17.5%	$48,000 - $53,500	Reduced EMTR, **increased** work incentive	125,000 people	125,000 people
Those who are eligible for IETC and are now in abatement range	$66,000 - $70,500	Increased EMTR, **decreased** work incentive	85,000 people	85,000 people
PIT rate change from 33% to 30%	$70,000 - $78,101	Reduced EMTR, **increased** work incentive	130,000 people	130,000 people
Those receiving changes to IWTC or FamilyBoost	$0 - $180,000	Increased EMTR, **decreased** work incentive		45,000 people, made up of: • 15,000 from IWTC • 30,000 from FamilyBoost
Total number of people whose work incentives are affected			**335,000** positively affected (reduced EMTR) **85,000** negatively affected (increased EMTR)	**335,000** positively affected (reduced EMTR) **130,000** negatively affected (increased EMTR)

EMTR analysis has been recently developed to support Treasury modelling and advice. Due to its experimental nature, Treasury considers these results have low reliability and medium risk.

Annex 2: Distributional analysis of options

Option 2

Officials provided distributional analysis of the PIT threshold and IETC changes in Option 2 in combination with other tax and transfer policies included in Budget 2024. These included the $25 per week increase to the In-Work Tax Credit (IWTC) and the introduction of the FamilyBoost policy, which gives parents a rebate of up to $75 per week for money spent on early childhood education fees. These four policies together are referred to as “the package”.

Distributional analysis provided in advice was based on economic forecasts from the 2023 *Half Year Economic and Fiscal Update*, and household data from the 2021 *Household Economic Survey* (HES). The Cabinet Paper includes distributional analysis based on the latest available economic forecasts and household data (i.e., 2024 *Budget Economic and Fiscal Update* forecasts and 2023 HES data). The distributional analysis in this Regulatory Impact Statement therefore differs slightly from what is in the Cabinet Paper.

Overall, the package increases the income of 93% of households[3] by $30 per week[4] on average. Households with children gain by $39 per week on average. A small number of households (0.5% of all households) have their income reduced from the package by $1 per week on average, due to an unintended interaction with the tax threshold adjustments and the calculation of part-year benefit payments. 135,000 households (7%) are unaffected. Many of these will be receiving main benefits and have no change because benefit rates are set in after-tax terms.

Household impacts are in comparison to household incomes at the same point in time (the year ending 31 March 2027) if the policy change was not made. Gains and losses do not indicate whether a household is better or worse off compared to the previous year, but only how their projected income in 2027 *with* the policy change compares to their projected income in 2027 *without* the policy change.

Figure 1 shows the weekly impact of the package on household incomes, grouped by equivalised income quintiles.[5] The number of households in each quintile who have their income increased or reduced is also shown (e.g., 394,000 households in the third quintile have their income increased by $32 per week on average). Only households in the first quintile have their income reduced, by $1 per week on average. These are households who receive main benefit income for only part of the year, and receive a slight reduction in benefit income due to an unintended interaction with the tax threshold adjustments and the calculation of part-year benefit payments. It is unlikely this could be avoided by designing the package differently.

The first quintile contains the smallest number of gaining households (290,000). Most of the households unaffected by the package are in the first quintile (100,000 out of 135,000). Households in the first quintile also gain by the least on average ($13 per week). This reflects the fact that people receiving main benefits, who have relatively low incomes, do not gain from the package as benefit rates are set in after-tax terms. The largest weekly gain goes to

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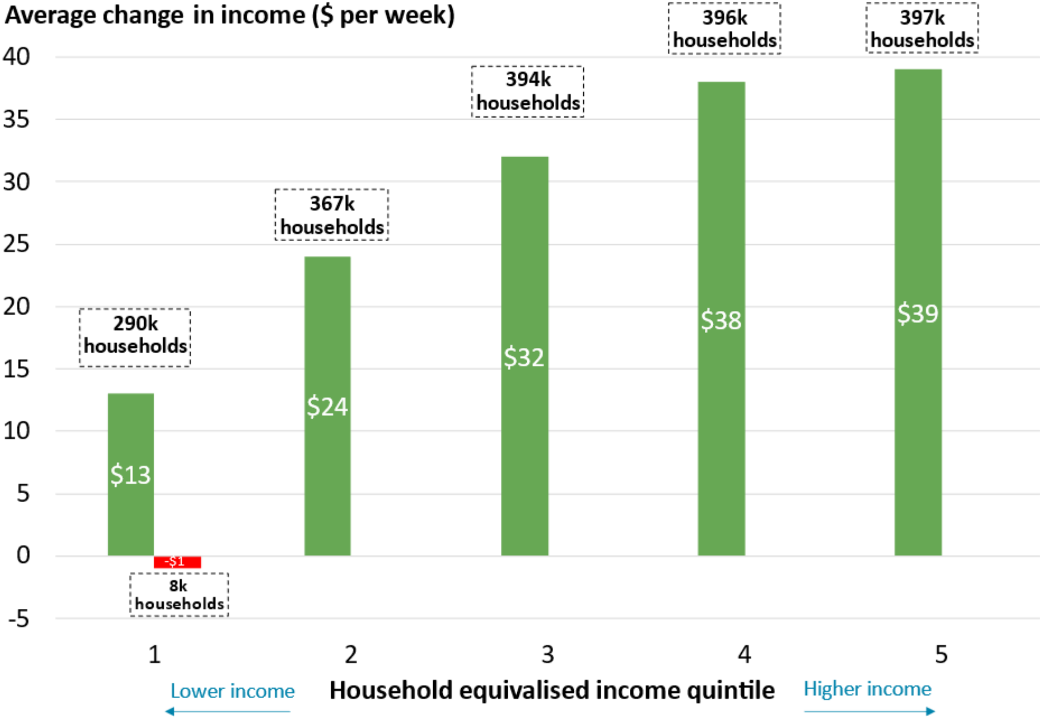
3 Households are defined as one or more people living together in a private dwelling and sharing facilities. A household could contain more than one family, which is defined as a single person or couple and any dependent children.

4 This is a measure of change in household disposable income. Note that while we have used equivalised household income to compare groups, the average gains and losses are not adjusted for household size or composition.

5 Income equivalisation accounts for different household compositions (e.g., the number of adults and children) to allow for like-for-like comparisons across households. Two households with different compositions (e.g., a single person compared to a couple with two children) need different levels of income to meet the same standard of living. Equivalisation attempts to account for the additional income needed to support more people and also economies of scale due to shared housing costs, utilities, etc.

the fifth quintile, reflecting the fact that the maximum gain from the PIT threshold adjustments occurs at a relatively high individual income level ($78,100).

Figure 1: Impact on household incomes by equivalised income quintile



Officials also provided analysis of how each individual component of the package impacts household incomes. The individual package components impact households as follows:

i. The **PIT threshold changes** increase net incomes for 1.831 million households (93% of all households) by an average of $25 per week. These changes will also reduce net incomes for a further 9,000 households (0.5% of all households) by an average of $1 per week due to an unintended interaction with the personal income tax threshold adjustments and the way part-year benefit payments are calculated.

ii. The **IWTC increase** increases net incomes for 160,000 households (8% of all households; 25% of households with children), including around 4,000 households that do not gain from the PIT threshold changes, by an average of $20 per week.

iii. The **IETC expansion** increases net incomes for 381,000 households (19% of all households) by an average of $10 per week.

iv. **FamilyBoost** increases net incomes for 80,000 households (4% of all households and 12% of households with children) by an average of $34 per week. The majority of these households are in the bottom half of the equivalised income distribution, and the lowest earning households gain by the most on average.

Individual-level analysis shows the impacts of the package by demographic group. Note that this analysis was developed later in the process and is based on the latest available economic forecasts and household data (i.e., 2024 Budget Economic and Fiscal Update forecasts and 2023 HES data).

Compared to the overall population, relatively fewer Māori, Pacific Peoples and women benefit from the package. Overall, 83% of individuals gain by an average of $16 per week. This compares to 74% of Māori gaining, 73% for Pacific Peoples, and 81% for women. Average gains for Māori and Pacific Peoples are equal to the overall population, while women gain by slightly less ($15 per week on average) due to lower incomes. By contrast, almost all seniors benefit from the changes (97%) due to the near-universal receipt of NZ Super, but by a smaller amount ($13 per week).

Options 3 and 4

To help understand the scale of the tax offset required to ensure no individual was worse off under Options 3 and 4 compared to the status quo, officials presented distributional analysis of these plans without the use of an offset. This is shown in Table 7.

Table 7: Individual and household impacts of Options 3 and 4, without a tax offset

Year ending 31 March 2027	**Option 3 (no offset)**	**Option 4 (no offset)**
Income level where individuals pay more tax compared with the status quo	Under $55,840 (Equivalent to around 47 hours on minimum wage)	Under $32,667 (Equivalent to around 28 hours on minimum wage)
Number of individuals aged 15+ with reduced disposable income compared to the status quo	1.111 million	0.656 million
Proportion of losing individuals that lose by more than $10 per fortnight	~75% of losing individuals	~40% of losing individuals
Average reduction in individual disposable income per fortnight	~$24 per fortnight	~$8 per fortnight
Share of all households that lose by more than $10 per fortnight	13.2% of households	2.8% of households

Multiplying the number of individuals losing by the average loss can provide a preliminary estimate of the total cost of compensating these individuals. This can serve as an approximation of the cost of a tax offset that would ensure no individual is worse off, as shown in Table 8. Larger offsets would be needed to ensure no one was worse off compared with the National plan.

Table 8: Summary of fiscal impacts of Options 3 and 4

	Option 3	**Option 4**
Preliminary estimate of annual cost of ensuring no earner is worse off	$0.6 - $0.8 billion p.a.	$0.1 - $0.2 billion p.a.
Indicative cost of threshold changes over forecast period (2024/25 to 2027/28)	$15.1 billion	$10.6 billion
Preliminary estimate of the combined cost over forecast period (2024/25 to 2027/28)	$17.5 - $18.3 billion	$11.0 - $11.4 billion

Option 5

In addition to reducing the fiscal cost, the cost-saving alternatives to Option 2 would alter the distributional impacts. These differences are summarised in Table 9.

Table 9: Distributional impacts of Options 5a-c compared with Option 2

	Option 5a *National plan but retain bottom threshold*	**Option 5b** *National plan but 10% less for each threshold*	**Option 5c** *National plan but 50% less for $70,000 threshold*
Key differences compared to Option 2	Individuals earning below $48,000 will not gain at all.	Individuals across the income spectrum will still gain, but by less.	Only individuals earning above $74,000 will gain by less.
Saving compared to Option 2	**$1.16 billion OFP** ($0.28b in 2027/28)	**$0.81 billion OFP** ($0.21b in 2027/28)	**$0.75 billion OFP** ($0.20b in 2027/28)
Impact on individuals by income range	• Individuals earning below $48,000 will not gain, • Individuals earning between $53,500 and $70,000 will gain by $13.22 per week, • Individuals earning above $78,100 will gain by $17.89 per week	• Individuals earning between $15,400 and $48,000 will gain by $1.88 per week, • Individuals earning between $53,000 and $70,000 will gain by $13.90 per week, • Individuals earning above $77,300 will gain by $18.12 per week	• Individuals earning between $15,600 and $48,000 will gain by $2.15 per week, • Individuals earning between $53,500 and $70,000 will gain by $15.38 per week, • Individuals earning above $74,000 will gain by $17.68 per week
Impact on households compared to Option 2	0.14 million households no longer gain **(7%)** 1.69 million households gain by less than Option 2 **(85%)**	1.83 million households gain by less than Option 2 **(92%)**	0.33 million households gain by the same amount **(17%)** 1.50 million households gain by less **(76%)**

Disclaimer for distributional outputs from the Treasury's TAWA model

These results are not official statistics. They have been created for research purposes from the Integrated Data Infrastructure (IDI) which is carefully managed by Stats NZ. For more information about the IDI please visit https://www.stats.govt.nz/integrated-data/. The results are based in part on tax data supplied by Inland Revenue to Stats NZ under the Tax Administration Act 1994 for statistical purposes. Any discussion of data limitations or weaknesses is in the context of using the IDI for statistical purposes, and is not related to the data's ability to support Inland Revenue's core operational requirements.

Regulatory Impact Statement: A childcare tax credit – "FamilyBoost"

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing Cabinet decisions on the direction of a childcare tax credit to support parents who have children in early childhood education.
Advising agencies:	Inland Revenue
Proposing Ministers:	Finance and Revenue
Date finalised:	12 March 2024

Problem Definition

The assumed policy problem is that the cost of early childhood education (ECE) is high relative to families' incomes. It is anticipated that this will result in some families being unable to afford some ECE hours, restricting the parent's ability to work and for the child to participate in ECE, or resulting in pressure on other types of family spending to maintain ECE hours. This may decrease parental labour market participation, ECE participation rates and families' income adequacy. It is anticipated that without government intervention, the problem will continue to worsen as the current high inflation environment and trends in the price measures for the ECE sector may result in ECE costs continuing to increase compared to incomes.

Executive Summary

The Government has indicated that it would like to alleviate the increasingly high cost of ECE relative to income by implementing a new childcare tax credit linked to childcare expenditure by 1 July 2024. The preferred parameters of the childcare tax credit, named FamilyBoost, was part of the National party's pre-election documents. The new tax credit sits alongside a package of changes outlined in coalition documents that would increase after-tax incomes through increases to tax credits and increases to tax thresholds.

The Government has outlined the primary objective of implementing a childcare tax credit is to directly increase the incomes of families who have children in ECE.

Administering a childcare tax credit as outlined in pre-election documents requires access to fees information that is linked to individual parents or caregivers, the children in their care, and to their family income for a broad segment of society. Currently no government agency has this fees information. There are two options for progressing the tax credit:

- Option 1 – develop a basic refund model that requires the fees information to be supplied from parents or caregivers, with a 1 July 2024 effective date, or,

- Option 2 – similar model but extend the implementation date by approximately two to three years to create information flows from ECE providers to the government on

individual fee payments, making the product automated from the parents' perspectives.

The primary trade-off between these two options is the date the product can be implemented by, and the level of effort required by potential recipients and the ECE sector.

Option 1 can be implemented quickly to provide prompt support but would place the onus on families to submit invoices on a regular basis to receive the childcare tax credit. Placing the onus on families could reduce the take-up of the tax credit, reducing the support received by eligible families. It also requires the ECE providers to update their invoices to ensure they are in the correct format for Inland Revenue to provide the tax credit. This option could be progressed with the intention of continuous improvements over time to reduce the burden on parents and align it closer to option 2. However, there is a risk that the basic model will be entrenched, with high compliance costs placed on parents and no replacement model ever designed and implemented.

Option 2 does not provide short-term benefit to parents as it would take longer to implement but would greatly reduce the compliance costs on parents, resulting in higher take-up than option 1. Administratively, option 2 would be more efficient for Inland Revenue to administer over the long run despite initial higher capital costs, s 9(2)(g)(i)

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However, this option has the risk that ECE providers may be unable to update their systems to create information flows of fees data to Inland Revenue and therefore the model is not feasible for some ECE providers and parents.

The best option depends on the Government's objectives and the resulting weighting given to the individual criteria. For example, if providing prompt support is the priority, a quicker implementation time would be preferred.

Limitations and Constraints on Analysis

Inland Revenue's ability to do a comprehensive policy analysis of this issue is constrained by the lack of publicly available ECE fees data, the pre-existing settings on the policy parameters, and time constraints.

The Government has indicated that providing prompt support to families facing cost of living pressures, through targeted assistance with ECE costs, is the priority. Therefore, it has directed Inland Revenue to implement "FamilyBoost", a childcare tax credit to increase the incomes of families who have children in ECE, by 1 July 2024. This has constrained the analysis to policy alternatives to "FamilyBoost" as outlined in the pre-election documents and precludes alternative policy options such as direct subsidies to providers and wider "care of child" financial support payments. Part of the Government's outlined policy parameters was for Inland Revenue to be the administrator of the payment. This further limited the scope of policy options that were considered to those that only Inland Revenue could implement.

In addition to policy design constraints, the lack of comprehensive ECE fees data from any government agency has required Inland Revenue to make assumptions about the severity of the policy problem and the factors causing it, as well as the impact of different options. This makes it difficult for any government agency to provide advice on how effective existing or new interventions are on the overall affordability of ECE. The lack of fees data also impacts the practicability of a tax credit linked to childcare expenditure.

Inland Revenue has not been able to undertake any consultation with the public due to time constraints and Budget secrecy conventions, despite the potential for significant compliance costs on the ECE sector and parents in implementing a childcare tax credit. This means that in preparing advice on options for implementing a childcare tax credit, we have made assumptions about:

- the ability of the ECE sector to make changes to implement the tax credit,
- the take-up rate by potentially eligible parents, and,
- the impact the tax credit would have on family incomes and ECE costs.

To assist in mitigating risks and verifying assumptions, we are requesting a Budget secrecy waiver to consult as soon as possible with the ECE sector. If the ECE sector is unable to make the changes necessary to implement the tax credit, officials will provide further advice to the Government on alternatives. The take-up rate of the policy depends on the option selected but will be monitored during the implementation and educational support provided to encourage take-up. Lastly, if either of the policy options considered in this paper are implemented, Inland Revenue will have some access to fees data (supplied either by parents or ECE providers) alongside income data, which can inform the Government of the tax credit's effect on ongoing ECE costs and family income adequacy. This would be a part of the post-implementation review. It may also support understanding of the impacts of wider government investment in the ECE sector.

Responsible Manager(s) (completed by relevant manager)

Maraina Hak

Policy Lead

Inland Revenue

s 9(2)(a)

12 March 2024

Quality Assurance (completed by QA panel)

Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	*The Quality Assurance panel from Inland Revenue has reviewed the "A child care tax credit – "FamilyBoost"" regulatory impact statement (RIS) prepared by Inland Revenue and considers that the information and analysis summarised in the RIS partially meets the quality assurance criteria. This is because the scope of the options analysis has been constrained by the lack of time to fully consider other options given the directive by the Government to provide the benefit through a tax credit mechanism. A comprehensive analysis of those other options outlined in the RIS may have provided a more appropriate option.* *In addition, the panel considered that the problem definition could be clearer but given the direction, assumptions and limitations*

	imposed on the analysis there is limited scope to further define the problem the policy is addressing. *Consultation with the sector has not been undertaken. The RIS would have benefited from feedback from consultation, including the views of the stakeholders on the options considered in the RIS.*

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. The assumed policy problem is that the cost of early childhood education (ECE) is high relative to families' incomes. The following section provides context on the ECE sector and future outlook on ECE affordability.
2. The 2022 Early Childhood Education Census showed that there were just over 181,000 children attending licensed early childhood services. Children attended for an average of 21.6 hours per week. Participation rates are highest for 3- and 4-year-olds, where 80% and 84% of children in the respective age groups were attending ECE in 2022. There were 4,597 licensed services operating at the time of the Census.[1]
3. Existing regulatory systems are in place to support families with childcare costs. These range from universal and specific ECE supports, such as childcare subsidies, to broader income adequacy payments that contribute towards the cost of raising children, such as the Family tax credit and Best Start tax credit. These supports have different policy rationales, including increasing workforce participation, increasing ECE attendance rates, providing a greater range of choice for parents (both in where to send their children and whether to send them to ECE at all), and alleviating child poverty by supporting income adequacy through direct payments.
4. Childcare supports are administered by several different agencies, including the Ministry of Education (MoE), the Ministry of Social Development (MSD) and Inland Revenue (IR). Support is provided either direct to the parent or direct to the service provider.
5. Each form of support targets a slightly different group and objective, with different eligibility requirements. People may be eligible for one or more of these supports. Examples of the supports include:
   - The ECE Subsidy. A universal subsidy paid directly to ECE providers for all children attending the ECE service with a daily limit of 6 hours per day and a weekly limit of 30 hours per week.
   - 20 Hours ECE Subsidy. A subsidy paid directly by MoE to ECE providers based on the number of children enrolled. The 20 hours covered by this subsidy replace the first 20 hours of the ECE subsidy. Associated with this funding are restrictions that specify parents cannot be charged fees for the 20 hours.
   - The Childcare Subsidy. Administered by MSD and paid directly to the ECE service provider for children up to the age of six of low- to middle-income families[2]. This subsidy is normally paid for up to nine hours of ECE a week if the parent(s) are not working, studying or training[3] and up to fifty hours a week if the parent(s) are working, disabled, or meet other conditions required by MSD.
   - Donations Tax Credit. Individuals can claim 33 percent of donations up to the amount of their taxable income. ECE payments can be claimed if they are

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[1] Some of the census information was very recently updated for 2023 data. The total number of children in ECE has increased.

[2] Families are eligible if they earn less than:
$2,144 before tax a week with 1 dependent child
$2,450 before tax a week with 2 dependent children
$2,756 before tax a week with 3 or more dependent children.

[3] Policy responsibility for the 9-hours component of Childcare Subsidy sits with Oranga Tamariki

optional and go to general funds and the service is an approved donee organisation/charity.

- Working for Families (WFF) tax credits, including the Family tax credit, In-work tax credit and Best Start tax credit. This programme is administered by Inland Revenue and MSD and provides a direct payment to families with children, including those in the early childhood age group. Best Start is targeted to parents with children aged 0 to 3 years old.

6. These above payments are periodically increased in value, either by automatic adjustment or periodic review. The exception to this is the Donations Tax Credit, which is set at a fixed proportion of charitable spending and will automatically reflect any increased donations on childcare but is limited to a fixed proportion of taxable income earned.
7. It should be noted that due to a lack of reliable access to fees data it is currently difficult for any government agency to provide advice on how effective the above interventions are in reducing ECE costs for parents and caregivers.

Future outlook on ECE affordability

8. It is anticipated that without Government intervention, the current high inflation environment and trends in the price measures for the ECE sector may result in ECE costs continuing to increase.
9. Other factors for the increase in ECE costs may include lack of fees transparency resulting in inefficient markets (from information asymmetries), increasing operating costs, and demand exceeding the supply of ECE centres in some locations. Additionally, there are non-monetary regulations in place for the ECE sector which can increase the cost of delivery.
10. The recent repeal of the planned extension of 20 Hour ECE to 2-year-olds also reduces future support to some families to meet ECE costs.
11. If ECE costs do rise, an increasing number of families may no longer be able to afford some ECE hours. This may restrict their ability to work or could result in pressure on other types of family spending to maintain ECE hours, consequently reducing families' income adequacy, work incentives and/or ECE participation rates.

Limitations on Policy Analysis

12. As providing prompt support to families facing cost of living pressures, through targeted assistance with ECE costs, is a priority, the Government has directed Inland Revenue to implement a childcare tax credit by 1 July 2024 to increase the incomes of families who have children in ECE.
13. This, alongside standard policy limitations such as time constraints and lack of available data, has constrained Inland Revenue's ability to do a comprehensive policy analysis. This section expands on those limitations and the impact they have had on the policy analysis.

Lack of fees data

14. Comprehensive fees data is not available from either MSD or MoE:

- MoE has an existing mechanism called the Early Learning Information collection (ELI), which collects attendance data and systems which store each child's name, date of birth and National Student Number (NSN). However, MoE does not collect any fees data from families or providers. MoE had received funding in Budget 2023 to construct a system through which providers would report their standard fee rates to the Ministry. This system has not yet been implemented and would not provide

granular detail on individual families' fees, including what portion of those fees are covered by other government supports.

- MSD holds comprehensive fees information for a small population, including the portion of the fee that is covered by other government support. However, this data is only held for recipients of the Childcare Subsidy (35,000 recipients for the 2022/23 year), therefore is not representative, and is collected via a manual process that places a high administrative burden on families, ECE providers and MSD staff. This process is not easily scalable.

15. Without comprehensive fees data, it is difficult for any government agency to determine the severity of ECE costs on families (including trends for the future), the factors that increase ECE costs (e.g., operational costs, impact of government regulation on the sector), and the efficacy of current and future government interventions in reducing ECE costs for parents and caregivers.

16. Instead, Inland Revenue has had to make assumptions about the severity of the policy problem and find alternative ways to feasibly implement a tax credit linked to childcare expenditure without easy access to current fees data.

Policy design limitations

17. The Government has requested a new tax credit, "FamilyBoost", that prioritises the following parameters:
    - direct payment to eligible parents on a household basis,
    - the payment be proportional to parents' actual childcare costs up to a capped amount per household,
    - the maximum payment be abated according to household income,
    - a regular payment,
    - administered by Inland Revenue, and,
    - implementable by 1 July 2024 to address current cost of living pressures.

18. These parameters define the set of options officials can examine in this analysis, meaning some significantly different alternatives to those proposed in this paper have not been considered in detail. Instead, the scope of policy options presented to Ministers have been limited to variations of direct tax credits that Inland Revenue can administer to increase incomes of families utilising ECE.

19. If there had been more scope and time available to do a comprehensive options analysis, Inland Revenue (alongside other agencies) would have considered a wider range of policy options to address the problem, including:

- reducing ECE fees through a direct subsidy to providers,
- regulatory price controls or changes to reduce the impact of other regulatory systems that increase operational costs for providers (e.g., play space requirements), or
- increases to incomes of families utilising ECE through other government support and/or wage growth.

20. This options analysis would include considering whether other agencies would be better suited to implement a new or expanded existing support instead of Inland Revenue.

Lack of public consultation

21. We have not been able to undertake any consultation with the public at this stage of the policy process due to time constraints and budget secrecy conventions, despite the potential for significant compliance costs on the ECE sector and parents in implementing a childcare tax credit. For example, depending on the tax credit model selected, parents may either be required to periodically upload invoices (with ECE

providers being required to ensure those invoices are in the correct format), or ECE providers will be required to share fees data directly with the government.

22. s 9(2)(g)(i) Therefore, it will be particularly crucial to consult with the ECE sector to determine the compliance costs associated with implementing a childcare tax credit, but especially regarding the cost of sharing fees data, and whether the ECE sector will support and are able to take up those necessary systems changes to do so.

What is the policy problem or opportunity?

23. The Government has indicated that they would like to increase the incomes of families who have children in ECE. As such, we have assumed the underlying policy problem is that the costs of early childhood education are high relative to families' incomes.

24. This assumption is supported by OECD research[4] that has identified that couples pay 37% of their income towards childcare in New Zealand. This is high both in absolute terms and relative to the OECD average (13% of couple's income), including to countries such as Australia (22% of couple's income) and United Kingdom (25% of couple's income).

25. The only available analysis on ECE affordability Inland Revenue could find is from MSD which reviewed the Childcare Subsidy and therefore only covered lower-income families' ECE affordability. The report indicated that ECE affordability has declined for low-income families because of the Childcare Subsidy not being adjusted to reflect inflation. However, a lack of availability of data on ECE fees over time prevents the analysis from being able to quantify this cost, and the analysis is only applicable to low or low-middle income families who are eligible (or would be if thresholds had been adjusted to reflect inflation) for the Childcare Subsidy.

26. Beyond this analysis, Inland Revenue does not have supporting evidence to back up the OECD data or to define the severity of the policy problem.

Implications of the assumed policy problem:

27. High ECE costs relative to income are likely to have implications for decreasing parental labour market participation, ECE participation rates and families' income adequacy. For example, a family may be unable to afford some ECE hours, restricting the parent's ability to work and for the child to participate in ECE, or resulting in pressure on other types of family spending to maintain ECE hours. Alternatively, even if

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4 Assumes full-time, centre-based care for two children aged two and three, and after any benefits designed to reduce the gross childcare fees. Due to data quality issues, the fees information that the OECD is believed to be using in their assessment is from 2013, with adjustments for inflation and other macroeconomic trends. Consequently, this figure may not be reliable.

See OECD (2023), Net childcare costs (indicator). doi: 10.1787/e328a9ee-en (Accessed on 16 November 2023)

families can afford ECE, they may still be incentivised to not work if the ECE fees exceed the net income gained from working.

28. Inland Revenue does not have data available to support the implications of high ECE costs relative to income on families in New Zealand on income adequacy or various participation measures.

Impacts of high ECE costs relative to income on population groups

29. High ECE costs relative to income disproportionately affects women, Māori and Pasifika, lower-income and rural population groups.

30. Women are disproportionately impacted by high ECE costs as they are more likely to take time out of the labour force to care for children, including as sole parents.[5] This impacts on a woman's long run labour market outcomes and increasing the gender wage gap. Therefore, any policy intervention to improve accessibility of childcare is more likely to benefit women by increasing work incentives, especially policy interventions that are targeted towards second earners or solo parents.

31. Research indicates that payment for childcare when children are at 4 or 5 years old varies by ethnicity. Survey data by Growing Up in New Zealand (Aotearoa's largest longitudinal study of child health and wellbeing) shows that "76 percent of families overall pay for care, with paying for care high among Europeans (78%) and Asians (77%), and lower among Māori (67%) and Pasifika (61%)".[6] This means any government support targeted at alleviating ECE costs will provide a reduced benefit to Māori and Pasifika families due to these two groups being less likely to pay for childcare, either due to ECE subsidies covering the cost already, lower ECE participation, or greater participation in informal/non-cash-based childcare.

32. A reduced benefit will also apply to wider groups of parents who have low or no fees. This extends to lower income households (who are likely more eligible for other subsidies) and rural groups (who may have limited geographic access to childcare options). Alternatively, any policy intervention to reduce ECE costs relative to income may increase uptake if cost is a barrier to these groups for accessing childcare, although we are uncertain of the impact of cost on ECE participation.

What objectives are sought in relation to the policy problem?

33. There are several potential objectives that a childcare tax credit could accomplish which will inform which of the potential options is preferred.

34. The Government has outlined the primary objective of "FamilyBoost" as directly increasing the incomes of families who have children in ECE (targeted by level of household income with full abatement at $180,000 household income).

35. Other potential objectives of a childcare tax credit include:

- Decreasing the amount payable for childcare costs
- Greater fee transparency in the ECE sector
- Increasing ECE participation
- Improving children's educational and/or development outcomes
- Increasing labour market participation rates

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5 82.4 percent of single parent households are led by women, and 91 percent of Sole Parent Support recipients are women (Ministry for Women).

6 See Sin, I. (2022). How do childcare experiences differ by ethnicity and for families with previous childcare access issues? Motu Economic and Public Policy Research. https://www.motu.nz/assets/Uploads/Use-of-childcare-after-access-issues-note-FINAL.pdf

36. These alternative objectives have not been a consideration in assessing options to implement a childcare tax credit, but it is likely that these will be impacted by achieving the primary objective nonetheless.

37. Alongside the primary objective of increasing incomes of families who have children in ECE, we have designed policy options within the parameters of the following secondary objectives:

- is timely and feasible to be implemented,
- aligns as closely as possible with the Government's policy proposal, and,
- minimises cost to government and compliance burden on parents.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

38. The criteria which will be used to compare options are:

- Increases in the income of eligible families
- Potential to promote fee transparency
- Compliance costs for providers (including ECE centres and student management system providers)
- Compliance costs for parents/caregivers
- Administrative costs
- Fiscal cost to the government
- Time required for implementation

What scope will options be considered within?

39. The scope is limited to the parameters requested by the Government for the "FamilyBoost" tax credit. In addition, the administration of a childcare tax credit (if proportional to ECE expenditure) requires access to fees information that is linked to individual parents or caregivers, the children in their care, and to their family income.

40. While Inland Revenue has some of the data required to administer a childcare tax credit (i.e., income data and bank account information for some potential recipients), other essential data is held by ECE providers and parents (i.e., ECE fee payments and enrolment/attendance details, relationship and household details).

41. Other agencies (MoE and MSD) also receive some of the necessary data, but not enough to implement "FamilyBoost" by 1 July 2024.

- MoE receive enrolment and attendance data for individual children from providers, but this does not include fees information. The child is also not linked to the parent in the MoE data set and neither MoE nor the ECE providers hold household income information.

- MSD are provided with some fees information from ECE providers and income information from parents for the Childcare Subsidy (35,000 recipients across 2022/23), but this is limited to fees information for lower-income families, and the information is manually collected and not easily scalable to cover the target group for "FamilyBoost". In comparison to MSD, Inland Revenue has wider access to individual income information and an existing family's data set linking a significant number of children to parents for WFF tax credits and Child Support.

42. Without current access to the fees data, the scope of policy options has been further limited to variations of direct payments that Inland Revenue can feasibly administer using known data sources and interactions, to increase incomes of families using ECE.

43. Implementing a product that meets the parameters set out by the Government will require new legislation and regulation and cannot be implemented within the Commissioner of Inland Revenue's existing powers. As such, there is not a non-regulatory option available.

What options are being considered?

44. The three options being considered are:

- Status Quo – do nothing
- Basic refund model using parents to supply fees information, delivered by 1 July 2024
- Detailed refund model using ECE providers data, extending timeline for implementation

Option 1 – status quo

45. Under the status quo, ECE costs would remain high, or would potentially continue to increase relative to the income families earn in New Zealand. Support would continue to be provided through Inland Revenue, MoE and MSD through existing subsidy products or through broad income support payments such as WFF payments, which are periodically adjusted by CPI. There would be some increase in after-tax income for families through the periodic adjustments to WFF tax credits, s 9(2)(f)(iv)

Option 2 – Basic refund model using parents to supply fees information, delivered by 1 July 2024

46. Option 2 is a childcare tax credit that is expected to be effective from 1 July 2024, but relies on parents or caregivers to submit invoices directly to Inland Revenue via myIR every 3 months. Inland Revenue would then calculate the refund based on their most recent income information. Parents are expected to be able to receive payments from October 2024 onwards. The calculation of these refunds would be final upon submission of the invoice and would not be adjusted if more recent income information becomes available. Consequently, parents should not incur debt and there would be no "square-up" process when assessing annual income tax returns.

47. This model uses information Inland Revenue already holds and minimises the additional information required to deliver a payment. New information sharing systems and agreements to collect and pass on fees information would not be required to be developed by MoE or ECE providers. ECE providers may need to update their systems to ensure fee invoices meet minimum required standards. s 18(c)(i) This approach is a variation of the current donations tax credit model, with the additional complication that ECE costs are ongoing, and income is combined for couples rather than based on individual income.

Option 3 – Detailed refund model using ECE providers data, extending timeline for implementation

48. Option 3 would extend the timeline for implementation by two to three years to allow the childcare tax credit to be automatically calculated based on data collected from ECE providers, reducing the compliance burden on parents and aligning it with the policy proposed by the Government.

49. Extending the timeline is necessary as the original policy outline of "FamilyBoost" has several features that cannot be delivered without extensive system changes for Inland Revenue, the MoE, and ECE providers – the most significant feature being creating information flows directly from ECE providers to Inland Revenue to reduce parent's compliance costs.

50. We consider it would take two to three years to consult with the sector, design, build and test relevant systems to ensure the data is high quality, secure, reliable and timely before the implementation of this childcare tax credit model. Internal consultation at Inland Revenue indicates that onboarding new providers to use gateway services (that is, enabling their software to interact directly with IR systems via a suite of application

programming interfaces) takes approximately nine months. Officials would need to consult with the ECE sector to determine precisely how long this would take and what alternatives would be required for providers that do not use software. Testing would be required to ensure the data sent in is correct, reliable and able to be correctly matched to the registered parent.

51. Allowing time for better information-sharing options to be developed between departments and ECE providers would be more efficient in the long term and reduce the burden on parents. s 9(2)(g)(i) improve the integrity of the claims and reduce the immediate fiscal cost of the proposal. It also reduces the risk of entrenching a less effective solution with high compliance costs for parents and caregivers.

52. Option 3 would allow for in-depth consultation with the ECE sector s 9(2)(g)(i) . This may result in a further consideration by officials of the other options post-consultation. Delaying implementation would also push out the benefit of this payment for parents and is less timely in relation to the current cost-of-living pressures.

How do the options compare to the status quo?

	Option One – Status Quo	Option Two – Basic refund model	Option Three – Extend timeline for implementation
Increase the income of eligible families	0	+ +	+ +
Potential to promote fee transparency	0	+	+ +
Compliance costs for providers	0	-	- -
Compliance costs for customers	0	- -	-
Administrative costs [7]	0	- -	- -
Fiscal cost to the government	0	- -	- -
Time required for implementation	0	-	- -
Overall assessment	0	- -	- -

[7] The administrative costs include both capital and operational costs.

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

53. Option 1 (Status Quo) provides no extra support to parents and therefore does not address the problem. It also has no administrative cost, compliance burden or fiscal cost.

54. Options 2 and 3 have different trade-offs but effectively deliver similar net outcomes. Those trade-offs essentially are the date the product can be implemented by (and therefore a tax credit provided) and the level of effort required by potential recipients/providers.

55. Option 2 (basic refund model) can be implemented by 1 July 2024 providing prompt support to parents, but places compliance costs on families to submit invoices to receive the childcare tax credit which could reduce take-up of this policy, also reducing the support available for eligible families. It also requires the ECE providers to update their invoices to ensure they are in the correct format for Inland Revenue to provide the tax credit. This option would have a reduced capital cost to implement, but higher operational costs than Option 3. Option 2 could be progressed with the intention of continuous improvements to integrity checks and some customer experience over time to align it closer to Option 3, or to run until the systems described in Option 3 are built. However, there is the risk that this option could be entrenched, with high compliance costs placed on parents.

56. Option 3 (extend timelines) does not provide short-term benefit to parents as it would take longer to implement but will greatly reduce the compliance costs on parents, resulting in higher take-up than Option 2. Administratively, this option would be more efficient for Inland Revenue to administer over the long run despite initial high capital costs, and s 9(2)(g)(i) . However, this depends on whether there is proper consultation and risk management as Option 3 does increase the providers' compliance costs, s 9(2)(g)(i)

57. Determining the best option depends on the weighting given to the individual criteria or any other objective and criteria considered relevant but not mentioned in the table. An overall positive proposal would be if the gains from the option far exceed the costs associated. To illustrate, if the Government wants to provide quick support to families with children in ECE, criteria regarding time required to implement and increasing the incomes of eligible families who have children in ECE will hold more weight. However, it should be noted that this comes with significant cost to the Government both fiscally, and to cover the administrative costs imposed on Inland Revenue.

What are the marginal costs and benefits of the option?

Option 2 – Refund Model

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of option 2 compared to taking no action			
Regulated groups *(ECE sector – including ECE providers and student management system providers)*	One-off cost to ensure invoices align with Inland Revenue's requirements to provide the tax credit to parents. This is more likely to impact smaller providers.	Low	Low
Regulators *(Inland Revenue)*	One-off cost to develop a new tax credit and ongoing operational costs to support the policy.	High	Medium
Others (parents receiving the payment)	Ongoing cost for parents to register and provide fees invoices every quarter.	Medium	Low
Total monetised costs		To be confirmed	
Non-monetised costs		Medium	Medium
Additional benefits of option 2 compared to taking no action			
Regulated groups *(ECE sector – including ECE providers and student management system providers)*	Potential increased demand for services (subject to availability).	Low	Low
Regulators *(Inland Revenue)*	N/A	N/A	N/A
Others (parents receiving the payment)	Receive a payment to alleviate the cost of ECE relative to income in the short-term.	Medium	High
Total monetised benefits		To be confirmed	
Non-monetised benefits		Low	Low

58. The impacts of the non-monetised costs and benefits have been determined through Inland Revenue's previous operational experience with social policy products, with large assumptions made on the costs for parents and the ECE sector.

59. The analysis also only covers the Refund Model – (i.e., assumes that continuous improvements would not occur to align the product closer to the pre-election proposal over time). If the continuous improvements were to occur to the point that the full model becomes available, it is expected that ECE providers would incur larger set-up costs as they amend their systems to provide fees information to Inland Revenue and compliance on parents would reduce. There would be additional costs on Inland Revenue to develop additional systems.

Option 3 – Extend the implementation timeframe

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of option 3 compared to taking no action			
Regulated groups *(ECE sector – including ECE providers and student management system providers)*	One-off cost to amending their systems to create information flows from ECE providers to Inland Revenue. Consultation is required to confirm the level of impact s 9(2)(g)(i)	High	Low
Regulators *(Inland Revenue)*	One-off cost to develop systems to capture ECE fees information and ongoing operational costs to support the policy.	High	Medium
Others (parents receiving the payment)	One-off cost to register	Low	Low
Total monetised costs		To be confirmed	
Non-monetised costs		High	Medium
Additional benefits of option 3 compared to taking no action			
Regulated groups *(ECE sector – including ECE providers and student management system providers)*	Potential increased demand for services (subject to availability).	Low	Low
Regulators *(Inland Revenue)*	N/A	N/A	N/A
Others (parents receiving the payment)	Receive a payment to alleviate the cost of ECE relative to income in the long-term but not in the immediate future.	Medium	High
Total monetised benefits		To be confirmed	
Non-monetised benefits		Low	Low

60. The impacts of the non-monetised costs and benefits have been determined through Inland Revenue's previous operational experience with social policy products, with large assumptions made on the costs for parents and the ECE sector.

Section 3: Delivering an option

How will the new arrangements be implemented?

61. The implementation details are dependent on the option selected, and as such the following is a preliminary indication of our approach.

Implementation arrangements

62. The Government has identified Inland Revenue as the administrator of the payment. Introducing a new tax credit would have a significantly high organisational impact on Inland Revenue to support the anticipated increase in initial and ongoing customer contact.

63. The organisational impacts include systems changes (either through developing a new system or utilising an existing system as a base for the tax credit) and investment into change management/staff training to support customers and ensure compliance. Additional staff would be required to manage additional contacts and support parents. This investment includes developing education and guidance thorough the Inland Revenue website to relevant stakeholders (ECE providers, student software system providers and parents) and for customer service to assist in any queries to ensure eligible parents are aware of and can access the credit.

64. Depending on the preferred option, "FamilyBoost" could come into effect as early as 1 July 2024 (Option 2), or as late as 2026 (Option 3). The design of Option 2 has accounted for an earlier implementation date of 1 July 2024, but does give short notice to ECE providers to update their invoices and to Inland Revenue to build the tax credit. As such it comes with risks around time to deliver. Option Three allows for sufficient consultation and preparation time for all parties.

65. Consultation with the ECE sector as part of the childcare tax credit work programme presents an opportunity for discussion about improving ECE data collections more generally, either as part of, or as a complement to the implementation of a childcare tax credit.

Implementation risks

66. A detailed assessment of implementation risks is yet to be compiled as it depends on which option is to be progressed. However, any option risks adding complexity to an already complex income support system and ECE support system. This can impose a burden on parents to understand and access the various supports, including requiring parents to interact with multiple agencies. Furthermore, it affects agencies' ability to distinguish the individual and combined efficacy of income and ECE supports.

67. The other risk relevant to either option is that IT system changes pose high uncertainty due to their complexity which can extend the time it takes to build, test, and implement any new products. This means any identified timeframes are an estimate, especially when the two options are reliant on ECE providers updating their systems, either with a minor adjustment (changing their invoices to comply) or a large adjustment (supplying ECE fees information to the government). This also impacts the software providers that ECE providers use.

68. Particular to Option 2, are the risks that there will be lower take-up due to compliance costs on parents, integrity risks associated with invoices or disclosed personal incomes, the implementation date of 1 July 2024 sitting within Inland Revenue's peak period of demand resulting in reduced levels of customer support available across Inland Revenue. Finally, there is a risk that the basic refund model will become entrenched without a replacement model ever designed and implemented.

69. Option 3 carries less integrity risk (as it would be largely automated) but is reliant on ECE providers being able and willing to update their systems to create information

flows of fees data to Inland Revenue. It also relies on accuracy of data and a consistent approach to recording information. If this fails to occur, officials will reconsider the other options listed and provide updated advice.

How will the new arrangements be monitored, evaluated, and reviewed?

70. The monitoring, evaluation, and review of the arrangement is yet to be completed as it depends on the option selected, and as such the following is only a preliminary indication of our approach.

Monitoring

71. To implement either option, resourcing would be required from Inland Revenue to monitor and verify tax credit registrations, claims, and any data supporting the claim to ensure parents meet the eligibility criteria for the tax credit and are receiving the correct amount. This includes monitoring income information to ensure parents are within the household income abatement thresholds.

72. s 18(c)(i)

73. For Option 3 (extend implementation), Inland Revenue would still have to monitor the fees information received by ECE providers to ensure the information is complete and correctly assigned to parent receiving the tax credit. However, they would not need to verify individual families ECE invoices which reduces the integrity risk and administrative burden on Inland Revenue.

Evaluation and review

74. The evaluation and review of any implemented childcare tax credit would likely be led by Inland Revenue in consultation with MoE, MSD and Treasury, but the specifics of the evaluation process are yet to be determined.

75. Regardless of the option selected, fee data could be used to supplement and inform decision making about the policy and its success by enabling officials to monitor impacts on sector fees. Any data collection efforts to support a childcare tax credit would also support improved understanding of the impacts of wider government investment in the ECE sector– noting that ECE is a significant area of government expenditure (currently over $2 billion per annum)[8]. This would support the work MoE, MSD, and Treasury do regarding childcare support.

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[8] This figure comes from the 2023/24 Estimates for Vote Education.
See The Treasury New Zealand. (2023, May 18). *Vote Education - Education and Workforce Sector - Estimates of Appropriations 2023/24.* https://www.treasury.govt.nz/publications/estimates/vote-education-education-and-workforce-sector-estimates-appropriations-2023-24

Regulatory Impact Statement: $25 per week increase to the In-Work Tax Credit

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing final Cabinet decisions in relation to the $25 per week increase to the In-Work Tax Credit
Advising agencies:	Inland Revenue
Proposing Ministers:	Hon Simon Watts, Minister of Revenue
Date finalised:	24 April 2024

Problem Definition

The effectiveness of the In-Work Tax Credit (IWTC) as an incentive to take up and stay in employment has been diminished over time, and the real value of the tax credit has eroded relative to wage growth. Recent inflation means families require more in-work support where available. The impact of inflation has been especially significant for families and their ability to meet household costs.

The policy objective of the Working for Families (WFF) package, which includes the IWTC, is to:

- increase financial incentives to work;
- ensure income adequacy, with a focus on low and middle income families with dependent children to address issues of poverty, especially child poverty; and
- achieve a social assistance system that supports people into work.

It must also achieve these objectives at a sustainable cost to government.

Executive Summary

In-work Tax Credit increase

The IWTC is one of two key instruments to “make work pay” within the wider context of the WFF package. It supports parents to take up and stay in work by providing a boost to their net income, provided they are in employment, and not receiving a main benefit or student allowance.

Currently, the IWTC is paid at a maximum rate of $3,770 per year ($72.50 per week) for a family of up to three children, with an additional $780 each year ($15 per week) for each subsequent child. This proposal (Option 2) would see the base rate of IWTC increased to $5,070 per year ($97.50 per week) from 31 July 2024.

Options considered for assessment

This proposal is a Government manifesto initiative – alternative options, other than the status quo, have not been considered.

Option 1: Status quo – no legislative or policy change

The IWTC would continue to be paid at a maximum rate of $3,770 per year ($72.50 per week) for a family of up to three children, with an additional $780 each year ($15 per week) for each subsequent child.

The impacts of option one

This option risks the policy objectives of the IWTC being further eroded if the value of the IWTC in relation to minimum wage continues to decrease. As such, this option is out of step with improving income adequacy for low to middle income families, increasing work incentives for low to middle income families, and helping the Government meet its child poverty reduction targets. However, this option does not bear an additional cost to the Government and would not require Inland Revenue to implement any changes.

Option 2: Increase of the in-work tax credit by $25 per week from 31 July 2024

Under option two, none of the existing statutory parameters in relation to eligibility and abatement would be adjusted.

The proposed implementation date would be 31 July 2024. The updated rate would take effect alongside the proposed changes to personal income taxes and the Independent Earner Tax Credit. Ad hoc notices of entitlements will need to be sent to WFF customers in June 2024 to inform them of the change. This is likely to increase administrative costs for Inland Revenue as these notices will be sent out during Inland Revenue's busiest period and are likely to drive increased customer contact.

Consultation has shown general support for increases to tax credit rates

In 2018, the previous Government established the Welfare Expert Advisory Group (WEAG) to advise them on the future of New Zealand's social security system, including the WFF scheme. The WEAG recommended fundamental changes to the design and targeting of WFF, as well as significant increases to main benefits and the Family Tax Credit (FTC).

In response, the previous Government established the WFF Review as a result of those recommendations. This review included a targeted engagement process with many stakeholders, including several academics and those representing groups who advocate for children. Most survey respondents were of the view that WFF does not currently pay enough support for families.

The impacts of option two

There will be increased financial resources available to low and middle income working families

This change will benefit approximately 170,000 families who currently receive the IWTC. They will benefit by a net average of $16.97 per week when factoring in the average rate at which the IWTC abates amongst all IWTC recipients.

There will be increased incentive for low and middle income families to take up and stay in paid employment

This change will lower replacement ratios, which measures the gap between income when receiving a benefit versus receiving income when in work. By increasing the IWTC, a family's income in employment would decrease by a greater proportion if they went onto a main benefit or vice versa.

Currently, a coupled family working 40 hours per week at minimum wage would retain 80.5% of their income if they left employment and went on benefit, and for a sole parent in the same

situation 66.3% of their income would be retained. After the increase to the IWTC, and all other things being equal, these replacement ratios would decrease to 78.8% for a coupled family, and 64.5% for a sole parent family.

There will be reductions to child poverty

The impact on child poverty of option 2 (increase the IWTC by $25 per week from 31 July 2024) has not been modelled independently to of the other Tax Package changes, due to time constraints.

It is estimated that the Tax Package, which includes a $25 increase to the In-Work Tax Credit, will reduce child poverty by around 14,000 children (+/- 6000) on the fixed-line AHC50 measure,[1] and by around 3,000 children (+/- 7000) on the BHC50 measure[2] in the 2027 tax year.[3]

The tax package increases the incomes of low-income working households faster than the increase in the cost of living, which reduces fixed-line AHC50 child poverty. However, the tax package may slightly reduce moving-line BHC50 child poverty, since the poverty line for this measure is set at 50% of the median household income, and the tax package is expected to increase the median household income.

The overall cost to the Government of Option 2 is estimated to be $607 million over the forecast period

The increase to the IWTC will cost $607 million over the forecast period which extends to 30 June 2028. There is an average cost of $152 million per annum of increasing the rates by $25 dollars per week for the 170,000 recipients who currently receive the IWTC.

Preferred option

Officials support the proposal to increase the IWTC by $25 a week. This will ensure that the real value of the support increases with wage growth and acts as an effective incentive to take up, and stay in, employment.

Minimum Family Tax Credit consequential amendment

The base rate of IWTC effects the calculation of the Minimum Family Tax Credit (MFTC) threshold. Therefore, any time the IWTC is adjusted, a consequential amendment to the MFTC should be considered.

The MFTC was designed to create a financial incentive, at the margin, for families to work and be better off not receiving a benefit. As of 1 April 2024, the MFTC threshold is set at $35,204. For people receiving MFTC, their after-tax earnings are topped up to this amount to ensure that they are better off in work, and receiving the MFTC, than they would be receiving a main benefit whilst employed. The MFTC ensures that a sole-parent family who

[1] AHC50 measures the number of children in households with incomes much lower than a typical 2018 household, after they pay for housing costs, and is measured by the threshold line set at 50 percent of the median income in 2017/2018 (base financial year), after housing costs are removed.

[2] BHC50 is a moving-line income measure, with the poverty threshold taken the year the data is gathered (low income before housing costs – moving-line measure). BHC50 measures the number of children in households with much lower incomes than a typical household, and is measured by the threshold line set at 50 percent of the median household income in the year measured.

[3] Note on TAWA modelling: poverty estimates use HES 2020/21 augmented using IDI data, inflated and population adjusted with HYEFU 2023 inflation estimates.

works more than 20 hours per week will always be at least $1 better off on a weekly basis than they would be on a benefit.

The IWTC and MFTC are both work incentive payments. Together, these payments can be considered to 'top up' a person's after-tax earnings to ensure that an individual is financially better off in work without a main benefit. Any increase in the IWTC is generally combined with a decrease in the MFTC threshold, as less of a 'top up' is required.

Impending overlap of the MFTC threshold and the WFF abatement threshold

As the MFTC threshold increases annually, it is also forecast that on 1 April 2027 it will overlap with the WFF abatement threshold. The WFF abatement threshold is currently fixed at $42,700 and is not periodically increased. There is a conflict of respective policy intents if this overlap were to occur. On the one hand, the MFTC threshold is a guaranteed minimum income for low income working families. On the other hand, the WFF tax credit abatement threshold is set at a level at which a family's income is considered to be too high for full entitlement. The overlap would also result in WFF customers facing effective marginal tax rates (EMTR)[4] of well over 100%.

This issue will also be considered when assessing the options for the MFTC consequential amendment.

Options considered for assessment

Option 1: Allow MFTC recipients to gain from both the IWTC increase and the personal income tax reductions

The MFTC threshold would increase marginally (by $112) following the increase to the IWTC and personal income tax changes on 31 July 2024. This would ensure that MFTC recipients receive the IWTC increase and benefit from the personal income tax change. This option has a fiscal cost of approximately $0.2 million per annum.

This option would support income adequacy and child poverty reduction. It would also increase the incentive for beneficiaries to move off benefit and to take up and stay in employment at the margin. However, this continues the wide hours range (from 20 to 34 hours of work) over which the 100% abatement rate applies for the MFTC. Given the high EMTRs that apply for MFTC recipients over this period, incentives for MFTC recipients to take up more work are decreased under this option.

This option would also speed up the impending cross-over of the MFTC threshold and the WFF abatement threshold. If these two thresholds cross over, both the work incentive aspects of these payments and the broader WFF income adequacy objective will be significantly hindered due to the resulting EMTRs for recipients being well over 100%.

Option 2: Decrease the MFTC threshold in line with existing policy, so that MFTC recipients receive less than they would currently

The MFTC threshold would decrease by approximately $27 per week or $1,404 per annum. This option will result in a reduction of $2.9 million per year for the IWTC costing. Lowering the MFTC threshold by $27 ensures that MFTC recipients remain $1 better off

[4] Effective marginal tax rates show the percent by which a dollar increase in gross income is reduced by taxes and the abatement of social security assistance.

per week compared with those working and receiving a benefit following changes to the IWTC.[5]

This option does not improve income adequacy or support child poverty reduction, as MFTC recipients will be worse off by this change. However, the earnings range over which the 100% abatement applies would be reduced, increasing the incentive to work longer hours.

This option would also mitigate the urgency of addressing the impending overlap of the MFTC threshold and the WFF abatement threshold, as reducing the MFTC threshold will delay this issue.

Option 3: Decrease the MFTC threshold so that MFTC recipients will receive the same amount that they do currently

The MFTC threshold would decrease by $23 per week or $1,196 per annum when the increase to the IWTC is introduced. MFTC recipients will not benefit from the IWTC change but will not be made worse off either. This will result in a reduction of $2.5 million per year for the IWTC costing.

Lowering the MFTC threshold by $23 is a minimal departure from the MFTC calculation as the threshold is set at a rate greater than $1 above the weekly after-tax earnings from employment whilst still on benefit. However, option 3 does not impact the work incentive aspect of the payment and does not leave any MFTC recipients worse off.

As this option reduces the MFTC threshold, it will delay the impending overlap of the MFTC threshold and the WFF abatement threshold.

Preferred option

Officials prefer the proposed changes under option 3 to lower the MFTC threshold by $23 per week or $1,196 per annum. This option delays the eventual MFTC/WFF abatement threshold cross-over without making MFTC recipients worse off. The MFTC's function to incentivise people to move off-benefit and into full time employment will also be preserved.

Limitations and Constraints on Analysis

Inland Revenue is responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated (this includes reference to "officials"). The analysis and advice have been produced for the purpose of informing key policy decisions to be taken by Cabinet.

The decision to increase the IWTC by $25 a week is a manifesto initiative included within the National Party Tax Plan (the Tax Plan) and was not affected by coalition negotiations. This policy proposal is solely concerned with an increase to the existing rate. Changes to the policy settings of the IWTC, including the rules for eligibility and abatement, are not in scope for any of the proposed options. The proposed changes are also premised on cost-of-living pressures having significant impacts on families raising children.

Officials have not considered alternative options that could also target low to middle income working families. This includes options that would address income adequacy of beneficiary families who are not in receipt of the IWTC. Our analysis is based solely on

[5] This decrease does not directly correlate to the IWTC increase due to the way main benefits abate.

evidence supplied to the WEAG, as consultation has not been undertaken due to the constraints that apply to Budget initiatives.

Inland Revenue was directed by the Government to implement this change by 31 July 2024 as part of the Budget process. This date allows the funding to be assessed against other government initiatives.

Assumptions underpinning the impact analysis

Treasury's micro-simulation model of the tax and welfare system (TAWA) has provided the distributional impact of the Tax Package, and particularly the impacts on child poverty reduction. This modelling considered the cumulative impacts of all changes, including the personal income tax changes, changes to the Independent Earner Tax Credit and the introduction of FamilyBoost. The impacts of the increase to the IWTC cannot be viewed individually because of this modelling.

Responsible Manager(s) (completed by relevant manager)

Maraina Hak

Policy Lead

Families and Individuals

Inland Revenue

s 9(2)(a)

24 April 2024

Quality Assurance (completed by QA panel)	
Reviewing Agency:	Inland Revenue
Panel Assessment & Comment:	The Quality Assurance panel from Inland Revenue has reviewed the "$25 per week increase to the in-work tax credit" regulatory impact statement (RIS) prepared by Inland Revenue and considers that the information and analysis summarised in the RIS partially meets the quality assurance criteria. This is because the scope of the options analysis has been constrained by the lack of time to fully consider other options given the directive by the Government. A comprehensive analysis of other options may have provided a more appropriate option. The analysis also does not consider the impact of the preferred option on current inflation and whether it has the potential to be inflation inducing itself. In addition, the panel considered that the problem definition could be clearer but given the direction, assumptions and limitations imposed on the analysis there is limited scope to further define the problem the policy is addressing. Consultation has not been undertaken. The RIS would have benefited from feedback from consultation, including the views of the stakeholders on the options considered in the RIS.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

Context within which action is proposed

Government commitment to reducing the cost of living:

Currently there are high cost of living pressures as New Zealand families are feeling the effects of inflation. The cost of living for the average New Zealand household increased 7.4 percent in the 12 months to the September 2023 quarter.[6] Higher prices for interest payments and grocery food were the biggest contributors to the 7.4 percent increase, however price increases to rent, insurance, and property rates also contributed.[7]

Government commitments in the Tax Package are intended to increase the after-tax pay of low to middle income earners through the following changes:

- Shifting income tax brackets to compensate for inflation;
- Introducing the FamilyBoost childcare tax credit; and
- Increasing WFF tax credits for working families.[8]

The proposed changes to WFF are premised on cost-of-living pressures having significant impacts on families raising children.

The IWTC is the key instrument to increasing financial incentives to work within the wider context of the WFF package:

WFF was implemented between 2004 and 2007 with the purpose of substantially boosting earlier Family Assistance entitlements. The key objectives of the WFF package were to:

- Increase financial incentives to work, and remain in work, by supporting families with dependent children, so that they are rewarded for their work effort;
- ensure income adequacy, with a focus on low and middle income families with dependent children to address issues of poverty, especially child poverty; and
- 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.

It must also achieve these objectives at a sustainable cost to government.

Around 56 percent of all families currently receive WFF, at an annual cost of $2.8 billion for the 2022 income tax year. WFF is made up of the following tax credits:[9]

- Family Tax Credit: (264,400 families, $1,966 billion annually): the main payment received by both beneficiary and non-beneficiary families and is not dependent on work status.

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[6] Taken from the household living-cost price index released by StatsNZ on 26 October 2023.

[7] Taken from the household living-cost price index released by StatsNZ on 26 October 2023.

[8] "National's Back Pocket Boost" on 30 August 2023.

[9] These numbers are based on the 2021-22 income tax year.

- In-work Tax Credit: (170,500 families, $502 million annually): the main in-work payment for families who do not receive a main benefit or student allowance.
- Best Start Tax Credit (138,200 families, $296 million annually): this payment provides $73 per week to all families with a child under one year old, and for lower income families with a child under 3.
- Minimum Family Tax Credit (3,200 families, $13 million annually): this payment tops up incomes of working families and guarantees a minimum income level for those working at least 20 hours per week in low-paying jobs and who do not receive a main benefit.

The IWTC is the primary instrument in the WFF package designed to incentivise employment uptake. It supports working parents, especially sole parents, to take up and stay in employment, by providing a boost to the earned income of low and middle income families to help ensure that they are better off in work than they are on a benefit. The payment depends on how much a family household earns, and the abatement rate is 27%.

The IWTC specifically addresses the effect of in-work poverty. Work has costs associated with it – both financial costs such as transport and childcare, and non-financial such as effort and opportunity costs, for example less time spent with children. Any additional income from work may be insufficient to meet the various costs associated with work. That is, a person may judge they are overall better off not working, particularly if they can rely on benefit payments.

As well as increasing families' financial incentives to move off benefit and into employment, the IWTC, alongside the Family Tax Credit , contributes to reducing child poverty by increasing the incomes of low-income working families with dependent children.

The real value of the IWTC has eroded over time:

Incomes derived from employment have increased by significantly more than benefit incomes due to wage growth exceeding the rate of income support over previous decades. This has reduced the real value of the IWTC given the payment rate has not increased as much when compared to wages. Over time the IWTC has become less important to the decision to work compared to wages. The value of the IWTC in relation to the minimum wage has decreased from 9.8 percent to 7.7 percent since 2018.

However, recent changes such as indexing main benefits to wage growth, and regular across the board increase to main benefits,[10] have increased the level of income a family can receive whilst on benefit. The effect of these changes on financial incentives to work are usually offset by corresponding increases to the minimum wage.

The relevant consideration for setting the level of IWTC is how much a family's income would decrease if they left employment and went onto a main benefit or vice versa. The table below compares the incomes a coupled family and a sole-parent family could receive if they each work 40 hours per week at the minimum wage, contrasted against the payments they would receive if they did not work and were on a main benefit.

[10] $25 per week increase to main benefits from 1 April 2020; $20 per week increase to main benefits from 31 July 2021; and $15 per week increase to amin benefits from 1 April 2022.

Replacement ratios: Sole parent and coupled family working 40 hours at minimum wage versus on benefit						
Year (rate applying from 1 April)	**2018[1]**	**2019**	**2020**	**2021[1]**	**2022**	**2023**
Family net income: 40 hours per week at minimum wage + Family Tax Credit + In-Work Tax Credit	$733.71	$777.66	$816.52	$852.15	$898.46	$940.05
IWTC as a % of family net income	9.8%	9.3%	8.9%	8.5%	8.1%	7.7%
Rate of replacement: Coupled Jobseeker Support + Family Tax Credit + Winter Energy Payment	68.9%	66.5%	67.9%	70.1%	78.6%	80.5%
Rate of replacement: Sole Parent Support + Family Tax Credit + Winter Energy Payment	62.0%	59.9%	61.4%	62.1%	64.7%	66.3%

Increases to benefit rates have negatively changed the proportional returns to employment over the previous two years, which means replacement ratios have not remained stable. In addition, the minimum wage now sits above the WFF abatement threshold. Currently, a coupled family working 40 hours per week at minimum wage would retain 80.5 percent of their income if they left employment and went on benefit, and for a sole parent in the same situation 66.3 percent of their previous income would be retained. This is an increase from 68.9 and 62.1 percent respectively.

The IWTC is intended to be a key factor contributing to the returns to employment for low and middle income New Zealand families. As these returns have not remained consistent over the previous two years the policy intent of the IWTC is not being fulfilled.

Key features of the regulatory system and its objectives

The Income Tax Act 2007 (the Act) contains provisions that determine the eligibility and entitlement for the IWTC. These are outlined in more detail below:

Eligibility:

A principal caregiver is entitled to the IWTC for a dependent child when:

- they meet the common eligibility criteria for WFF;
- the principal caregiver, or their partner, do not receive an income-tested welfare benefit, a student allowance or a partner's allowance;
- the principal caregiver, or their partner, must normally be an 'earner'; and
- Also, the 'earner' must derive income. Income can be a PAYE income payment such as salary and wages, and income other than a PAYE income payment such as interest, rents and dividends.

Entitlement:

The IWTC is currently paid at a maximum rate of $3,770 per year ($72.50 per week) for a family of up to three children, with an additional $780 each year ($15 per week) for each subsequent child. For instance, a family with four children would receive up to $87 per week and a family with seven children would receive up to $132 a week.

All WFF tax credits are subject to an income test, so the amount received is reduced as family income increases over the $42,700 abatement threshold. The FTC is abated first, followed by the IWTC. Both payments abate at a rate of 27 cents for each additional dollar of family scheme income (FSI).

FSI represents the pooled financial resources of a family unit. FSI is net income of the principal caregiver and their partner plus or minus any relevant adjustments. There are several adjustments that can be made to the net income in order to determine FSI.

Consequential impacts on the MFTC

Changes to the IWTC and the personal income tax rates have a consequential impact on the MFTC threshold.

Main objective of the MFTC

The MFTC was designed to create a financial incentive, at the margin, for families to work and be better off not receiving a benefit. For people receiving MFTC, their weekly after-tax earnings are topped up to this amount to ensure that they are at least $1 better off per week in work than they would be receiving a main benefit whilst employed.

Eligibility:

A principal caregiver is entitled to MFTC for a dependent child when:

- they meet the common eligibility criteria for WFF;
- the principal caregiver, or their partner, do not receive an income-tested welfare benefit, a student allowance or a partner's allowance;
- the principal caregiver, or their partner, are considered a "full-time earner". Full-time is defined as 20 hours or more per week for a sole parent, and 30 hours per week or more for a two-parent family;

Generally, only the hours worked to receive PAYE income payments – such as salary and wages – are counted towards the above work hours requirement. Hours worked to derive non-PAYE income payments – such as interest, rents, and dividends – do not satisfy the work hours requirement.

Entitlement:

As of 1 April 2024, the MFTC threshold is set at $35,204 per annum – the threshold is increased annually to account for increases to main benefits. For people receiving MFTC, their after-tax earnings are topped up to this amount to ensure that they are marginally better off in work than they would be receiving a main benefit whilst employed. The MFTC abates at a rate of 100% for every dollar earned over the MFTC threshold.

The impending overlap of the MFTC threshold and the WFF Families abatement threshold

The WFF tax credit abatement threshold is currently set at $42,700. This is the point at which the FTC and IWTC entitlements start to reduce at 27%. Unlike the MFTC threshold, which is increased every year in line with benefits, the WFF tax credit abatement threshold is not periodically adjusted. It should be noted that the WFF threshold is a gross threshold, whereas the MFTC threshold applies to a customer's net income. This is due to the MFTC's function in topping up a customer's after tax earnings so that they are always marginally better off in work than they would be receiving a main benefit whilst employed.

As the MFTC threshold increases annually, it is forecasted that on 1 April 2027 it will overlap with the WFF abatement threshold. This will mean that WFF customers will face EMTRs of

well over 100%. MFTC recipients who are some of the lowest income working families would face decreases in their income as they work additional hours.

Example of overlap:
Under this example the Minimum Family Tax Credit threshold is increased to $43,000 (before tax) and the Working for Families tax credits abatement threshold remains at $42,700 (before tax).

Mila is a sole parent who works at a supermarket for 35 hours per week on minimum wage and earns $42,900 dollars. Following the crossover, she will face an effective marginal tax rate of 128.6%. This means that for an additional $1 she earns, her tax credits reduce by $1.28 and her total income drops as a result. She is not incentivised to work any additional hours.

This is a result of the following reductions of her income via:

- 17.5% personal income tax;
- 82.5% Minimum Family Tax Credit;
- 1.6% ACC levy; and
- 27% Working for Families abatement (the additional abatement once the overlap happens).

This could be made worse if Mila has student loan repayments (12%) or receives the Accommodation Supplement (25%).

There is a conflict of respective policy intents if this overlap were to occur. On the one hand, the MFTC threshold is a guaranteed minimum income for low income working families. On the other hand, the WFF tax credit abatement threshold is set at a level at which a family's income is considered to be too high for full entitlement.

What is the policy problem or opportunity?

Problem definition

The IWTC has helped increase incomes amongst low and middle income working households, however the real value of the support has diminished overtime. Over previous decades, incomes derived from employment have increased by significantly more than benefit incomes due to wage growth exceeding the rate of income support over an extended period. Over time the IWTC has become less important to the decision to work compared to wages. The value of the IWTC in relation to the minimum wage has decreased from 10.7 percent to 7.7 percent since 2016.

As such, the IWTC is not meeting its policy objective as a work incentive payment, nor does the IWTC rate reflect the desires of the Government and national, social, and economic contexts, particularly in relation to the cost of living. This is in part due to the lack of legislative requirement to automatically increase the rate of IWTC over time, unlike the regular Consumers Price Index (CPI) adjustments to the FTC and BSTC. The rate of IWTC was last increased in Budget 2015, from $60 a week to $72.50 a week (from 1 April 2016), as part of the Child Material Hardship package.

Stakeholders involved

The primary stakeholders are low to middle income working families who are in receipt of the IWTC. They have a significant, personal interest in increases to their income. At the margin the IWTC can have a significant impact for parents to move off-benefit and into employment. In addition, the IWTC also contributes to reducing poverty and improving adequacy for this demographic. Restricted access to material goods or restricted capacity for social

participation can have significant flow on effects to other areas of life such as physical and mental health. These flow on effects can impact a household's access to work opportunities, which has negative ramifications for the household's living standards.

Wider society is also a stakeholder in this issue. The consequences of poverty lead to greater public expenditure, particularly on healthcare and the justice system, as well as the loss of potential tax revenue. Increased expenditure on in-work welfare has the capacity to encourage work force participation, and any reduction in poverty rates will lead to savings in other areas.

What objectives are sought in relation to the policy problem?

Working for Families scheme objectives

WFF has three primary objectives:

1. Increase financial incentives to work, and remain in work, by supporting families with dependent children, so that they are rewarded for their work effort;
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
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.

It must also achieve these objectives at a sustainable cost to government.

These objectives must be considered when evaluating any proposed changes to WFF along with any more specific objectives that are being sort in relation to a particular proposal. It is generally possible to achieve two of the three objectives for any given policy change, but not all three.

1. Improving financial incentives to work

Improving financial incentives to work will encourage people who are able to work to seek (and remain in) employment. For most people, paid work is a key means of achieving improved wellbeing. However, financial incentives are only one (and not necessarily the most important) of many factors that influence people's decisions on whether, or how much, to work.

2. Improving income adequacy for low and middle income people

While recent changes to the welfare system (including the Families Package, the $25 a week increase to main benefits on 1 April 2020 and the indexation of main benefits to average wage) will help to improve the living standards of low-income people, income adequacy and child poverty issues remain. Any changes to WFF should have a net positive impact on these issues, particularly as these credits are an important tool to meet child poverty reduction targets as required under the Child Poverty Reduction Act 2018.

3. Achieve a social assistance system that supports people into work

There is a continued need to modernise and simplify the WFF system to better respond to changing work and care arrangements. Any changes to WFF should seek to improve the client experience and improve the interface between benefit and work.

Paying welfare support at a cost that is sustainable to government

The government is required to act and pursue its policy objectives in accordance with the principles of responsible fiscal management as set out in the Public Finance Act 1989. These principles include managing fiscal risks facing the government, having regard for the impact on present and future generations, and ensuring the Crown's resources are managed effectively and efficiently. The WFF scheme should be delivered in accordance with these principles.

Specific objectives relating to the $25 per week increase to the IWTC

The policy objective of this change can be viewed as twofold:

Help increase financial incentives to work by increasing the gap between income on benefit and income when in-work

A fundamental purpose of the IWTC, as stated in the supporting policy paper to joint Ministers when it was introduced was "to improve replacement ratios, (i.e., the gap between income on benefit and income when in work") .[11] The relevant consideration for setting the level of IWTC is therefore generally the existing "gap" between benefit levels and wages for low and middle income families, and how the size of the gap has moved.

Decrease the cost-of-living pressures for families raising children

Inland Revenue understands that Government commitments are intended to increase the after-tax pay of low to middle income earners. The proposed increase to the IWTC is premised on the cost-of-living pressures having significant impacts on families raising children.

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[11] "Future Directions: Regular Adjustments of Family Income Assistance" on 19 March 2004.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

The following criteria is derived primarily from the WFF objectives. The income adequacy and financial incentives to work criterion will be given the highest weighting, as they align with specific objectives relating to the $25 per week increase to the IWTC.

Income adequacy

This will measure the degree to which the incomes of low and middle income households are improved. It will demonstrate the average increases households can expect to their incomes once abatement of financial assistance is considered.

Impacts on child poverty

These will be measured using fixed line AHC50[12] and moving line BHC50.[13] Options which have greater reduction in the number of children in AHC50 and BHC50 poverty are preferred. Options should not be so tightly targeted that, as a result, more children are pushed under the poverty line.

Administrative benefit

This will measure the degree to which changes to WFF improve the client experience and improve the interface between benefit and work.

Financial incentives to work

The impact of these proposals on financial incentives to work are considered. These are primarily measured using replacement ratios, which consider the gap between income on benefit and income when in work.

Fiscal cost

This will measure the overall cost to the government of each individual option.

Ease of implementation

This will measure the difficulty for Inland Revenue to implement each individual option.

What scope will options be considered within?

- Options are solely concerned with an increase to the existing rate.

Out of scope

- Changes to the policy settings of the IWTC, including the rules for eligibility and abatement, are not in scope for any of the proposed options.

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[12] The percentage of children living in households with less than 50 percent of the median equivalised disposable household income after housing costs are deducted (for the 2017/18 base financial year).

[13] The percentage of children living in households with less than 50 percent of the median equivalised disposable household income before housing costs are deducted.

- Alternative options have not been explored that could also target low and middle income working families. This includes options that would address income adequacy of beneficiary families who are not in receipt of the IWTC.

What options are being considered?

Option One – *No increase of the in-work tax credit*

The status quo is no legislative or policy change. The IWTC would continue to be paid at a maximum rate of $3,770 per year ($72.50 per week) for a family of up to three children, with an additional $780 each year ($15 per week) for each subsequent child. This option risks the policy objectives of the IWTC being further eroded if the value of the IWTC in relation to minimum wage continues to decrease. As such, this option is out of step with improving income adequacy for low to middle income families, increasing work incentives for low to middle income families, and helping the Government meet its child poverty reduction targets. However, this option does not bear an additional cost to the Government and would not require Inland Revenue to implement any changes.

Option Two – *Increase of the in-work tax credit by $25 per week from 31 July 2024*

The IWTC standard rate would be increased to $5,070 per year ($97.50 per week) from 31 July 2024. The IWTC subsequent child rate would remain at $780 each year ($15 per week) for each subsequent child.

None of the existing parameters in relation to eligibility and abatement would be adjusted. The principal caregiver, or their partner, must not receive an income-tested welfare benefit, a student allowance or a partner's allowance. The IWTC would continue to abate at a rate of 27% for each additional dollar of family scheme income earned over the WFF abatement threshold ($42,700), following the full abatement of the FTC.

The implementation date would be 31 July 2024. The updated rate would take effect alongside the proposed changes to personal income taxes and the Independent Earner Tax Credit. Ad hoc notices of entitlements will need to be sent to WFF customers in June 2024 to inform them of the change.

Modelling of impacts

This change will benefit approximately 170,000 families who currently receive the IWTC. They will benefit by a net average of $16.97 per week when factoring in the average rate at which the IWTC abates amongst all IWTC recipients.

There will be increased work incentives

This change will lower replacement ratios, which measure the gap between income when receiving a benefit versus income when in work. The increase to the IWTC means there is more income available for low and middle income families who are in paid work. This will increase the "gap" between benefit levels and wages for these families.

After the increase to the IWTC, and all other things being equal, these replacement ratios would decrease to 78.8 percent for a coupled family, and 64.5 percent for a sole parent family.

There will be implementation implications for Inland Revenue and customers

To progress this change through Budget 2024, and include it in Budget night legislation, ad hoc notices of entitlement are required to be sent to WFF customers. Usually, notices of entitlement are sent out in February, during the standard WFF rollover process. This could

cause confusion for these impacted customers, who already have a high customer contact rate with Inland Revenue due to their reliance on WFF support. This customer contact will coincide with busy time for Inland Revenue in which it is issuing individual income tax assessments.

Inland Revenue will need to undertake significant preparatory work before Budget 2024 announcements. This includes issuing communications and guidance material, as well as updating Inland Revenue's website.

There will be reductions to child poverty

The impact on child poverty of option 2 (increase the IWTC by $25 per week from 31 July 2024) has not been modelled independently to of the other Tax Package changes, due to time constraints.

It is estimated that the Tax Package, which includes a $25 increase to the In-Work Tax Credit, will reduce child poverty by around 14,000 children (+/- 6000) on the fixed-line AHC50 measure,[14] and by around 3,000 children (+/- 7000) on the BHC50 measure[15] in the 2027 tax year.[16]

The tax package increases the incomes of low-income working households faster than the increase in the cost of living, which reduces fixed-line AHC50 child poverty. However, the tax package may slightly reduce moving-line BHC50 child poverty, since the poverty line for this measure is set at 50% of the median household income, and the tax package is expected to increase the median household income.

The overall cost of this option is estimated to be $607 million over the forecast period 2024/25 to 2027/28

The increase to the IWTC will cost $607 million over the forecast period which extends to 30 June 2028.

Consequential impact on the Minimum Family Tax Credit

Any increases to the IWTC will have a consequential impact on the MFTC threshold. Options for addressing this impact will be assessed using the following criteria.

Income adequacy

This will measure the degree to which the incomes of low and middle income households are improved.

Financial incentives to work

The impact of these options on financial incentives to work are considered. This includes any effect the change will have on the range of working hours over which the MFTC abates, as

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[14] AHC50 measures the number of children in households with incomes much lower than a typical 2018 household, after they pay for housing costs, and is measured by the threshold line set at 50 percent of the median income in 2017/2018 (base financial year), after housing costs are removed.

[15] BHC50 is a moving-line income measure, with the poverty threshold taken the year the data is gathered (low income before housing costs – moving-line measure). BHC50 measures the number of children in households with much lower incomes than a typical household, and is measured by the threshold line set at 50 percent of the median household income in the year measured.

[16] Note on TAWA modelling: poverty estimates use HES 2020/21 augmented using IDI data, inflated and population adjusted with HYEFU 2023 inflation estimates.

this has a corresponding impact on work incentives – particularly given the 100% abatement rate.

Fiscal cost

This will measure the overall cost to the government of each individual option.

The impending overlap of the MFTC threshold and the WFF abatement threshold

This will consider whether the options exacerbate or quicken the eventual crossover between the MFTC threshold and the WFF abatement threshold.

Option One: allow MFTC recipients to gain from the IWTC increase and personal income tax cuts

Under option one, the IWTC would flow through to MFTC recipients and the MFTC threshold would increase marginally (by $112) per annum on 31 July 2024 to allow MFTC recipients to benefit from the personal income tax changes. This is a significant departure from the way the MFTC is calculated, as the guaranteed income provided for by the MFTC would be set approximately $27 above the after-tax earnings from employment whilst still on benefit (which accounts for the IWTC increase and the estimated relief from the personal tax rate changes).

This option would ensure that MFTC recipients receive the IWTC increase and benefit from the personal income tax changes, which will support income adequacy and child poverty reduction. Allowing the IWTC changes to flow through would further increase the incentive for beneficiaries to move off benefit and to take up and stay in employment at the margin, particularly at 20 hours per week.

However, this option continues the wide hours range (from 20 to 35 hours of work) over which the 100% abatement rate applies for the MFTC currently.[17] As MFTC recipients are subject to significant EMTRs, particularly between 20 and 35 hours of work, this option decreases incentives to work more hours.

Increasing the MFTC threshold would also speed up the impending cross-over of the MFTC threshold and the WFF abatement threshold. If these two thresholds cross over, the work incentive aspect of these payments and the broader WFF income adequacy objective will be significantly hindered due to the resulting EMTRs for recipients being well over 100%. There will also be ongoing issue in deciding what to do about the artificially inflated threshold every year; starting 1 April 2025.

This option has a fiscal cost of approximately $0.2 million per annum. This is a result of letting MFTC recipients benefit from the personal income tax changes.

This option is preferred by the Ministry of Social Development and the Child Wellbeing and Poverty Reduction Group in the Department of the Prime Minister and Cabinet.

Option Two: Decrease the MFTC threshold in line with existing policy, so that MFTC recipients receive less than they would currently

Under option two, the MFTC threshold would decrease by approximately $27 dollars per week or $1,404 per annum. Lowering the MFTC threshold by $27 per week adheres to the current MFTC threshold calculation, as this amount ensures that MFTC recipients remain $1

[17] Assuming no change to the minimum wage rate.

better off per week compared with those working and receiving a benefit following the IWTC increase and the changes to the personal income tax rates.[18]

This option reduces the MFTC threshold to account for both the IWTC increase artificially inflating the MFTC guaranteed amount and the personal income tax rate changes. MFTC recipients will therefore be made worse off by this change as their net incomes will decrease. For example, if a family is working less than 33 hours per week, they are likely to experience a reduction in net income of up to $104 per annum under this option. This option therefore does not improve income adequacy or support child poverty reduction.

As MFTC recipients will not financially benefit from the IWTC increase following these changes, the increased incentive to take up and stay in work associated with the IWTC increase will not flow through. However, at minimum wage, the earnings range over which the 100% abatement rate applies would be reduced by one and half hours, increasing the incentive for MFTC recipients to work longer hours.

This option will also mitigate the urgency of addressing the MFTC/WFF abatement threshold cross over, as reducing the MFTC threshold will delay the eventual cross over.

This option will result in a reduction of $2.9 million per year for the IWTC costing.

Option three – Decrease the MFTC threshold so that MFTC recipients will receive the same amount that they do currently

Under option three, the MFTC threshold would decrease by $23 dollars per week or $1,196 per annum when the increase to the IWTC is introduced. This change reduces the MFTC threshold in such a way that a family does not benefit from the IWTC change but are not worse off as compared to status quo. The MFTC threshold would then be readjusted with the next benefit increase as per the usual process on 1 April 2025.

This option is a departure from the existing calculation to the MFTC threshold that has been operating, as it would ensure that the threshold is set at a rate greater than $1 above the after-tax earnings from employment whilst still on benefit. However, option three provides for minimal departure from the MFTC calculation so as to not cause inconsistency with the policy intent of the MFTC.

As MFTC recipients will not benefit from the IWTC increase but will not be made worse off, this option has a neutral impact on income adequacy and child poverty reduction. The MFTC's function to incentivise people to move off-benefit and into full time employment will also be preserved.

As this option reduces the MFTC threshold, it will delay the MFTC/WFF abatement threshold cross over and mitigate the urgency of addressing this issue.

This option will result in a reduction of $2.5 million per year for the IWTC costing.

Officials prefer the proposed changes under option 3 to lower the MFTC threshold by $23 per week or $1,196 per annum. This option delays the eventual MFTC/WFF abatement threshold cross-over without making MFTC recipients worse off. The MFTC's function to incentivise people to move off-benefit and into full time employment will also be preserved.

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[18] This decrease does not directly correlate to the IWTC increase due to the way main benefits abate.

How do the options compare to the status quo/counterfactual?

	Option One – *Status Quo*	Option Two – *Increase of the IWTC by $25 per week from 31 July 2024*
Income Adequacy	0	+ +
Financial incentive to work	0	+ +
Administrative benefit	0	0
Child poverty impact	0	+
Fiscal cost	0	-
Ease of implementation	0	-
Overall assessment	0	+ + +

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

1. As discussed in objectives section, it is difficult to achieve all three objectives of the WFF scheme. Which is demonstrated in the above table.
2. Option Two improves income adequacy and the financial incentives to work, but it comes at a significant fiscal cost.
3. Option Two is an improvement on the status quo.

MFTC consequential change – how do the options compare to the status quo/counterfactual?

	Status quo	Option One – *MFTC threshold is increased*	Option Two – *Decrease the MFTC as per the calculation*	Option Three – *Decrease the MFTC until no one loses*
Income Adequacy	0	+ +	-	0
Financial incentive to work	0	+ / -	+ +	+
Child poverty impact	0	+	-	0
Fiscal cost	0	0	+	+
MFTC/WFF crossover	0	-	+ +	+
Overall assessment	0	+ +	+ + +	+ + +

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

1. Option one improves income adequacy and child poverty reduction, unlike options two and three. However, option one exacerbates the MFTC/WFF overlap.
2. Option two mitigates the MFTC/WFF crossover, improves work incentives, and has delivers minimal savings. However, it has a negative impact on income adequacy and child poverty reduction.
3. Option three mitigates the MFTC/WFF crossover and improves work incentives to a lesser degree compared to option two. It also offers minimal savings. However, unlike option two, under option three there is a neutral impact on income adequacy and child poverty reduction.

What are the marginal costs and benefits of the option?

Option Two – Increase of the IWTC by $25 per week from 31 July 2024

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Working for Families recipients	The proposed timing of the change may create confusion for recipients, which cause them to contact Inland Revenue.	Low	High
Inland Revenue	There will be capital and operating costs of these changes but will be self-funding through existing maintenance and development programme for core systems.	Low	High
The Government	Ongoing, annual fiscal cost. This assumes full take-up.	$607 million over the forecast period which extends to 30 June 2028. There is an average cost of $152 million per annum.	Medium
Total monetised costs	Ongoing, annual fiscal cost. This assumes full take-up.	$607 million over the forecast period which extends to 30 June 2028.	Medium
Non-monetised costs	The proposed timing of the change may create confusion for recipients, which cause them to contact Inland Revenue.	Low	High
Additional benefits of the preferred option compared to taking no action			
Working for Families recipients	170,000 households will benefit from an ongoing, weekly increase in income. This assumes full take up.	Average weekly increase of $16.97.	High

Children in poverty (when considered as a component of a wider Tax Package)	Although the rate increase occurs, we cannot predict the duration of its impact. Lifting the income of a child's family above a threshold does not guarantee that they will no longer suffer the effects of poverty or that their income will remain above the threshold permanently.	14,000 children lifted out of AH50 poverty or 3,000 children out of BHC50 poverty	Low. The impact on child poverty reduction of the increase to the IWTC by $25 per week from 31 July 2024 has not been modelled independently of the other Tax Package changes. In addition, there are significant uncertainties with TAWA modelling for poverty impacts.
Increased incentive to take-up and stay in employment	This change will lower replacement ratios, which measure the gap between income when receiving a benefit versus income when in work.	170,000 households will have increased incentive to take-up and stay in employment.	Low. Replacement ratios observe a direct transition between full-time work and benefit for families in a specific scenario. In reality, families' employment decisions are more fluid than being directly in or out of work, and there ae a range of factors that contribute to these decisions beyond the marginal dollar return.
Total monetised benefits	170,000 households will benefit from an ongoing, weekly increase in income. This assumes full take up.	Average weekly increase of $16.97.	High
Non-monetised benefits	170,000 households will have increased incentive to take-up and stay in employment. Child poverty reduction (when considered as a component of a wider Tax Package)	Medium 14,000 children lifted out of AH50 poverty or 3,000 children out of BHC50 poverty	Medium Low

Section 3: Delivering an option

How will the new arrangements be implemented?

To progress this change through Budget 2024, and include it in Budget night legislation, ad hoc notices of entitlement are required to be sent to WFF customers. Usually, notices of entitlement are sent out in February, during Inland Revenue's standard WFF rollover process. This could cause confusion for these impacted customers, who already have a high customer contact rate with Inland Revenue due to their reliance on WFF support. This customer contact will coincide with Inland Revenue's busiest time of the calendar year in which it is issuing individual income tax assessments.

Inland Revenue will need to undertake significant preparatory work before Budget 2024 announcements. This includes issuing communications and guidance material, as well as updating Inland Revenue's website.

As this is an extension of an existing tax credit, it is not expected to create significant implementation costs.

How will the new arrangements be monitored, evaluated, and reviewed?

This proposed change adjusts the rate of the IWTC, therefore no new or additional monitoring is required.

The effects of the proposed changes can be monitored using data Inland Revenue currently collects as part of administering WFF. This data includes the number of WFF recipients, the makeup of those families, the amount and type of payments made, and end of year assessment data on under and overpayments. This administrative data provides descriptive information about WFF recipients, and the actual fiscal cost to the Government of the chosen settings.