Regulatory Impact Statement – Changes to Personal Tax, the Research & Development Tax Credit and KiwiSaver

[9 December 2008]

EXECUTIVE SUMMARY

There is evidence to suggest that high marginal and average tax rates hamper New Zealand's economic growth and productivity.

High personal tax rates, and inconsistencies in marginal tax rates across income types and different forms of investment, negatively impact on labour productivity, labour participation, and migration decisions. These disparities also create tax base integrity risks.

To reduce these problems a package of personal tax rate reductions, threshold changes, and the introduction of an Independent Earner Tax Credit is proposed. Given fiscal constraints and the need for short-term stimulus, this will be funded by the repeal of the R&D tax credit and changes to certain features of KiwiSaver.

The overall impact of these changes is forecasted to be positive for economic growth and, in the medium-term, for the government's fiscal position.

ADEQUACY STATEMENT

The Regulatory Impact Analysis Team has reviewed this Regulatory Impact Statement and considers it to cover the information required and accurately reflect the analysis undertaken in relation to the proposal. The analysis itself is considered to be adequate in relation to the problem definition and the level of impact analysis undertaken (with information gaps having been explicitly acknowledged). However, due to the timeframes involved, the RIA consultation requirements have not been met.

STATUS QUO AND PROBLEM

The current personal tax settings

As a result of the 2008 Budget, the Income Tax Act 2007 provides for the following personal tax rates and thresholds:

Marginal rate	1 October 2008	1 April 2010	1 April 2011
12.5%	Up to $14,000	up to $17,500	up to $20,000
21%	$14,001 to $40,000	$17,501 to $40,000	$20,001 to $42,500
33%	$40,001 to $70,000	$40,001 to $75,000	$42,501 to $80,000
39%	over $70,000	over $75,000	over $80,000

The current personal tax structure is *progressive* in nature as it results in an increase in the ratio of tax liability to income as income increases. There is also a targeted social assistance programme where monetary benefits are abated as income rises, leading to high effective marginal tax rates (MTRs) at middle income levels. The existing personal tax system is not generally inflation-indexed and it relies heavily on self-assessment.

Nature and magnitude of the problems with current personal tax settings

Consistency with broad base low rate tax policy framework

The modern criteria for an efficient tax system typically focus on minimising 'dead-weight costs' (e.g. the loss in efficiency as a result of tax-motivated choices), taxpayer compliance costs, and administration costs (of the collecting revenue authority), while taking into account tax incidence and equity issues and the informational limitations of policymakers. The number of tax system frameworks that are able to achieve this is small. One tax framework which more consistently meets these criteria is known as the Broad-Base-Low-Rate (BBLR) framework.

The best evidence available suggests that the BBLR framework is the optimal approach to tax policy for New Zealand in the medium-term. This framework aims to improve economic efficiency (and ultimately enhance economic growth performance) by reducing the distortions to economic decision-making caused by taxes. The BBLR framework achieves this by employing extensive tax bases and applying low tax rates to those bases in order to reduce the behavioural distortions caused by the tax system as far as possible. In other words the BBLR framework aims to make tax a neutral factor in decisions, so that decisions can be made based on their underlying economic merit rather than being influenced by tax considerations. The BBLR framework attempts to do this while at the same time raising the revenue required to fund government expenditures (and striking a balance between the associated taxpayer compliance and Inland Revenue administration costs incurred to achieve this revenue objective). High tax rates are inconsistent with the BBLR tax policy framework, which seeks to minimise the economic harm caused by taxes. While pursuing a BBLR framework, other factors such as equity and the tax system's redistributive role are also taken into account in tax policy design.

High marginal and average tax rates are damaging to economic growth

For income taxes in particular, the BBLR framework involves taxing a wide base of income at low MTRs on the basis that high MTRs are damaging to economic growth. High MTRs negatively impact on economic growth by unduly influencing decisions to work, save, invest, and consume, leading to inefficient allocation of scarce resources. Studies show that, by reducing the associated after-tax returns, high MTRs:

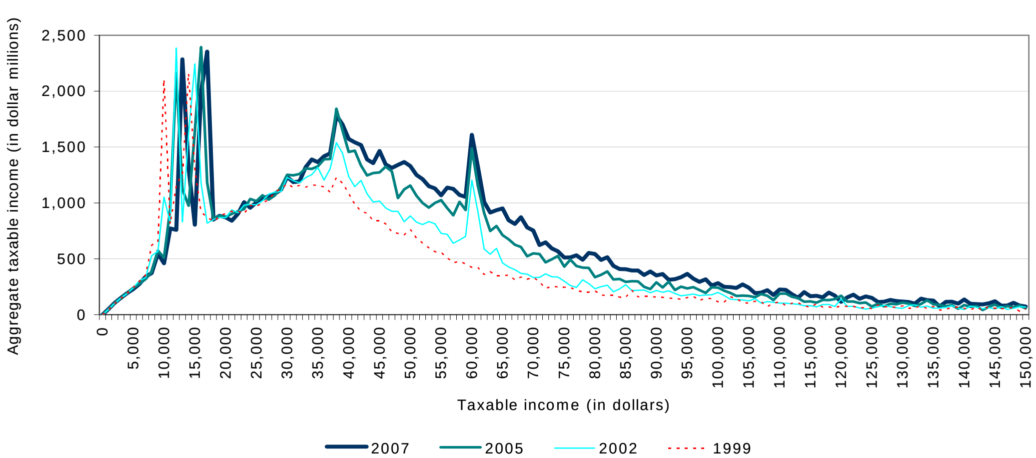
- discourage individuals from investing in their own skills and human capital;

- discourage people from seeking more productive work opportunities;
- make businesses less willing to undertake risky investments;
- discourage innovation and entrepreneurship;
- inhibit business growth; and
- increase the likelihood that productive businesses will exit the market.

Total New Zealand *income* tax revenues, as a percentage of GDP, are higher than the OECD average and have a particular emphasis on labour taxes. Although high MTRs reduce the incentives to increase hours worked, and the decision to undertake further employment, high *average* tax rates (ATRs) influence labour participation decisions, and particularly the decision to enter the workforce. Unless changes are made, fiscal drag will result in many taxpayers facing ATRs at 20-year highs by 2018, even with the tax cuts provided in Budget 2008. It is known that within the overall New Zealand workforce participation figures, particular groups of taxpayers (e.g. non-primary earner household members) have low participation rates but are relatively responsive to tax rates. Australian data has shown that non-participants in the labour market are responsive to ATRs, and it is estimated that Australia's recent tax changes will encourage a significant increase in participation from new labour market entrants. Therefore, although participation rates in the New Zealand labour force, like Australia, are relatively high, it is likely that reductions in tax rates will improve productivity and participation in the labour market.

Further, New Zealand statistics show that, based on the current personal tax rate structure (including working for families tax credits (WfF)), around 35% of all primary earners will face MTRs of 39% or greater (rising to 50% by 2018). There is also significant evidence of tax-planning to mitigate the exposure to high MTRs which is undermining the integrity and efficiency of the tax system. For example, IRD data shows increasingly large 'spikes' in the taxpayer income distribution at incomes around $38,000 and $60,000, with 'troughs' immediately above those values. This is shown by the graph below:

Aggregate taxable income of individuals by $1,000 bands of taxable income (year ended March)

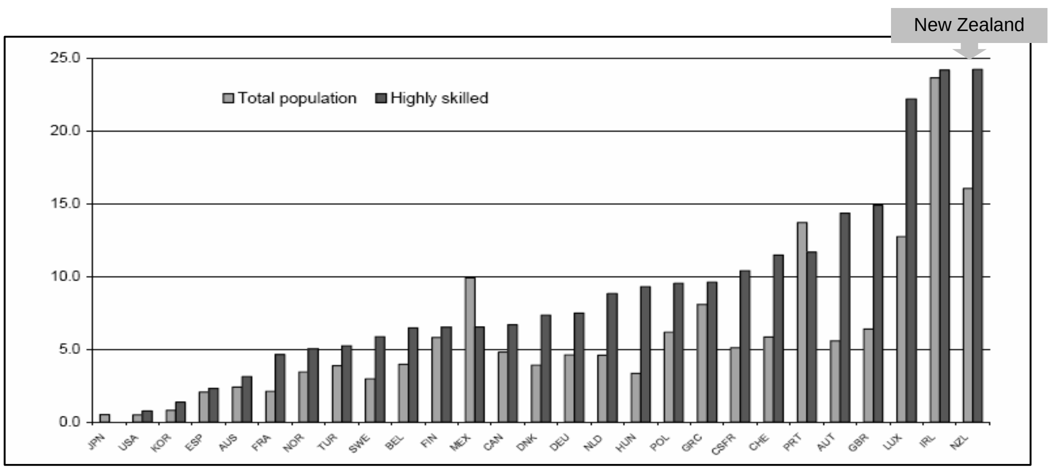


Note: The data for the year ended March 2007 is at June 2008 and incomplete.
Source: Policy Advice Division, Inland Revenue

There is also evidence of the growing use of trusts (where income can be taxed at a final rate of 33%) since the increase of the top personal tax rate to 39%. Also, the difference between the top personal tax rate of 39% and the company tax rate of 30% creates distortions such as tax-motivated incorporation.

As well as affecting participation within New Zealand, in an increasingly globalised environment high tax rates also affect the decision of workers, especially highly-skilled workers, to stay in New Zealand or to work abroad. New Zealand's highly-skilled labour has become increasingly mobile and sought-after globally. This is underscored by trans-Tasman migration in particular, causing problems for New Zealand in terms of skills and knowledge retention and the ability to foster an environment of innovation and entrepreneurship. This labour mobility issue is highlighted by the fact that around 25% of skilled New Zealanders now live abroad. The substantial magnitude of this expatriation is illustrated in the table below:

2000: New Zealand expatriates as a % of all native born (OECD countries: total population and highly skilled)



Personal income taxes in particular are damaging

A number of recent studies (including OECD studies), have concluded that some taxes are more damaging to economic growth than others. In particular, they have found that income taxes are the most damaging while consumption and certain property taxes are least damaging. Further, personal income tax progressivity appears to adversely affect Gross Domestic Product (GDP) levels.

International and domestic evidence highlights three existing aspects of New Zealand's tax system which are particularly harmful for revenue integrity, economic efficiency and productivity growth:

- High rates of personal income tax;
- Large differentials between the top personal and corporate rates of tax; and
- Different tax rates applying to different sources of income and different forms of investment.

This evidence suggests a focus on the reduction of personal and corporate tax rates in order to maximise the growth gains from tax reductions. In determining where to most immediately focus tax cuts, a key consideration is the need to address differences in tax rates applicable to different sources of income and different business vehicles or investment forms - which provide tax arbitrage opportunities and cause investment and tax-planning responses to divert income towards tax-favoured forms. As a result of this tax-induced behaviour, investment may be diverted into investments producing high post-tax returns, despite higher pre-tax returns elsewhere. This reduces national welfare through lower overall returns to the economy. Such behaviour can also create serious and unsustainable tax system integrity risks for the government. In addition, these disparities also reduce equity between taxpayers, as an individual's tax liability is less a function of the quantum of income earned and more a function of the type of income and manner in which it is earned.

An example of rate disparities across certain forms of income and investment vehicles can be seen in the following tables:

Examples of rate disparities across certain forms of income in New Zealand

Taxable Income	Marginal tax rate if earned through PIE (high earner)	Marginal tax rate if held direct* (high earner)	Marginal tax rate if held by a trust* (& taxed at trustee level)
Interest	30%	39%	33%
Dividends	30%	39%	33%

* Assuming the individual is not a trader and shares are not bought for purpose of resale. With respect to land, it is assumed that the individual is not a dealer, developer, subdivider, or builder and that the land was not purchased with the purposes or intention of resale.

Examples of rate disparities across certain investment vehicles in New Zealand

Investment vehicle	Marginal tax rate
Sole proprietor/individual	0%-39% depending on total taxable income
Portfolio Investment Entity (PIE)	Typically 19.5% or 30% depending on prior year income of investor
New Zealand Company	30%, then marginal rate of shareholder upon distribution
Trust	Trustee income: 33%; if beneficiary income: generally marginal rate of beneficiary
Qualifying company/LAQC	Income taxed at 30%. There may be claw back on payment of dividend to high marginal rate recipient but also potential to pass through capital gains through payment of tax-free dividend; losses may be passed through to LAQC shareholders for use at their marginal rate (e.g. 39%)
Partnerships	Ability to use exemption thresholds to escape tax on sale of underlying interest in assets (e.g. up to $50,000 depreciation recovery). Otherwise marginal tax rate of individual partner applies: 0%-39%

In addition, horizontal inequity exists within the current tax system as individuals on the same income level face differing MTRs and ATRs depending on their personal circumstances. For example, an individual without children earning $35,000 per year derived entirely from salary/wages will pay around $146 more per week in net taxes than an identical individual who has one child (assuming no other household income). This is a result of the targeted WfF tax credits. Perceived inequity in the application of taxes can undermine the integrity of the system and result in reduced voluntary compliance.

Consequently, the negative effects on efficiency and equity, combined with the tax system integrity risks associated with these disparities, shows that a lowering of personal taxes and alignment of tax rates on different forms of income and investment are key matters to address. However, such changes cannot be undertaken in a vacuum and therefore must be considered in the overall context of fiscal and macroeconomic constraints. For example, the current fiscal and macroeconomic situation requires prudence concerning the extent of changes that can be made in the short to medium term.

Fiscal and macroeconomic context

New Zealand is currently in a recessionary period characterised by lower than average consumption spending and economic growth, and increasing unemployment. Short-term economic stimulus, such as that provided by a package of tax rate reductions, will encourage people to continue spending, invest in human capital and to increase employment opportunities. Such a stimulus can help smooth the economy's regular business cycle, maintaining a higher level of economic growth than would otherwise have occurred. This is beneficial for New Zealand as a whole, particularly in terms of overall standards of living.

With a deteriorating global economic outlook New Zealand is expecting weaker economic growth in the next few years, resulting in slower tax revenue growth and increased government expenditure. In particular, revenues from GST and corporate tax are predicted to fall, and expenditure on benefit payments, superannuation, debt servicing and KiwiSaver are predicted to rise. This is likely to lead to sustained operating balance deficits and higher debt-to-GDP ratios. Under the fiscal responsibility provisions of the Public Finance Act 1989, the Crown is required to achieve and maintain prudent levels of total debt. This provides some constraints around the extent to which tax reductions can be made.

Accordingly, it is critical for any alterations to the tax system to take into account the fiscal and macroeconomic implications of these changes in the short, medium and longer-term. The BBLR framework assists in managing these implications through revenue recycling: that is through the elimination or modification of less growth-enhancing features of the tax system and the application of the savings towards a reduction in tax rates. All other variables held equal, this process should produce an overall improvement in economic efficiency as a result of lowering the level of distortion caused by tax rates (and the wider tax system).

The options available to fund personal tax changes are discussed below under the 'Alternative Options' and 'Preferred Option' sections of this statement.

OBJECTIVES

The overarching objective of the tax system is to raise the revenue needed to fund government expenditure, in a fiscally responsible manner, while doing the least harm possible to economic growth and productivity.

The objective is to move systematically and incrementally toward lower taxes pursuant to a BBLR approach to taxation, which will:

- Improve incentives for labour supply, entrepreneurship, and the retention of skilled labour within New Zealand;
- Improve the quality of investment and savings by decreasing tax-induced distortions that divert savings and investment into tax-favoured forms; and

- Contribute to a wider reform agenda aimed at boosting future productivity growth whilst being sensitive to equity considerations.

As a step toward these objectives, a shorter-term objective is to reduce the economic effects of the most harmful taxes; particularly personal income taxes. As the top personal marginal income tax rate is significantly higher than the corporate and trust tax rates, a short-term objective is to lower personal rates in order to reduce the existing distorting disparity. This is consistent with a medium-term goal of aligning personal, trust, and company tax rates at a maximum of 30%.

Another key short term objective is to boost labour productivity and participation and to retain skilled labour in New Zealand. Since MTRs and ATRs impact on labour productivity, participation, and migration decisions, a reduction in effective MTRs and ATRs will reduce the negative impact in these areas.

In addition, the objective is to achieve the tax reduction in the most cost-effective manner (including funding through the removal or modification of other less growth-enhancing features of the tax system where possible, providing further benefits through rationalisation), with due attention being paid to the government's commitment to equity and wealth distribution, and to the fiscal and macroeconomic effects of the tax changes.

ALTERNATIVE OPTIONS

Personal tax changes

A number of alternative options were canvassed to deal with the aforementioned problems of high and inconsistent tax rates. From the evidence presented above, raising taxes in order to remove disparities clearly runs contrary to a BBLR framework and the aim of improving incentives for participation, labour productivity and migration. Therefore only options including tax rate reductions are considered suitable.

In deciding upon the magnitude of tax rate cuts and threshold changes, the government is constrained by the fiscal and macroeconomic implications. The fiscal responsibility provisions of the Public Finance Act 1989, coupled with the most recent macroeconomic forecasts, puts constraints around the level of tax rate reductions and threshold changes that would be sustainable, particularly given the requirement to maintain prudent levels of total Crown debt. A package of smaller tax reductions is not considered adequate to sufficiently improve labour productivity, participation, and migration incentives or provide the necessary fiscal stimulus given existing macroeconomic conditions. Although tax rate reductions below the preferred option are possible, the suggested tax changes represent a balance between medium term goals and the current fiscal and macroeconomic constraints.

To meet the objective of improving labour participation through a decrease in effective ATRs, alternative options to the IETC are available. An alternative way of providing an improvement to participation incentives is through a different set of tax rate and threshold changes. However, this alternative was rejected as it is fiscally expensive and it is not well targeted at encouraging an important group within society to enter the workforce.

In the context of a targeted credit, two alternative mechanisms of providing the credit were considered. These were delivery through the PAYE system as income is earned, or through an end-of-year rebate (or potentially somewhere in between). An end-of-year rebate mechanism is cheaper to administer and is likely to be more accurate (given that the total income and circumstances of each applicant will be known after the end of the tax year). However, the receipt of the tax credit as income is earned provides superior work incentives as the credit is received sooner. Given the objectives of the reform, and the relatively minor difference in delivery costs, the rebate mechanism is not the preferred option.

In order to facilitate the changes to personal tax rates, various options for funding the changes were considered. Increasing other tax types to pay for the reduction in personal taxes runs contrary to the principle of increasing New Zealand's international attractiveness, and is inconsistent with the BBLR approach to taxation. Another option considered was *not* offsetting the reduction in tax revenues through the removal and modification of other areas in the tax system. However, not funding the changes was deemed too fiscally costly given the already large projected future deficits. The table below shows the fiscal cost of making the personal tax changes without offsetting the cost through other tax system changes:

Fiscal cost of personal tax changes with no offsetting gains

($ million)	2008/09	2009/10	2010/11	2011/12	Out-Years	5-year total
Tax rates and threshold changes	211	818	702	616	719	3,066
Independent Earner Rebate	44	239	356	364	353	1,356
Total Cost	**255**	**1,057**	**1,058**	**980**	**1,072**	**4,422**

Options for reducing government expenditure include expenditure within the tax system, or from other areas of general expenditure, including core Crown expenditure. By implication the BBLR approach provides that less growth-enhancing tax mechanisms are recycled into tax rate and threshold changes. Consequently, in terms of tax system efficiency (and keeping administration costs low) the savings should initially come from less growth-enhancing areas within the tax system. Two areas of spending have been identified from within the current tax system – the R&D tax credit, and modification of the KiwiSaver scheme.

R&D tax credit: options for repeal or modification

If there are externalities associated with certain activities, there is an economic case for providing a concession for these activities from the BBLR framework. If, for example, firms undertaking R&D fail to capture all of the benefits, then left to their own devices, they may undertake an inefficiently low level of such expenditure. However, the 2001 Tax Review commented that externalities are pervasive and it is generally impossible to measure the size of the relevant external effects of intervening government measures. Therefore, deviations from a broad base low-rate approach should be made only when a substantial burden of proof is discharged.

OECD tax recommendations in respect of New Zealand are mixed. The 2007 working paper on the taxation system in New Zealand recommended limiting exceptions to the corporate tax base by removing the current preferential tax treatment for certain activities or industries and resisting the introduction of new tax concessions. However, the 2007 review of innovation policy identified the absence of larger tax incentives as a notable weakness.

Information on whether there is underinvestment in R&D in New Zealand relative to other countries is mixed. OECD comparative data indicates that the ratio of business R&D to GDP is low. However, recent work indicates that levels are higher than can be expected for countries with similar characteristics to New Zealand and that business expenditure on R&D may have been under-reported because of survey design (by about 65% in 2006).

Tax credits for expenditure on R&D have applied from the 2008-09 income year. Businesses conducting eligible R&D can claim a 15% refundable tax credit in respect of that expenditure. However, there are some concerns around the R&D tax credit. The first of these relates to the estimated fiscal cost of maintaining the credit, being $373 million per annum from 2011/2012. There are also concerns about the effectiveness of the credit. The aim of the credit was to generate additional R&D, thereby increasing productivity in the economy. However, given international experience, and anecdotal evidence, the government is concerned that little additional expenditure will be generated as a result of the credit. There are two principal causes of concern: firstly, firms can claim the credit on pre-existing R&D investment plans, and secondly, recharacterisation of expenditure (to fit the eligibility criteria) may occur. Research in Australia has shown that expenditure claimed under the Australian equivalent of the R&D tax credit contains a significant element of recharacterised expenditure. There is clearly a risk that this may occur in the New Zealand context. In addition, the credit involves significant compliance costs for firms and their advisors in preparing returns and in determining which expenditure is eligible for the credit.

Given the above concerns, and the significant fiscal and compliance costs involved, the credit may not be justified by a sufficient increase in R&D investment.

There are alternatives to repealing the R&D tax credit in its entirety. These include reducing the scope of what constitutes ‘eligible expenditure’ and the rate of the refundable credit itself. However, these options were not preferred as they still entail a significant fiscal cost and they do not address the concerns around whether the credit will be effective in encouraging new R&D investment. The efficiency gains from applying the revenue towards personal tax reductions are considered superior to any gains derived from the continuation of the R&D tax credit in a modified form.

KiwiSaver: options for modification or retention of existing scheme

KiwiSaver is one of two major policy initiatives designed to lift the level of household saving, the other being lower taxes on personal saving in Portfolio Investment Entities. The overall objective of the KiwiSaver scheme is to encourage New Zealanders to acquire long-term savings and asset accumulation habits in order to improve their financial well-being particularly in retirement; and to make KiwiSaver an enduring and affordable scheme for members, employers, and taxpayers.

A short-term objective is to reduce areas of the scheme that do not impact positively on savings incentives and to apply those saved revenues to higher-value areas. It is considered that the most immediate higher-value use of the revenue is a reduction in personal tax rates as this will improve savings incentives through an increase in the after-tax returns from savings.

The KiwiSaver and PIE reforms include more favourable tax treatment for saving in the form of financial assets. They also make personal saving easier and more "automatic". The *existing* KiwiSaver scheme provides that:

- Employees can choose to either contribute 4% or 8% of their gross salary or wages to their KiwiSaver account, with the default rate being 4%;
- Employers are required to make compulsory employer contributions to their employees' KiwiSaver schemes. The required rate of contributions commenced at 1%, rising to 4% on 1 April 2011;
- Employers receive an employer tax credit of up to $20 a week per employee through the PAYE system, to offset the cost of compulsory employer contributions; and
- Employer contributions are exempt from employers' superannuation contribution tax (ESCT), subject to some limits. The exemption from ESCT applies to the lesser of an amount equal to the employee's contribution, or 4% of the employee's gross salary or wages. Any employer contributions over the exemption are subject to ESCT.

There are concerns around the value of the government's expenditure on KiwiSaver for several reasons. Firstly, the cost of the KiwiSaver tax incentives is substantial and increasing due to higher than expected uptake. Secondly, there are significant concerns over whether KiwiSaver's incentives are overly generous – particularly given the related PIE tax incentives. Further, there is now doubt as to whether KiwiSaver expenditure represents an efficient use of resources given the scheme's potential to:

- facilitate the re-allocation of existing savings rather than generating additional new saving;
- reduce overall levels of savings because of reduced levels of Government saving; and
- make the distribution of retirement wealth more inequitable.

In particular, there is concern that people on low incomes may not be able to afford to join KiwiSaver and gain access to the incentives. There is also some concern that employers and employees will struggle to meet their minimum contribution commitments in tightening economic conditions. The first annual KiwiSaver evaluation report identifies affordability (in particular the minimum 4% employee contribution rate) as a feature of the scheme that could be discouraging enrolments by low income earners**.**

For these reasons, a reduction of the government's expenditure on KiwiSaver is favoured to fund the tax reductions which have a greater potential to be growth enhancing.

In addition to the preferred option discussed below, the alternative options that were considered to modify KiwiSaver to address these issues included:

- Reducing the minimum contribution rate to 2% for all KiwiSaver Members (i.e. new and existing members) including for existing members who currently make a minimum contribution of 4%. This option is likely to attract some new entrants to the scheme. However it is unlikely that many of these new entrants would be amongst the lowest income earners, who would typically have an increase in their disposable incomes as they move into retirement and receive New Zealand Superannuation. Existing members whose contributions will be reduced from 4% to 2% will have increased options to invest in other forms of long-term saving (or to increase current consumption. The savings incentives are preferable under the preferred option because existing members retain their current contribution rate at 4% unless they elect to contribute at the lower rate of 2%.

- Retaining the employer tax credit (ETC). This option was not considered a viable option as it is considered that there are other positive inbuilt savings incentives in KiwiSaver to encourage improved savings habits and greater savings levels. Such incentives are further complemented by favourable tax treatment under the PIE regime for savings. Therefore the retention of the ETC, even at a reduced amount, creates unnecessary and unsustainable extra fiscal cost. For the same reasons, the status quo, or a smaller reduction in relation to either the employer superannuation contribution tax exemption or the fee subsidy were not considered to meet the objectives sought.

In relation to member tax credits (MTCs), two alternative options were considered:

- *Reduction of the MTC to 2% of wages*
  One option involved a MTC of $20 per week but capped at 2% of wages. At a contribution rate of 2%, employees earning less than $52,000 per year would put in less than the current contribution rate of $1040 per year. So if the maximum MTC is capped at 2%, those employees could not obtain the maximum MTC, which could reduce their incentives to save and to develop effective savings habits. This also creates equity issues if a person has no income, for example, where contributions are out of capital or a partner's income or the member has a loss for tax purposes. In addition, Inland Revenue has indicated that basing the MTC on income and contributions (rather than just contributions) would create significant delivery problems. Requiring income data and associated changes to systems has significant administrative and compliance costs, and adds to the scheme's complexity. For these reasons this option was not preferred.

- *MTC capped at $780 per annum - minimum contribution rate of 2% but MTC continues to match member's contributions up to maximum of $780.*
  This option goes part way to addressing the concerns raised by the Council of Trade Unions' option (discussed below), within a tighter fiscal constraint. While the fiscal cost is lower than the preferred option, on balance, this option is not preferred as earners may be worse off than under the present arrangements. Although this option is less costly than the preferred option, it is considered that the savings incentives of the preferred option are preferable to those provided by this option. Furthermore, the additional fiscal cost is justified by the increased incentives for earners, particularly lower-income earners, to save.

PREFERRED OPTION

Given the problems and objectives outlined in the sections above, and the alternative options available, the preferred option consists of four components:

- Changes to personal tax rates and thresholds;
- Introduction of an Independent Earner Tax Credit;
- Repeal of the R&D tax credit; and
- Changes to KiwiSaver.

Each of the preferred components will require technical changes to legislation and regulation to give effect to the substantive changes. The substantive changes, and their impacts, are discussed below.

Changes to personal tax rates and thresholds

The preferred option involves making amendments to the Income Tax Act that would rebalance the personal tax rate structure as follows:

Rate	1 April 2009
12.5%	Up to $14,000
21%	$14,001 to $48,000
33%	$48,001 to $70,000
38%	over $70,000

Rate	1 April 2010
12.5%	up to $14,000
21%	$14,001 to $50,000
33%	$50,001 to $70,000
37%	over $70,000

Rate	1 April 2011
12.5%	up to $14,000
20%	$14,001 to $50,000
33%	$50,001 to $70,000
37%	over $70,000

Rationale for the preferred option

Globalisation, in terms of increased international competition for goods, capital and labour, is changing the context in which domestic taxes are set. Globalisation is on an upward trend, and though individual countries such as New Zealand can run against those trends in the short term, doing so is generally unsustainable in the longer-term. Importantly, New Zealand cannot ignore the impact of globalisation on its labour market. Our vulnerability as a nation to labour mobility was discussed under the ‘Status Quo and Problem’ section of this statement.

These trends have significant implications for New Zealand’s tax policy settings: taxes on labour in particular can no longer be set independently of international developments. The consequences of doing so are increased out-migration of the personal tax base (and the skills and knowledge bases). Setting personal and corporate tax rates independently of each other is also increasingly undermining tax system integrity via tax planning and arbitrage opportunities as well as tax-motivated incorporation.

Given the relative mobility of New Zealand labour, the sensitivity of human capital to taxes, and the need to compete internationally for skilled labour, a coordinated strategy for reform of the personal tax rate structure in New Zealand is necessary.

The damage to growth arising from high MTRs and ATRs (through personal taxes in particular) has also been highlighted under the ‘Status Quo and Problem’ section of this statement. This damage is impeding growth which is a key determinant of the quality of New Zealanders’ living standards. The preferred personal tax changes aim to reduce this damage (i.e. reduce the negative impact of taxation on labour productivity, participation, and migration decisions). The changes should be viewed as part of a strategic objective of reducing MTRs and ATRs over time as macroeconomic and fiscal conditions allow. This longer-term drive to reduce the impact of taxes on economic decision-making is a fundamental part of following the BBLR approach to tax policy.

The preferred tax structure changes outlined above will lower individuals' MTRs and ATRs in a manner that is fiscally responsible and appropriate in the macroeconomic context. The package is fiscally sustainable as it is funded through the removal of the R&D tax credits and certain KiwiSaver changes. These are discussed in more detail below. Consequently, the preferred option is self-funding and does not result in imprudent debt consequences for the government. Given the tightening economic conditions as a result of a recessionary period and a crisis in the global financial sector, the short-term fiscal stimulus provided by the tax cut package should assist in reducing the severity of the macroeconomic situation for New Zealand. Current economic conditions have underscored the need to act quickly in providing this stimulus.

The reduction in personal tax rates under the preferred option will also assist in easing the tax base integrity concerns arising through tax avoidance and tax arbitrage that occur out of a disparity of rates across investment forms – particularly by closing the gap between the top personal tax rate and the corporate tax rate.

Introduction of an independent earner tax credit

The changes to personal tax also include the introduction of an independent earner tax credit (IETC) from 1 April 2009 that will deliver $10 per week to individuals that earn income of between $24,000 and $44,000 and do not receive a benefit, WfF tax credits or New Zealand superannuation. The IETC will be abated at 13 cents for every dollar of income earned over $44,000. The amount of the IETC will increase to $15 per week from 1 April 2010. For salary and wage earners the IETC will be delivered each pay period by way of a reduction in PAYE tax that the employer withholds.

The IETC is preferred because it increases incentives for participation in the workforce by targeting a specific group within society. This group is represented by those earning below the full-time minimum wage of just below $25,000 per annum. By encouraging increased labour participation – there are positive flow-on effects for growth. Another key benefit from the targeted feature of the mechanism is that it helps minimise the associated fiscal cost, which less targeted options do not.

Overall, the preferred option involves lowering MTRs and ATRs. This will help enhance New Zealand's growth prospects by providing an improvement in labour productivity, labour participation, and labour migration, as well as reducing the magnitude of the existing tax base sustainability issues arising through rate disparities. Although there may be a regressive element for those earning slightly under the $24,000 threshold relative to those earning slightly above it, this is considered to be outweighed by the overall economic benefits arising from increased participation. Further, the IETC will improve incentives for those earning below $24,000 to move toward full-time work by reducing the ATRs that apply between $24,000 and $50,000 for those eligible for the IETC, and by providing an incentive to meet the $24,000 minimum threshold income for the IETC. As this threshold is below the full-time income of someone earning the statutory minimum hourly wage, all full-time workers should earn enough income to meet the minimum income threshold of the IETC.

Repeal of the R&D tax credit

The third component of the preferred option is the repeal of the R&D tax credit from the 2009/10 income year.

Rationale for the preferred option

Given the concerns with the effectiveness of the tax credit outlined above, as well as the significant fiscal and compliance costs, repealing the tax credit is the preferred option. Other options considered, such as modification to the rate or eligibility criteria, do not sufficiently address these concerns and still involve a fiscal cost. Therefore repeal of the tax credit and commitment of the majority of the savings to fund personal tax reductions is preferred.

For the reasons given above, and as the R&D tax credit represents a notable exception to the BBLR approach to taxation, using the savings from repeal of the tax credit to fund the personal tax reductions is considered to have greater growth-enhancing potential than its retention.

Government support for R&D continues through various existing grant mechanisms. In order to further R&D investment, the government has decided to commit part of the savings from the repeal of the tax credit to alternative R&D development.

KiwiSaver

The options that are preferred in relation to the modification of the KiwiSaver scheme, and the reasons these are preferred, are set out below.

Proposal 1: Reducing minimum employee contribution rates to 2%

The new minimum contribution rate for employees proposed is 2% of gross wages. Existing members would retain their current contribution rate unless they elect to reduce their contribution to the lower rate (2%). The default rate for new members would be 2%, although they could choose to contribute at a higher rate. The new minimum matching contribution rate for employers will also be reduced from 4% to 2%.

This option is preferred as it partly mitigates the disadvantages associated with a lower member contribution rate of 2% at a reduced fiscal cost. The design of KiwiSaver is heavily based on behavioural literature, which suggests that due to inertia many existing members are likely to remain on the 4% contribution rate and not elect to contribute at the lower rate. This option addresses the affordability issue for those on lower incomes (who may struggle to save at a 4% rate) while maintaining overall savings at a higher level than the 2% minimum. Apart from providing greater support in retirement for savers, a higher level of saving has wider benefits in terms of supporting financial system development.

Proposal 2: Repealing the employer tax credit (ETC)

In the short-term employers would bear the full cost of removing the ETC, as reducing the employer minimum contribution rate to 2% would only impact over time. It should be noted that this cost will also impact on the Crown as an employer. In any event, although employers would bear the full cost initially, it is likely to be passed onto employees in the longer-term through lower wage increases. If employers impose the cost differentially on KiwiSaver members, it will reduce the incentive to save. However, some employers are likely to eschew this approach (i.e. keeping take-home wages the same for members and non-members). To the extent this happens there will be only a small reduction in the incentive to save.

Given the economic climate and the need to fund tax reductions that have greater growth-enhancing potential, this option is preferred to the alternatives of either retaining the credit, or reducing the amount or application of the credit, despite the costs to firms of removing the ETC. These costs would fall heavily on firms in labour intensive industries, where there are large numbers of KiwiSaver members. While the cost could potentially be offset through lowering tax rates and harmonising tax rates for different forms of investment, there could be some transitional issues, particularly for firms that are just breaking even. Such firms would be unlikely to fully benefit in the short term from a reduction in tax rates because their taxable income would already be low - having to incur the full cost of the ETC could result in some hardship for these businesses. However, the personal tax cuts will also help fund fiscal stimulus from which these employers should benefit.

Proposal 3: Reducing the employer superannuation contribution tax exemption (ESCT) to 2%

Reducing the employer superannuation contribution tax exemption (ESCT) to 2% for KiwiSaver and other qualifying schemes is preferred as it contributes toward higher-value tax cuts. Given other saving incentives in KiwiSaver and the complementary PIE regime, the higher tax exemption creates unnecessary fiscal cost. Therefore, the preferred option is to reduce the tax exemption and divert the savings into the higher-value tax cuts.

Although reducing the ESCT exemption to 2% for KiwiSaver and other qualifying schemes is likely to have a small effect on saving incentives and consequently on financial system development, this impact will be smaller than complete removal of the tax exemption, while recognising the fiscal objectives outlined above.

Proposal 4: Reducing member tax credits (MTCs)

Minimum contribution rate of 2% but MTC continues to match member's contributions up to maximum of $1,040

Under this proposal from the Council of Trade Unions, the amount of the member tax credit can continue to be calculated on the basis of the level of contribution by the member, up to a maximum of $1,040 per year. If salary or wages are less than $52,000, the member may still choose to contribute at the minimum 2% rate, and, as a consequence, not receive the full MTC on their contribution level. Alternatively, they could contribute more than the minimum 2% in order to receive the maximum credit of $1,040 per year. Non-employees will receive the amount of the credit based on their contribution level up to a maximum of $1,040 per year.

While the fiscal impact of this option is greater than capping the MTC at 2% of a member's wages regardless of their contributions (i.e. an additional $791 million over 5 years), it is preferred as it provides better savings incentives and is more equitable than the alternative options. Further, it does not create additional administrative or compliance costs than those currently being incurred in relation to member tax credits.

Proposal 5: Discontinuing the fee subsidy of $40 per annum.

Removal of the fee subsidy is unlikely to discourage non-members from joining the scheme. The impact will be felt most by members who are on contribution holidays and who are not receiving the MTC.

This option is preferred as overall, the risks and negative impacts from discontinuing this benefit are considered relatively minor, and the growth benefits from recycling the revenue are considered to be greater than the benefits of retaining the fee subsidy.

Impacts of the preferred option

Fiscal impact

The table below shows the net operating balance impact of proceeding with:

- Changes to the personal tax rate structure;
- Introduction of the new independent earner tax credit;
- Discontinuation of the R&D tax credit from the beginning of the 2009-10 income year; and
- Changes to KiwiSaver.

cost/(saving) in $millions	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**5-year total**
Tax rates and threshold changes	211	818	702	616	719	3,066
Independent Earner Tax Credit	44	239	356	364	353	1,356
Removal of Research & Development tax credit	(54)	(243)	(290)	(332)	(373)	(1,292)
KiwiSaver changes	(86)	(657)	(828)	(947)	(1,021)	(3,539)
Net reduction in operating balance	**115**	**157**	**(60)**	**(299)**	**(322)**	**(409)**

The government intends to use one third of the savings from the repeal of the R&D tax credit to fund other innovation initiatives. The fiscal costs outlined above do not include that cost because they are outside the scope of the bill. However, once those innovation initiatives are put into effect the net costs of the total package will increase accordingly.

The fiscal impact of the four changes above yields net savings of $409 million over the five-year forecast period, with $322 million in ongoing net savings. The cost of tax rates and threshold changes were calculated using Treasury's micro-simulation model (known as Taxwell), based on 2006/07 Household Economic Survey data. The cost of the Independent Earner Tax Credit was calculated using Inland Revenue's model based on tax return data. Where appropriate, the above numbers include an offsetting tax claw-back (15.54%) on the basis that taxpayers will spend a portion of their tax cut on goods and services that attract GST and excise taxes. The cost of the tax changes above also takes account of consequential changes to New Zealand Superannuation payments.

If there is an increase in claims from businesses accelerating their R&D programmes to bring forward expenditure planned for future years, the savings for the 2008/09 and 2009/10 years from repealing the tax credit may be less than indicated in the table above. Given that sufficient information is not available to judge how claims will be affected, the figures given in the table constitute the best information available on the savings from repealing the credit.

The KiwiSaver changes in the table above include the removal of the ETC, the change in cost of the MTC, an adjustment in the cost of the ESCT exemption, and the removal of the Fee Subsidy.

The ETC cost was calculated at the Pre-Election Economic and Fiscal Update 2008 (PREFU08).

The MTC change in cost from PREFU08 is due to the change in the minimum employee contribution rate from 4% to 2%. For those earning under $52,000 per year, 2% of gross salary is not equal to the maximum MTC of $1040. As some people will top up their contributions to $1040 per year, an average contribution rate of 3% was assumed.

The ESCT exemption cost was adjusted through both a forecasting change and a policy change. The forecasting change was adjusted using updated enrolment data from PREFU08 (the previous cost was based on the Budget Economic and Fiscal Update 2008). The change in policy that affects the cost of the ESCT was the capping of compulsory employer contributions at 2%. Decreasing the ESCT cap meant that more tax will be collected through increased company profits due to the decrease in expected employer contribution costs.

The Fee Subsidy cost was also calculated at PREFU08.

Macroeconomic impact

The macroeconomic effects of the entire package of changes are difficult to predict with certainty, particularly given the current macroeconomic environment and the fact that R&D and KiwiSaver are relatively new initiatives. However, Treasury considers that the key macroeconomic effects derive primarily from the tax cuts (including the IETC) and it is the effects from the tax cuts that are most immediately able to be modelled. The discussion below relates to the tax changes over and above those made through the 2008 tax cut package.

Personal tax changes

The impact of personal income tax cuts and the IETC on the economy are seen mainly through greater aggregate demand arising from higher private consumption driven from larger disposable incomes. Treasury has estimated that the proposed changes to personal taxes could increase growth in real GDP by approximately 0.3% beyond the level of growth there would have been in the absence of the changes, over the year to 31 March 2010.

This estimate assumes the tax changes will only impact on the labour market through increased employment (i.e. higher consumer spending boosts the demand for labour). No change in the supply of labour from the tax cuts has been assumed in the modelling, as there is insufficient reliable data on this variable. However, notwithstanding this, as a consequence of the tax cuts, it would be expected, at the margin, increased incentives to participate in the workforce, increased incentives to work longer, and increased incentives for skilled labour to stay in or relocate to New Zealand. Therefore these changes may have a flow-on impact on the productivity and growth of the economy through their impact on the labour market

The precise nature of the response to personal tax cuts is difficult to predict. For example, the effect could be smaller if the weaker economic environment encourages households to save more of the tax cuts than has been assumed.

R&D Tax Credits

Given the concerns about the effectiveness of the R&D tax credit it was considered that there were minimal effects in repealing it, although due to its relatively new introduction there is insufficient data to quantify any marginal effects. The government considers that there are greater growth benefits from personal tax cuts and therefore that it is preferable to repeal the R&D tax credit and apply the savings towards that end. Further, to the extent that the repeal of the tax credit reduces recharacterisation of expenditure (and the associated costs in doing so), there will be positive flow-on effects for growth. It is not possible to quantify these aggregate benefits due to data limitations.

KiwiSaver

Given that current KiwiSaver policy settings are considered very generous in the areas currently being modified, it is considered that the removal/scaling back of these features will have minimal impact on household savings levels. Again, there is insufficient data available to quantify this impact. The key macroeconomic effects in respect of the KiwiSaver scheme are reflected in the growth benefits from personal tax reductions. However, a reduction in the minimum contribution rates may result in many KiwiSaver accounts with small balances. This could have a negative impact on overheads and fees.

Compliance cost impact

The preferred option has three separate elements which may cause compliance costs: 1) lowering of personal tax rates, increasing thresholds, and the IETC; 2) repeal of the R&D tax credit; and 3) changes to KiwiSaver.

Each of these components should be assessed separately for their compliance costs; although there may be some reduction in aggregate compliance costs through economies of scale if firms and individuals are able to make these changes at the same time.

Personal tax changes

The personal tax changes (including the IETC) will have implications for employers and employees. The IETC will be delivered through the PAYE system. This minimises the associated compliance costs for employers and employees.

The delivery of the tax credit through the PAYE system will necessitate new tax codes being used by employers. There will be a one-off compliance cost in understanding and processing these new tax codes. This cost will be mitigated by using standard tax change procedures with which employers are already familiar. There should be no significant differences for small and medium-sized enterprises and large businesses in this regard.

Employers will not need to collect new information from their staff, or make substantive systems changes. Similar compliance impacts will occur in relation to the self-employed and contractors, who will need to ensure they understand the new rates and changes, and where applicable, the IETC. There will be some additional compliance costs for people that have not received the correct amount of IETC during the year. These people may be required to file a personal tax summary with Inland Revenue in order to determine their final tax liability.

Although exact costings are not available given time constraints, overall the compliance costs for these changes are considered minimal.

Repealing the R&D tax credit

The R&D tax credit currently entails compliance costs for firms and organisations who are seeking the credit in respect of work that falls within the eligible expenditure criteria. These firms incur compliance costs in the form of specialist assistance in calculating tax credit claims, and in the form of systems modifications in order to collect the required information. There are indications that substantial resources have been diverted within New Zealand advisory and consulting firms to assist taxpayers in claiming R&D tax credits. The repeal of the credit would remove these compliance costs on an ongoing basis. There will be a minimal compliance cost for firms and their advisors in understanding these changes, but no system or process changes will need to be made as a result, so this will be a minimal one-off compliance impact. Therefore it is expected that the repeal of the tax credit will, on balance, and on an on-going basis, decrease compliance costs for these firms. The minimal costs of understanding these changes can be mitigated by an effective communication programme which is being developed.

Many firms undertaking R&D and advisors to these firms are likely to have incurred significant set-up costs in relation to the implementation of the R&D tax credit, particularly in relation to large R&D projects. As the R&D credit has not yet been in operation for a full income year, data on these costs is not available. However, the aggregate benefits associated with tax reductions are expected to substantially outweigh these costs.

KiwiSaver changes

The KiwiSaver changes will have compliance costs for employees, employers and providers.

Compliance costs faced by employees (including those who will become employees in the future) will be in understanding the changes, and responding to these when the changes are introduced (for existing members), or when they enter the KiwiSaver scheme (e.g. when the enter the workforce, or become members later on).

Existing employees will need to consider the changes to the minimum contribution rate, and notify their employer if they wish to use the lower 2% contribution rate. In addition, on an ongoing basis, employees will be able to consider whether they wish to change their contribution rate, as is permitted under the scheme every three months unless an employer allows a more frequent change.

In relation to employees who become members of KiwiSaver in the future, as part of the automatic enrolment process, unless the employee notifies the employer of a contribution rate, the employee will be defaulted to the new 2% rate. An employee will be able to elect a higher rate by notifying their employer of that higher rate. If an employee who is already a member starts new employment on or after 1 April 2009 and does not notify the employer of a contribution rate, that employee will default to the new 2% rate. The compliance costs are unlikely to be higher for these employees than the previous arrangements, unless they were familiar with the prior arrangements, in which case they will have to ensure they understand the revised arrangements. As for existing members, new members will be able to reconsider their contribution rate at three-monthly intervals, unless their employer allows more frequent changes.

Removal of the fee subsidy will impact on KiwiSaver members who have account with small balances and no contributions and inadequate returns as their account balances will erode overtime.

While there is insufficient data to accurately quantify these compliance costs, overall it is expected that the impact on employees will be minor, and will largely occur on a one-off basis; although there will be minimal ongoing costs.

The KiwiSaver changes will also impact employers. Employers will be affected by the minimum member contribution changes, removal of the employer tax credit, reduction in the minimum employer contribution rate, and the change in the ESCT rules.

The change in the minimum member contribution rate will cause one-off costs to employers. Employers will need to action requests from their existing employees to adopt the new 2% contribution rate. For those employees that default to the new 2% rate, employers may need to action requests to adopt a higher rate. The impact will depend on the number of requests received. Payroll systems may need adjustment to allow for a 2% contribution rate and the default rate from 1 April 2009 being 2%.

The proposed matching compulsory employer contribution cap of 2% will have minimal impact on employers, as the current compulsory rate is 1% and was due to increase to 2% on 1 April 2009. Employers who currently contribute more than 2% voluntarily will be able to continue to do so although they may now want to reassess given that the previous requirement for employers to eventually contribute at the 4% rate will not proceed. These compliance costs will be minimal.

The reduction in the ESCT exemption will only impact on those employers who are making an employer contribution of more than 2%. For these employers it will require them to become familiar with ESCT rules for the first time. It will also require them to split their contributions between the taxable amount and the exempt amount and deduct ESCT from the taxable amount and pay that tax to Inland Revenue as part of the PAYE process. These compliance costs will be one-off, in understanding the changes, and making decisions about how to respond to these changes, and if they choose to continue contributing at a higher rate, will also be ongoing. There is a possibility that employers currently offering more than a 2% employer contribution may reconsider their KiwiSaver offer to minimise these compliance costs.

The discontinuation of the employer tax credit will mean that some employers will face a real increase in remuneration costs. In addition, once the changes are implemented, employers will need to change their payroll systems to remove the employer tax credit. The cost of removing the ETC would fall heavily on firms in labour intensive industries, where there are large numbers of KiwiSaver members. While the cost could potentially be offset through lowering tax rates and harmonising tax rates for different forms of investment, there could be some transitional issues, particularly for firms that are just breaking even. Such firms would be unlikely to fully benefit in the short term from a reduction in tax rates because their taxable income would already be low - having to incur the full cost of the ETC could result in hardship for these businesses. However, the personal tax cuts will also help fund fiscal stimulus from which these employers will benefit in tightening economic conditions.

Early notification, and good communication, of these changes will mitigate these compliance costs to an extent as employers will be able to adjust in advance. A communications strategy is being prepared.

Therefore the compliance costs for employers in relation to the KiwiSaver are moderate. These changes are likely to impact more heavily on small and medium enterprises that will have to invest comparatively more time implementing these changes. These compliance costs have not been quantified due to insufficient data and time. In addition, employers have faced prior changes to KiwiSaver, which may increase the degree of frustration with these changes and the perceived compliance costs.

A third group that will face compliance costs from these proposals are KiwiSaver providers. This will be a one-off cost, as the proposal will require KiwiSaver providers to amend their investment statements and documentation to reflect: 1) the 2% employee contribution rate; 2) the compulsory employer contribution rate of 2%; and 3) the discontinuation of the fee subsidy. This will require providers to redraft and reprint their investment statements incurring both legal and printing costs. To minimise these compliance costs, a limited regulatory exemption is recommended so that existing investment statements continue to be valid for a period of time to allow the new documentation to be drafted, printed and available for issue.

Therefore, although quantification is not possible, compliance costs for providers will be a one-off cost of amending their documentation. This will impact more heavily on smaller providers.

Administration cost impact

There will be administrative costs to Inland Revenue in respect of the preferred option. These are assessed below for each component of the preferred option.

Implementing personal tax changes

The estimated administration costs of implementing the changes to personal tax and the IETC through the PAYE option are:

	$ million				
	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13 & outyears**
Operating	2.832	6.493	8.420	8.420	8.420
Capital	0.835	0.553	-	-	-
Total (lower range)	**3.667**	**7.046**	**8.420**	**8.420**	**8.420**
Contingency (25%)	0.917	1.762	2.110	2.110	2.110
Total (upper range)	**4.584**	**8.808**	**10.530**	**10.530**	**10.530**

Inland Revenue have indicated that they will need to revise their operating approach to the generation of personal tax summaries (PTS) to manage the work volume resulting from these changes. The proposed solution for this is to reduce the circumstances where a PTS is automatically generated, and Inland Revenue are comfortable that this approach will be manageable and will mitigate organisational risk.

Repealing R&D tax credit

Repealing the R&D tax credit will lead to administrative savings in the longer term. In the short-term, although the credit is to be repealed, administrative costs will still be incurred through the management of disputes, returns filing, processing and auditing. In addition, Inland Revenue anticipate that some claims may be brought forward to take advantage of the credit, increasing the volume of work, and posing staffing challenges. In addition, an evaluation programme of the credit will need to be refocused on the sole year of the tax credit's availability.

The savings from 2010/11 onwards derive from the resources that will no longer be required to process and audit R&D tax credit claims. However, a minor capital charge may apply for a number of years. Repealing the R&D tax credit is estimated to result in the following administrative savings:

$ million						
	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14 & outyears**
Operating	-	-	(1.816)	(3.137)	(3.279)	(5.700)

Implementing KiwiSaver changes

The administration costs of the KiwiSaver changes are estimated as follows:

	$ million				
	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13 & outyears**
Operating	3.206	0.664	0.356	0.316	0.316
Capital	0.949	0.028	-	-	-
Total (lower range)	4.155	0.692	0.356	0.316	0.316
Contingency (20%)	0.831	0.138	0.071	0.063	0.063
Total (upper range)	4.986	0.830	0.427	0.379	0.379

The costs arise from dealing with an increased number of telephone calls and increased complexity in the processing of employer monthly schedules.

These estimates are in addition to the KiwiSaver legislative and remedial work already underway as a result of the July 2008 Tax Bill. These changes will need to be undertaken in conjunction with that work and timeframe. A contingency (20%) has been included to allow for any increased costs as a result of the tight schedule to implement these changes on top of a significant existing KiwiSaver workload.

Discontinuing the ETC will lead to further administrative savings in the longer term. In the short-term, administrative costs will still be incurred through employer enquiries, revenue assessments and account reviews. The savings from 2010/11 onwards derive from the resources that will no longer be required to manage and process the ETC including handling general enquiries and managing exceptions. However, a minor capital charge may apply for a number of years.

IMPLEMENTATION AND REVIEW

Personal tax changes, IETC, and R&D tax credit repeal

Under the RIS requirements, this section does not need to be completed in respect of tax policy changes. Implementation issues for each of these are discussed above.

KiwiSaver

A comprehensive communications programme outlining the scope and implementation timeline will be developed. This will ensure that the proposals are signalled in advance and affected parties have sufficient time to adjust.

KiwiSaver is also the subject of a comprehensive Joint Evaluation Strategy. This process will provide quantitative and qualitative data on the impact that KiwiSaver (including the current proposals) has had on savings activity. It will also provide data on the recent PIE tax-related savings changes. However, a full evaluation of results will not be available until 2013.

CONSULTATION

Given the unusual timeframes around these changes, consultation was not as extensive as it would have been under the Generic Tax Policy Process (GTPP). However, despite a very limited timeframe, consultation was done among relevant government departments for each of the changes; and where possible proposals were discussed with other stakeholders.

Personal tax

Although not a formal requirement, in normal circumstances the full GTPP would be undertaken in developing these legislative proposals. This would typically entail the development of a Government discussion document, the receipt and analysis of public submissions, and the subsequent refinement of policy proposals. However, given the timing of the election, the policy objectives of reducing the damage caused by high tax rates, and the need to provide fiscal stimulus as soon as is practicable, the passing of urgent legislation will be required prior to the end of 2008 in order to bring the proposals into timely effect. This leaves insufficient time to follow the full GTPP process. Notwithstanding the fact that there has been limited time to consult, the proposals for personal tax cuts and threshold changes were signaled well in advance of the 2008 election in the National Party's election Manifesto. Inland Revenue and the Treasury have been consulted in connection with these proposals. The Department of the Prime Minister and Cabinet has been informed.

R&D tax credits

The repeal of the R&D tax credit to fund a reduction in personal tax rates was included in the National Party's election Manifesto. Since the election no additional consultation specifically on the repeal of the R&D tax credit has been undertaken. However, there has been public comment that the R&D tax credit may not result in additional R&D. Other public comment has been made to the effect that the removal of the tax credit may reduce productivity growth (although using the resulting revenue to reduce personal taxes will also increase productivity). There has also been public comment from those who potentially benefit from the tax credit supporting its retention. Inland Revenue and the Treasury were consulted, and the Ministry of Research, Science and Technology was informed, in connection with these proposals. The Department of Prime Minister and Cabinet has been informed.

KiwiSaver

The National Party's KiwiSaver and Superannuation election Manifesto policy was released in October 2008. This policy statement underpins the proposals outlined above. The National Party did not consult external stakeholders in connection with its Manifesto policy. The following departments were consulted in connection with these proposals: Inland Revenue, the Treasury, the State Services Commission, the Department of Labour, the Ministry of Economic Development, and the Securities Commission. The Investment Savings and Insurance Association, the Financial Services Federation and the Association of Superannuation Funds of New Zealand have also been consulted in relation to any transitional relief with compliance with other legislation and the Securities Regulations 1983. The Department of Prime Minister and Cabinet has been informed.