Coversheet: Families Package

Advising agencies	The Treasury, Inland Revenue, Ministry of Social Development, Ministry for Vulnerable Children
Decision sought	To repeal the Family Incomes Package legislation from Budget 2017 and introduce the Families Package
Proposing Ministers	Minister of Finance

Summary: Problem and Proposed Approach

Problem Definition **What problem or opportunity does this proposal seek to address? Why is Government intervention required?**
The Government's objective to improve income adequacy for families with children and reduce child poverty would be better achieved by repealing the tax cuts introduced by the former Government's Family Incomes Package in Budget 2017. The reversal of the tax cuts would raise more than sufficient revenue for their proposed increases to transfer payments, as well as introducing new transfer payments. At the same time, the Independent Earner Tax Credit would be reinstated.

Proposed Approach **How will Government intervention work to bring about the desired change? How is this the best option?**
The Families Package redistributes a significant portion of the revenue from reversing the tax cuts to increased transfer payments. The proposed changes will positively impact many families with children and individuals (including superannuitants).

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
The main expected beneficiaries are: low and middle income families with children, beneficiaries, low income earners without children, and superannuitants. The Government will receive a revenue gain from the reversal of the tax cuts. By reversing the previous Government's income tax threshold changes, the Families Package is estimated to raise revenue by $8.364 billion over the forecast period, which is used to fund the costs of the Package, estimated at $5.527 billion over the forecast period. Implementation costs are approximately $27.2 million over the forecast period. This means that over the five year forecast period, the Families Package has an estimated positive impact on the operating balance of approximately $2.837 billion.

Where do the costs fall?
Relative to the Family Incomes Package, there is a net fiscal savings from the reversal of

the tax cuts. That aside, there will be greater implementation costs for the administrating agencies. The non-monetised costs include impacts on labour supply and compliance costs for individuals interacting with agencies. In particular, the Families Package as a whole will likely have a net negative impact on labour supply due to the increase in transfer payments (owing to an overall stronger income effect).

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?
The likely risks include: 1. Missed opportunity to reinstate a more targeted Independent Earner Tax Credit (IETC) that could have resulted in fiscal savings, and provide more incentive for labour supply. 2. While the Families Package will improve incomes for many low income families with children, there is a small group of low income households who may be negatively affected relative to the Budget 2017 Family Incomes Package. Officials will do more work to determine how many families may be impacted in this way using MSD's administrative data, and Ministers will make decisions about whether and how to compensate this group. All the families in this group will be better off compared to the settings in the absence of the Budget 2017 changes. 3. Potential for reduced work incentives as a result of high effective marginal tax rates in some cases. This results in workers paying more tax for every dollar of extra income earned. These impacts are considered to be manageable, and reflect a deliberate policy intent to shift spending to low-income families and low-income families with children. The recycling of money from repealing the Budget 2017 Package will offset the increased cost associated with the introduction of new credits and transfers, and leave room for additional investment in other services. A transitional assistance fund will be made available for anyone who is unintentionally financially disadvantaged as a result of the Package for a maximum 12 months from the date of grant, or until the client experiences a change in circumstances that results in them receiving higher net income (whichever is sooner). The introduction of targeted forms of social assistance in some cases results in high effective marginal tax rates that could impact work incentives. In addition, taxes on high-income earners will remain unchanged from current levels. As a result, these risks have been mitigated to the extent possible, or recognised as requiring further review. The Package will benefit many families in New Zealand, and is part of a broader set of policies to improve the lives of all New Zealanders. However, the existing tax and transfer system is still complex, and at times creates high effective marginal tax rates. The Government has stated that it will undertake a wider review to investigate options to improve the overall welfare system, taking into consideration broader objectives of equity, effectiveness, simplification, fiscal costs and work incentives. Any unintended impacts from the Families Package could also be addressed as part of that wider review.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.
There is no significant incompatibility with the Government's "Expectations for the design of regulatory systems."

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
Treasury is confident that the evidence supports the proposal. This evidence on the distributional impacts, effect on child poverty and fiscal cost consists mostly of historic and current analysis based on Inland Revenue tax administrative data, MSD administrative data and Treasury's TAWA microsimulation model.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
The Treasury
Quality Assurance Assessment:
Not applicable for 100 day plan priorities
Reviewer Comments and Recommendations:
Treasury comments are based on revised expectations for Regulatory Impact Assessments covering 100-day plan priorities. The Regulatory Impact Statement shows how the proposed package of reforms shifts the balance of measures included in the Budget 2017 Family Incomes Package, to be more in line with the Government's objectives. It also sets out the likely impacts on households and in fiscal terms. In addition, as noted in in Section 1 of the Regulatory Impact Statement "Key Limitations or Constraints on Analysis" only the proposed package has been assessed. Consequently, it is not possible to be confident that the Government's objectives are being met in the best way and with the least unintended consequences. The proposed review of the tax and transfer system may provide an opportunity for fuller consideration of the impact of the measures in practice and of other ways in which the same objectives might also be met.

Impact Statement: Families Package

Section 1: General information

Purpose
The Treasury has lead the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. Inputs were also received from Inland Revenue and the Ministry of Social Development. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.

Key Limitations or Constraints on Analysis
Scoping the problem The Government has a 100 day commitment to "legislate to pass the Families Package, including the Winter Energy Payment, Best Start and increases to Paid Parental Leave, to take effect from 1 July 2018".[1] As part of this commitment, the Government has decided to repeal elements of the 2017 Family Incomes Package.[2] This involves reversing the tax cuts to allow the Government to reinvest that money elsewhere.[3] A significant proportion of the increased revenue would be redistributed in order to: 1. increase **Working for Families** tax credits further (increasing the eldest child rate and abatement threshold), 2. introduce two new transfer payments (**Best Start** and **Winter Energy Payment**), and 3. reinstate the **Independent Earner Tax Credit** to compensate for the reversal of the tax cuts (i.e. to compensate low-income individuals who would have benefited from increasing these thresholds) 4. extend **Paid Parental Leave** (from 18 to 26 weeks by 2020) 5. retain the **Accommodation Supplement** and **Accommodation Benefit** changes from Budget 2017. The extension of Paid Parental Leave is not considered in this RIS; it has been progressed through a separate legislative process. For further information and context, we recommend that readers refer to the previous RIS prepared for the implementation of the Family Incomes Package in Budget 2017: http://www.treasury.govt.nz/publications/informationreleases/ris/treasury/bfi/ris-tsy-bfi-may17.pdf. The following analysis will be discussed mainly in relation to the Family Incomes Package. **Range of options considered** The timeframe to implement the Families Package to meet the Government's 100 day plan limited the range of options that could be considered for the Package. As a result, the options considered as part of the advice prepared for Ministers were small variants (if any) of the individual components, rather than substantial alternatives. These include the following: 1. Repealing the Budget 2017 tax cuts (no other options considered); 2. Increasing to the Families Tax Credit payments, increasing the abatement rate to 25%, and raising the abatement threshold to $40,700 (no other options considered); 3. Introducing the Best Start tax credit to help families with the cost in a child's early years; 4. Reinstating the Independent Earner Tax Credit; 5. Retaining the Accommodation Supplement, and Accommodation Benefit increases as

[1] http://www.labour.org.nz/100days

[2] http://www.labour.org.nz/familiespackage

[3] http://www.labour.org.nz/tax

announced in Budget 2017 (no other options considered);

6. Introducing the Winter Energy Payment for people receiving New Zealand Superannuation, a Veteran's Pension or a main benefit; and
7. Increasing the Minimum Family Tax Credit threshold further to take account of the loss of the Winter Energy Payment.

Criteria used to assess options

The Government's overarching objectives of the Families Package are to:

1. Deliver more money to families with children;
2. Reduce child poverty; and
3. Free up fiscal resources over the next four years to contribute to further investments in housing, health, education, and other priorities.

We will also consider the impacts on efficiency (mainly labour supply), and administration and compliance. Together, these criteria form the main principles of a good tax and transfer system.

We will assess the components of the Package against these criteria.

Quality of data used for impact analysis

The analysis of the Families Package was undertaken using administrative data from Inland Revenue and Ministry of Social Development (MSD), and results from microsimulation modeling by the Treasury based on the Household Economic Survey (HES). The analysis includes previous analysis completed for the Family Incomes Package.

As part of the microsimulation modeling by the Treasury, assumptions were inherently made as a result of using survey data. The distributional impacts that are included in the Cabinet paper (and later in this document) are estimates and accompanied by a set of caveats, including where some estimates might be over- or under-estimated.

Given the timeframe for providing advice, the Treasury was not in a position to undertake behavioural modeling on the policies. The qualitative judgments regarding the impacts on labour supply, therefore, are based on previous analysis of the Family Incomes Package.

Consultation and testing

A key constraint in the process was the need to move quickly to meet the Government's 100 day commitments. This has resulted in no public consultation, and limited consultation with other agencies.

The components of the Families Package were well-publicised as part of the Labour Party's election campaign. While public consultation in the usual manner (such as through the Generic Tax Policy Process) has not occurred, the policies will not be a surprise to the general public when implemented.

Responsible Manager (signature and date):
Mark Vink, Manager, Tax Strategy The Treasury Date

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

Changes to the income tax thresholds announced in Budget 2017 (as part of the 2017 Family Incomes Package) were estimated to deliver considerable savings to taxpayers per annum. As announced in Labour's election manifesto, these tax threshold changes will not come into force. Instead, the savings will be used elsewhere, but mainly to offset the costs of increased transfers in the Families Package.

Broadly, the Families Package is targeted more towards increasing transfers for low and middle income families with children, as well as individuals. These families with children will receive higher entitlement from the Working for Families changes (through the Family Tax Credit and Minimum Family Tax Credit changes) and the new Best Start payment. Some individuals will benefit primarily from the reinstatement of the Independent Earner Tax Credit and the Winter Energy Payment.

Higher-income families and individuals will lose the tax cuts they would have received under the Family Incomes Package.

The Budget 2017 Accommodation Supplement and Accommodation Benefit changes will proceed as planned on 1 April 2018. As discussed above, the extension of Paid Parental Leave is progressed separately, but also forms part of the Government's broader package of assisting families with children.

2.2 What regulatory system, or systems, are already in place?

New Zealand has a progressive personal income tax system as well as a range of other taxes, notably a company income tax and goods and services tax (GST). In addition there are a range of transfer payments primarily administered by Inland Revenue (as tax credits) and the Ministry of Social Development (as benefit payments).

The most significant of these transfer payments are Working for Families tax credits, main benefit payments, supplementary assistance (including housing subsidies and Disability Allowance), and hardship assistance.

The combination of personal income taxes, tax credits and welfare payments need to be understood as a system of tax and transfers, as the parts can interact in complex ways.

The main issues that have been identified with the tax and transfer system are high effective marginal tax rates (EMTRs), complexity, and questions on whether it could better support income adequacy and reduce poverty. The system could also be reviewed from the recipient's viewpoint to reduce the degree of compliance and improve take-up rates.

With regard to the Families Package, the introduction of the Best Start and Winter Energy Payment will improve incomes for many families; however, it will also increase the complexity of the system and, in some cases, raise EMTRs thereby creating work disincentives.

As part of more strategic work on the tax and transfer system, officials will consider options for simplification and improving work incentives, and the equity and efficiency of the range of transfer payments.

For reference, the **Budget 2017 Family Incomes Package** had five elements outlined below. None of these elements have come into force, as changes were due to take effect on 1 April 2018:

1. Changes to the tax thresholds: Increased the $14,000 income tax threshold to $22,000, and the $48,000 threshold to $52,000. This was projected to provide a tax reduction of $11 a week to people earning $22,000 or more rising to $20 per week for anyone earning $52,000 or more.

2. Changes to the Family Tax Credit – Increased the maximum credit for the first child under 16, and for each subsequent child under 16. In addition, the abatement rate is increased to 25 per cent, and the abatement threshold decreases to $35,000 (from $36,350 currently).

3. Discontinued the Independent Earner Tax Credit: Independent Earner Tax Credit to be discontinued, from 1 April 2018. Those claiming it would be fully compensated by the changes in income tax thresholds mentioned above.

4. Accommodation Supplement - Increased the maximum payment rates for a two person household by between $25 and $75 a week, and for larger households by between $40 and $80 a week. Update the allocation of places into Accommodation Supplement Areas to reflect updated rental costs. These changes would increase support for families with high housing costs, and help to meet their rental, board or mortgage payments. Increase in the maximum amounts and updates to the make-up of the Accommodation Supplement Areas are the first such changes since 2005.

5. Accommodation Benefit - Increased weekly payments by up to $20 a week for students to reflect increasing housing costs for students. Roughly 41,000 students would receive the benefit, with the majority of them living in Auckland, Wellington and Christchurch.

2.3 What is the policy problem or opportunity?

The Budget 2017 Family Incomes Package would be less likely to meet the current Government's objectives for the wider Families Package (outlined below). As stated earlier in this RIS, these objectives are to:

1. Deliver more money to families with children;
2. Reduce child poverty; and
3. Free up fiscal resources over the next four years to contribute to further investments in housing, health, education, and other priorities.

While the Package will result in a more redistributive outcome, the Package's net impact on labour supply is likely to be negative and small. This contrasts to the Family Incomes Package which had a broadly neutral impact on labour supply. We will discuss the likely impacts of each component below.

2.4 Are there any constraints on the scope for decision making?

As the Government had publicly signalled a commitment to introduce its Families Package within its first 100 days, and directed officials to proceed accordingly, officials' advice to Ministers was focussed primarily on the implementation of the Package. There were several opportunities to shape some specific aspects of the policies, but these were limited. Thus, the analysis was prepared on the basis that the decision to proceed with the Government's tax and transfer changes had already been made.

2.5 What do stakeholders think?

Because the Families Package is one of the Government's 100 day commitments, the timeframe for finalising design details and implementing the policies was restricted. This has impacted our ability to test stakeholder views and consult on the possible impacts, including other Government agencies.

We have therefore not consulted stakeholders on the specific proposals in this assessment. The Government did, however, campaign on these policy proposals.

Section 3: Options identification

3.1 What options are available to address the problem?

As previously mentioned, options considered were limited to those that met the Government's stated priorities. When there was opportunity, variations of the components of the Families Package were presented to the Ministers for consideration.

Assessment criteria

When assessing the impacts of policy changes, we have used the following statements:

- very consistent
- consistent
- neutral
- inconsistent
- unclear

Proposal 1: Repeal the 2017 increases to income tax thresholds:

Multi-criteria analysis – repeal increases to income tax thresholds

Objective	Consistency
Deliver more money to families with children	Inconsistent*
Reduce child poverty	Inconsistent*
Contribute to freeing up money to contribute to other priorities	Very consistent

*when considered in isolation of the other components of the package

As incomes rise, the marginal tax rates that individuals face also increase. Increasing tax thresholds provide greater relative rewards for medium and high-income earners. This is in part because they don't qualify for the majority of the other benefits. To redistribute revenue to the lower income population, and for use elsewhere in the Government's fiscal plan, the Government has decided to repeal the Budget 2017 changes to income tax thresholds.

The proposed Budget 2017 tax thresholds adjustments were designed to improve work incentives. In all, 1,350,000 families excluding superannuitants and students would have benefited from the Budget 2017 Family Incomes Package. However, targeted payments would likely have a larger impact on income adequacy for low and middle-income earners. In the context of the Government's stated priority to introduce the Families Package, this change is consistent because it frees up money to be reprioritised elsewhere.

No other options were considered for this component of the Families Package.

Proposal 2: Changes to the Families Tax Credit:

Multi-criteria analysis – changes to the Families Tax Credit

Objective	Consistency
Deliver more money to families with children	Very consistent*
Reduce child poverty	Consistent*
Contribute to freeing up money to contribute to other priorities	Not consistent

*when considered in isolation of the other components of the package

The combination of these changes will increase the amount of Working for Families payments for families currently receiving them, and increase the number of families eligible for Working For Families by over 30,000. The changes to the Family Tax Credit are focussed on providing targeted assistance for people with children. Alignment of the Families Tax Credit for secondary children would support working families as well as beneficiary families and is strongly targeted to those with low incomes.

Families with children will benefit from:

1. increasing the Family Tax credit base for the eldest child to $ 5,878 (up from the Budget 2017 proposal of $ 5,303);
2. adopting the Budget 2017 changes to the Family Tax Credit base rate for subsequent children; and
3. raising the abatement threshold to $42,700 (instead of $35,000 as per Budget 2017).

The changes to the Family Tax Credits are more generous relative to the Family Incomes Package, which will likely have a slightly negative labour supply impact.

Proposal 3: Introduce a Best Start payment to help families with the cost in a child's early years:

Multi-criteria analysis – Introduce the Best Start tax credit

Objective	Consistency
Deliver more money to families with children	Very consistent*
Reduce child poverty	Consistent*
Contribute to freeing up money to contribute to other priorities	Not consistent

*when considered in isolation of the other components of the package

As part of the Government's policy to assist families with children, the introduction of the Best Start payment is a new transfer that aims to explicitly support families with young children.[4] Best Start gives nearly 65,000 newborns a year extra support ($60 a week) in the first year of their child's life. For low and middle income earners, that support will continue until their child turns three.

The tax credit is very consistent with the new Government's objective of targeting relief at poorer families. When children are aged one to two, the payment will abate above $79,000 of family income at 21 cents in the dollar. In order to promote simplicity in the tax system and prevent individuals from receiving double benefits, Best Start will replace the current Parental Tax Credit and will be paid after Paid Parental Leave payments end (if recipients qualify).

Because the payment is universal during the child's first year, the tax credit is not targeted to reduce child poverty.

The introduction of Best Start and its abatement at 21% will increase disincentives to work for a group of families between $80,000 and $95,000. The combination of abatement on different transfer payments and tax means that some families receiving Best Start could face an effective marginal tax rate of over 100%.

[4] http://www.labour.org.nz/familiespackage

Proposal 4: Reinstate the Independent Earner Tax Credit:

Multi-criteria analysis – retain the IETC

Objective	Consistency
Deliver more money to families with children	Partially Consistent
Reduce child poverty	Inconsistent
Contribute to freeing up money to contribute to other priorities	Inconsistent

*when considered in isolation of the other components of the package

When introduced in 2009, the IETC was intended to increase incentives for participation in the workforce for those earning below the full-time minimum wage of just above $24,000 per annum. The IETC delivers $10 per week or $520 per year to individuals earning between $24,000 and $44,000 per annum (abating at a rate of 13 cents per dollar earned above $44,000 until it is fully abated at $48,000).

The characteristics of those receiving the IETC have changed over time as wages have increased, this has resulted in a higher proportion of part time wage earners who are entitled to the tax credit. Removing the IETC would have meant that low-income earners were worse off, if viewed in isolation. There are two broad groups of people who access the IETC: people on low incomes, without children (as they are not eligible for Working for Families), and also higher earning couples, if one of the partners qualifies for the IETC, who may or may not have children.

Removing the IETC was designed to achieve fiscal savings. Analysis indicated that the IETC was not effectively achieving its intended purpose of increasing labour supply. However, in the context of the Government's stated priority to introduce the Families Package, reinstating the IETC benefit will ensure that low income earners are not worse off than under the Budget 2017 proposal.[5]

Previous analysis showed that when introduced, the IETC would have a small positive impact on labour supply.[6] Although the IETC is no longer targeted at full-time minimum wage earners as first intended, reinstating the tax credit will result in low-income wage earners remaining eligible for the tax credit.

There are a range of potential modifications to the IETC so that it is better targeted and could reduce its cost. These options would all result in some people (i.e., low-income workers) being disadvantaged relative to their current entitlement. These options range from

[5] IETC viewed in isolation, and not taking into account the impact of the proposed Budget 2017 tax cuts.

[6] Treasury Report, 2017. Options for Reinstating the Independent Earner Tax Credit.

increasing the minimum threshold to increasing the abatement rate and reducing the actual quantum of the tax credit. In the longer term other options could include to link the tax credit to family incomes or having an hours test to limit the eligibility of the tax credit.

Proposal 5: Accommodation Supplement, and Accommodation Benefit.

The changes to the maxima Accommodation Supplement, and increases in the Accommodation Benefit from Budget 2017 will remain in effect under the new Families Package and will therefore not be discussed in this section.

Proposal 6: Introduce a Winter Energy Payment

Multi-criteria analysis – Introduce the Winter Energy Payment

Objective	Consistency
Deliver more money to families with children	Consistent
Reduce child poverty	Partially consistent
Contribute to freeing up money to contribute to other priorities	Inconsistent

*when considered in isolation of the other components of the package

The Winter Energy Payment (WEP) is eligible for those in receipt of a main benefit, New Zealand Superannuation (NZS) or a Veteran's Pension (VP) to heat their homes in winter by increasing the amount of money available over the winter months.

The introduction of WEP will deliver financial assistance to over a million people, including many families with children, and families with children in poverty. Because WEP eligibility is restricted to recipients of a main benefit, New Zealand Superannuation or a Veteran's Pension, some low income families with children will not benefit from WEP. MSD estimates that approximately 40% of children in hardship will not be eligible for this payment.

The proposed design of the WEP creates a situation where some beneficiaries become worse off if they move into work, or increase hours of work. However, the impact of this issue is expected to be relatively small.

Proposal 7: Increasing the Minimum Family Tax Credit threshold to take account of the loss of the Winter Energy Payment.

The Minimum Family Tax Credit (MFTC) provides a guaranteed minimum level of after-tax income to families in full-time work, by topping up after-tax income to a set threshold. It is proposed that the MFTC threshold be increased for the 2018/19 tax year, starting 1 April 2018, from $23,816 to $26,156 (from $458 to $503 a week). This increase will take into account the usual annual threshold increase to reflect expected inflation increases in main benefit rates, and also takes into account the introduction of the Winter Energy Payment. Without this increase, the policy objective of ensuring that all beneficiaries are better off in work at any time of the year would not be achieved. Around 4,000 families will gain from this increase.[7]

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?
An additional consideration within the context of this Package was the feasibility of implementing the policies by 1 July 2018. The package has been designed to be affordable within the Government's fiscal strategy. The ease of administration and the compliance costs of recipients were taken into consideration when the components of the Package were designed. The potential behavioural impacts were also considered and recognised as needing further review.

3.3 What other options have been ruled out of scope, or not considered, and why?
The criteria for progressing these changes were set by the Government and further changes were ruled out of scope by the Government. The Government's broader objectives could have been met through other means, including the points below. 1. Examining the tax and transfer system framework in light of the Government's broader strategy for child poverty reduction, and investigating options to improve the overall welfare system. The Government has stated its plans to consider a broader review of the welfare system. 2. Removing the IETC because of it is poorly targeted nature, and improving work incentives through other changes to the tax and transfer system, 3. More tightly targeting payments to income levels to improve income adequacy for the poor. For example, WEP eligibility could be based on income instead of being a recipient of a main benefit or superannuitant to more tightly target low-income households. 4. Continuing to pay the Winter Energy Payment to those who exit a main benefit into employment, for the remainder of the winter, to preserve existing financial incentives to work. Greater targeting of payments and mitigation of work disincentives were considered; however, officials came to the view that the complexities and cost of these measures did not justify their introduction.

[7] Inland Revenue estimate based on administrative data.

Section 4: Impact Analysis

Note: this section is not required as part of the 100 day plan RIS requirements.

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?
Changes to personal taxes and transfers involve trade-offs among key objectives of: efficiency / growth / work incentives, equity, fiscal integrity, ease of compliance/administration, and fiscal cost. There is no perfect or optimal tax and transfer system, and any tax structure will incorporate value judgments. The preferred options as discussed in this document meet the Government's priorities for the Families Package and broader objectives for the tax system.

5.2 Summary table of costs and benefits of the preferred approach

Tax proposal	Impact group: The State / Government	*Impact group:* Low income earners	Impact group: Low-income families with children:	Impact group: High-income families
Impact of proposed approach, compared to taking no action (i.e. compared to Budget 2017)				
1. Repealing Budget 2017 tax cuts	Repealing the Budget 2017 tax cuts will provide fiscal savings that could be used elsewhere.	The loss of additional income will be offset by additional transfers and the reinstated IETC.	The loss of additional income will be offset by additional transfers.	This will impact on after tax wages as this group is unlikely to qualify for other benefits.
2. Changes to the Families Tax Credit	The changes to Working for Families will translate into a fiscal cost for the state.	Low-income earners without children will not be eligible to receive the increased tax credit or benefit from the raised abatement threshold.	• Around 30,000 families newly qualify for Working for Families. • Partly due to increased abatement threshold of $42,700 (compared to $35,000 under Budget 2017). • Increased credit of $5,878 for eldest child aged between 16 and 18 ($5,303 in Budget 2017). • $4,745 for subsequent children irrespective of age.	Eligibility depends on family income and the number of children per family.[8]
3. Introducing	The introduction of Best Start	Low-income earners without children	• Around 65,000 new-borns will	• This group will receive the

[8] https://www.workingforfamilies.govt.nz/

Best Start	will translate into a fiscal cost for the state.	will not be eligible to receive the payment.	receive extra support of $60 per week. • Low and middle-income families will receive benefit up to age 3.	payment only for the first year. • The benefit abates above $79,000 at a rate of 21c / dollar of household income. • There is potential for high effective marginal tax rates for this group.
4. Reinstate IETC	The introduction of the IETC will translate into a fiscal cost for the state.	• Those earning between $24,000 and $44,000 without a main benefit will receive the full benefit of $10 per week. • After $44,000 the credit abates at a rate of 13 cents in a dollar up to $48,000 where it is fully abated. • Around 500,000 individuals will remain eligible for the IETC.	• This group will not be eligible for the IETC as they qualify for Working for Families.	This group will only qualify for the benefit if a low-income partner meets the qualifying criteria.
5. Introduce Winter Energy Payment	The introduction of the WEP will translate into a fiscal cost for the state.	• Only low earners who receive a main benefit (or superannuation or a veteran's pension) are eligible for WEP. • For those qualifying, an additional $450-700 per year depending on family size. • There is potential that WEP lowers work incentives during the winter months	• Only those families who receive a main benefit (or superannuation or a Veteran's Pension) are eligible for WEP. • For those qualifying, an additional $700 per year depending on circumstances. • There is potential that WEP lowers work incentives during the winter months	• People receiving NZ superannuation (or the Veteran's Pension) will be eligible for WEP. • Some of these will be high-income earners.
Overall Impact (Evidence Certainty)	Fiscal savings (High certainty)	Better off (High certainty)	Better off (High certainty)	Worse off (High certainty)

Potential impact on low-income families and child poverty

In order to estimate the potential impact of the proposed Families Package on the Government's main policy objectives of income adequacy and child poverty, the following results were generated by the Treasury's micro-simulation model of the tax and welfare system – TAWA.[9]

Measuring the distributional impact on families

The Families Package is designed to deliver more money to families with children and reduce child poverty. Table 1 shows the distributional impacts by decile for families with dependent children:

- The average gain is $34 per week, with around 335,000 families with children gaining relative to the currently legislated Budget 2017 changes.
- The average loss is $28 per week, with 251,000 families with children disadvantaged relative to the currently legislated Budget 2017 changes.

The Treasury's indicative modelling has identified a small but undetermined number of families who appear to be negatively impacted at the third income decile relative to the previous Government's Budget 2017 Family Incomes Package (see Δ in the Table).

Approximations in the modelling assumptions and data itself make it difficult to be precise about the number and circumstances of those who may be affected. This is a consequence of the interaction between the Accommodation Supplement and the Family Tax Credit. Those in the affected group would all be at least $7 per week better off compared to the settings in the absence of Budget 2017 changes.

[9] All calculations should be considered as estimations.

Table 1 presents the impacts by decile for Tax Year 2020/21 (from 1 April 2020 to 31 March 2021).[10]

Family taxable income decile	Total number of Families	Number of families gaining	Average weekly gain for gaining families	Number of families disadvant-aged	Average weekly loss for losing families	Minimum income in decile
1	59,000	59,000	$ 36	*	*	*
2	59,000	57,000	$ 31	*	*	$ 20,000
3	59,000	55,000	$ 28	Δ	$ (2)	$ 28,000
4	59,000	59,000	$ 42	*	*	$ 47,000
5	59,000	50,000	$ 39	9,000	$ (11)	$ 67,000
6	59,000	32,000	$ 24	26,000	$ (19)	$ 83,000
7	59,000	10,000	$ 18	49,000	$ (23)	$100,000
8	59,000	8,000	$ 35	51,000	$ (30)	$121,000
9	59,000	*	*	56,000	$ (34)	$150,000
10	58,000	*	*	56,000	$ (35)	$204,000
All	586,000	335,000	$ 34	251,000	$ (28)	

Δ *Potential for low income families to be disadvantaged relative to Budget 2017 package*

- There is a small group of households in decile three who may be negatively affected at the third income decile relative to the previous Government's Budget 2017 Family Incomes Package.
- Approximations in the modelling assumptions and data make it difficult to be precise about the number and circumstances of those who may be affected. However, any families affected in this way are likely to be:
  i. Earning between $30,000 and $35,500 of taxable income, with one income earner over $20,000
  ii. Below the AS maxima after the 1 April 2018 changes
  iii. Not receiving the Winter Energy Payment or the Minimum Family Tax Credit
  iv. Not in receipt of main benefit or superannuation
- Officials will do more work to determine how many people may be impacted. Those in the affected group would all be at least $7 per week better off compared to the settings in the absence of Budget 2017 changes.

Source note: Access to the Household Economic Survey data was provided by Statistics New Zealand under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975. The results presented here are the work of Treasury, not Statistics New Zealand.

Notes for Table 1

[10] This year represents the full impact of the Families Package, and avoids the modelling complexities of implementing Best Start on 1 July 2018.

- All measures of change are relative to the currently legislated Budget 2017 changes.
- Only families with dependent children have been included. Families without dependent children are not shown in this table – they will be primarily affected by the reversal of the tax cuts and reinstatement of the Independent Earner Tax Credit.
- This analysis was carried out using Treasury's micro-simulation model of the tax and welfare system – TAWA. All calculations should be considered as estimations.
- Deciles and decile boundaries are determined by family taxable incomes in the status quo.
- Families are counted as gaining (losing) if their annual disposable income increases (decreases) by 0.1c or more.
- As paid parental leave is under-reported in HES, the estimate of PPL expenditure will be an underestimate. This will result in in upwards bias in the estimate of Best Start expenditure.
- The number of children aged under one in the HES survey is approximately two thirds of the number in the estimated resident population. Best Start expenditure and consequences will therefore be underestimated, even after considering the upward bias from under-reporting of PPL.
- Elements with stars "*" are suppressed for confidentiality as values must have more than 3000 counts (weighted) and 10 or more sample units.
- Minimum wage changes are excluded from this analysis.

The impact of the Package on child poverty

The impacts on low-income poverty are presented as additional impacts to the currently legislated Budget 2017 changes. The Budget 2017 changes moved around 49,000 children above the 50% low-income poverty measure and around 36,000 children above the 60% low-income poverty measure.

Overall, the Families Package is expected to further reduce the number of households below these low-income lines. Table 2 below presents the estimated reduction for each measure.

Table 2: Reduction in numbers of children in low-income households[11]

Low-income Measure (Before Housing Costs)	**Reduction in number of children in low-income households additional to the Budget 2017 changes**
	2018/19
50% of median household income	12,000
60% of median household income	13,000

Fiscal impact / cost of the Families Package

This section outlines the fiscal impact of introducing the Families Package and reversing the previous Government's tax cuts. Note that the figures used in this section are best estimates as at 21 November, and these will be included in the final fiscal forecasts for the Half Year Economic and Fiscal Update (HYEFU). All figures are gross of clawback.

Table 3: The overall revenue impact of the Package:

[11] The reductions in child poverty are not additive across years.

	$m – increase/(decrease)				
	2017/18	2018/19	2019/20	2020/21	2021/22 & out-years
Reversing income tax thresholds and reintroducing the Independent Earner Tax Credit tax cuts	486	1,896	1,896	1,976	2,059
Tax impacts from Families Package	-	8	8	17	18
Total Revenue impact (before clawback)	**486**	**1,904**	**1,904**	**1,993**	**2,077**

The table below represents the total expense impact of introducing the Families Package (excluding implementation costs), and highlights some of the major expense components.

Table 4: The total expense impact of introducing the Families Package, with some major expense components highlighted:

	$m – increase/(decrease)				
	2017/18	2018/19	2019/20	2020/21	2021/22 & out-years
Working for Families	(97)	540	530	520	510
Best Start	-	80	231	373	451
Winter Energy Payment	-	443	448	455	465
Other expense components	17	94	100	177	190
Total Expense impact (before clawback)	**(80)**	**1,157**	**1,309**	**1,525**	**1,616**

Note that these estimates also include the costs associated with recent changes to Paid Parental Leave. These were agreed separately by Cabinet [CAB-17-Min-0497 refers] but are included in this estimate of the cost of the Package.

Over a five year period the total estimated impact of the Families Package is an increase in the operating balance of $2.837 billion. The updated estimate is $23 million lower than the amount used to determine future Budget allowances agreed by Cabinet [CAB-17-MIN-0506].

Table 5: Net impact of introducing the Families Package. (This represents the total impact of the Package, before clawback, which has a positive impact on the operating balance).

	$m – increase/(decrease)				
Families Package: Net impact	2017/18	2018/19	2019/20	2020/21	2021/22 & out-years
Increased revenue impact (before clawback)	486	1,904	1,904	1,993	2,077
Increased expense impact (before clawback)	(80)	1,157	1,309	1,525	1,616
Net Positive impact on the Operating Balance (before clawback)	**566**	**747**	**595**	**468**	**461**

Given the small variance, and that the Half Year Economic and Fiscal Update will reflect the most up-to-date impacts of the Package, it is proposed that the impact flows directly through to net core Crown debt rather than be managed against the Budget 2018 operating allowance.

5.3 What other impacts is this approach likely to have?
This section discusses in more detail the impacts of the Package components on work incentives. 1) Repealing Budget 2017 tax cuts. The rationale behind changing the income tax thresholds was to mitigate the impact of high marginal tax rates (MTRs) on behaviour. As incomes increase, the marginal tax rates individuals face also increase. This has the effect of weakening work incentives by reducing the rewards of extra work received by the worker. High MTRs can also encourage people to structure their affairs to reduce their tax obligations. Personal income tax rates were last changed in 2010. Since that time, median income has increased from $40,000 to $48,000. Incomes across the distribution have also increased. In particular, where the median income earner in 2010 faced a MTR of 17.5 percent, they now face 30 percent. New Zealand's labour force participation rate is relatively high. However, if income tax thresholds are not adjusted periodically, work incentives could be diminished over time. The interaction of tax and targeted transfers means some taxpayers face abating assistance. Abatement can push effective marginal tax rates (EMTRs) considerably higher than statutory MTRs. This reduces the returns from extra work even further. Although the policy intent of the new Families Package is clear in terms of improving incomes for low income families, the decision to not increase tax thresholds over time might have negative consequential impacts on labour supply for low, middle and high-income earners. Although this improves the progressiveness of the tax system (i.e., higher income earners being taxed higher than low income earners), the long term tax risk associated with high-income earnings might result in skills and capital flight. 2) Changes to the Families Tax Credit. Working for Families provides targeted assistance to increase family income to support families to raise their children and provide incentives to move off benefits and into work. This is achieved through a combination of conditions on entitlement and income thresholds above which entitlement begins to abate. Targeted payments are likely to have a greater impact on income adequacy than tax rate or threshold changes. However there are inevitable trade-offs as Government transfers inherently reduce incentives to work for some recipients. The degree to which those incentives are reduced will vary depending on design, and some transfers will provide greater disincentives than others. Increasing or better targeting childcare payments may reduce barriers to labour force participation for those with children. With the increase in Working for Families as proposed by the Government, there is a risk of increasing the base of recipients eligible for the tax credit, and any future increase in the rate will result in considerable fiscal cost. 3) Introducing a Best Start payment to help families with the cost in a child's early years.

The Best Start payment is one of the Government's policy interventions that is aimed at increasing incomes for families with children and reducing child poverty. More specifically, the scheme targets babies and toddlers, with extended benefits for low and middle-income families.

Legislatively, the payment would be treated as a Working for Families tax credit, so it can use existing definitions, customer information and processes, including the current Approved Information Sharing Agreement between Inland Revenue and the Ministry for Social Development, but would continue to be a separate payment with its own abatement and payment regime.

Although the Families Package, including Best Start, will improve incomes for many families, it will have a small, negative impact on work incentives and labour supply. It will also add complexity to the overall tax and transfer system, which can affect take-up rates. Decisions on the detailed design of Best Start considered how they could help minimise these effects, as well as balance fiscal costs, compliance and administrative impacts, equity and efficiency concerns.

In order to facilitate the implementation and improve the administration of the payment, various detailed decisions were required. Overall these detailed decisions aim to improve the targeted nature of the payment in terms of the eligibility of recipients and overlap between other forms of government assistance. The Best Start payment increases the relative complexity of the tax and transfer system.

4) Reinstate the Independent Earner's Tax Credit.

Analysis showed that when introduced, the IETC would have a small positive impact on labour supply. However, data indicates that the IETC is not currently well targeted towards full-time low-wage earners, and has a low uptake rate of around 32% during the year, with most recipients claiming it at the end of the year or later. This suggests that the IETC is not a fundamental factor in individuals' decisions about work during the year.

Reinstating the IETC as currently configured would be straight forward, with a fiscal cost of approximately $220 million per annum. Proposed changes to simplify the filing obligations for individuals as part of Inland Revenue's Business Transformation will result in automatic refunds for all intended recipients, increasing the overall cost by an additional $35 million (possibly from 2020 onwards) if no other changes are made to the IETC.

Not adjusting the parameters of the IETC might result in more part time individuals becoming eligible for the credit in future. This might negatively impact on the original intent (targeting full time wage earners), labour supply objectives and overall cost of the tax credit.

The Government will consider options to improve the effectiveness of the Independent Earner Tax Credit as part of a wider review of the tax and transfer system.

5) Introduce a Winter Energy Payment (WEP) for people receiving New Zealand superannuation / main benefit.

People may become accustomed to receiving the additional payment through WEP and may perceive the stopping of the WEP as a reduction in their income. This risk is particularly high for clients who “smooth” their electricity bills out over the course of the year (frontline staff at Work and Income often suggest this or automatic payments to clients as a way to manage these expenses).

The design of the WEP creates a situation where some beneficiaries become worse off when they earn additional income in a particular income range, thereby creating disincentives to moving into work or increasing hours of work. The problem with the WEP mainly affects recipients of the Jobseeker Support payment, who do not have children. At the point where a person’s benefit is completely abated, at approximately 23 hours at the minimum wage, working an additional hour would result in the person being approximately $13 a week worse off in winter. However this would seem to be a rare scenario.

A more likely scenario is increasing work by 10 hours during winter, for example from 20 to 30 hours of work. The person will gain extra wages, but will lose their WEP payment, and their remaining benefit, leaving them $72 a week better off. Under current policy, or in the summer months, a person working a further 10 hours will be $93 better off. People in this situation are no worse off financially, but face less incentive to increase their hours of work.

Analysis suggests the scale of this problem is modest. Issues with work incentives at the margin of benefit exit are also significantly wider than WEP. The primary cause of the small gain from wages at the benefit cut-out point is the high abatement that beneficiaries face as they work part-time. For Jobseekers, any income over $80 per week is abated at 70c/$1, before tax.

5.4 Is the preferred option compatible with the Government’s ‘Expectations for the design of regulatory systems’?

N/A

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

Changes arising from the repeal of the Budget 2017 changes to tax income thresholds and the Independent Earner Tax Credit – together with the introduction of the Families Package – will be included in an Omnibus Bill to be introduced and enacted under urgency before the end of 2017.

The proposed Bill will therefore be added to the 2017 Legislative Programme with a category 2 priority.

This will require a significant number of legislative amendments, which will be set out later, alongside the draft legislation.

A number of Inland Revenue Acts currently bind the Crown. The above noted amending Bill would not alter the status quo in this respect. The amendment would follow the positions of the relevant principal acts involved.

Inland Revenue's tax law drafting unit and the Parliamentary Counsel Office have been consulted on the proposed changes.

6.2 What are the implementation risks?

There will be implementation risks for businesses required to make changes to their systems. We have not consulted with affected people owing to time constraints. Where ever possible we sought to minimise compliance impacts on people by using existing mechanisms to deliver the targeted assistance proposed in this assessment.

Public materials (websites, etc.) will be updated to make the changes clear to the public. Frontline staff will be provided with training to understand the changes to the tax and transfer system so that they can clearly communicate with clients.

There will be implementation risks for the administering agencies (IRD and MSD), especially given the relatively short timeline for changes. However, changes to systems are expected to be well-tested before they go live, and both administering agencies have considerable experience with managing large payment systems.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
The tax and transfer system is complex. Although each individual measure is set in terms of qualifying criteria and individual benefit, the overall impacts of the Families Package will have various distributional effects on different income groups. MSD will be monitoring the number of its clients affected by the changes, including: number of MSD clients gaining from the Family Tax Credit payment rate increase (and average gain), the number of MSD clients gaining from Best Start, the number gaining from the Accommodation Supplement and Accommodation Benefit changes (and average gain), the number of people gaining from the Winter Energy Payment and the consequential impacts on Hardship Assistance of the Winter Energy Payment, Family Tax Credit and Best Start (which will involve both gains and losses). MSD will also be monitoring the growth of rental costs for Accommodation Supplement recipients, and the proportion of rental costs that the Accommodation Supplement covers, over time. Measures of poverty and hardship are currently reported in MSD's Household Incomes Report and Non-incomes Measures Reports. These reports provide estimates of the overall levels of poverty and hardship based on Statistics New Zealand's Household Economic Survey (HES), with a delay of around two years largely driven by the survey methodology. These reports cannot quantitatively attribute changes in poverty and hardship to changes in transfer payments, but any changes to transfers are mentioned as part of a qualitative discussion of possible drivers of any shifts seen in the overall levels. Inland Revenue's system will enable data collection so that the effectiveness of the measures can be assessed. This assessment will feed into Inland Revenue's Generic Tax Policy Process (GTPP) which provides for the evaluation and review of new legislation.

7.2 When and how will the new arrangements be reviewed?
Arrangements are expected to be reviewed as part of the monitoring described above. The Government has also announced its intention to undertake a broader review of the tax and transfer system, which could provide an opportunity to evaluate the effectiveness of some of the changes of the Families Package. Inland Revenue's Generic Tax Policy Process (GTPP) also provides a framework for review. The GTPP is a multi-stage policy process that has been used to design tax policy (and subsequently social policy administered by Inland Revenue) in New Zealand since 1995. The final step in the process is the implementation and review stage, which involves post-implementation review of legislation and the identification of remedial issues. In practice, any changes identified as necessary following enactment would be added to the tax policy work programme, and proposals would go through the GTPP.