

The Treasury

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- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
- [40] Not in scope
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Tax policy report: Further advice on the Budget 2021 proposal to increase main benefits – further option for setting the MFTC threshold

Date:	30 March 2021	Priority:	High
Security level:	Sensitive - Budget	Report number:	IR2021/144 REP/21/3/318 T2021/814

Action sought

	Action sought	Deadline
Prime Minister	Agree to recommendations	1 April 2021
Minister of Finance	Agree to recommendations	1 April 2021
Minister for Social Development and Employment	Agree to recommendations	1 April 2021
Minister of Revenue	Agree to recommendations	1 April 2021

Contact for telephone discussion (if required)

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30 March 2021

Prime Minister
Minister of Finance
Minister for Social Development and Employment
Minister of Revenue

Further advice on the Budget 2021 proposal to increase main benefits – further option for setting the MFTC threshold

Purpose

1. This report provides advice on a further option for setting the Minimum Family Tax Credit (MFTC) threshold in the context of a Budget bid proposing an increase to main benefits of \$25 per adult from 1 July 2021 and a further \$25 per adult from 1 April 2022 [IR2021/096 refers]. The option changes the way the Winter Energy Payment (WEP) is calculated in the MFTC threshold and is referred to as the flat rate “reduced WEP” option.

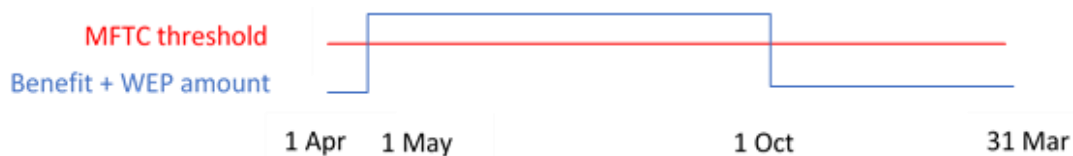
Context and background

2. This report follows previous advice provided to Ministers on the above Budget bid [IR2021/094 refers] and on options to reduce the fiscal cost of an MFTC increase [IR2021/124 refers]. The Ministers of Finance, Revenue, and for Social Development and Employment had agreed to a continued partial alignment approach to set the MFTC threshold based on report IR2021/124.
3. This partial alignment approach was agreed by Ministers for the upcoming increases to main benefit abatement thresholds, as it balanced the trade-offs between policy intent, financial incentives to work, fiscal cost and impacts on the Working for Families review that is currently underway.
4. A partial alignment option ensures all sole parent families (approximately 90 percent of MFTC recipients), but not necessarily two parent families, would be financially better off receiving the MFTC rather than remaining on benefit. This partial alignment represents a significant increase and has a fiscal cost of \$52 million over the forecast period. This approach also begins to place pressure on the WFF abatement threshold on a pre-tax basis.
5. The MFTC formula currently assumes that the WEP is paid over 12 months, rather than the five months it is actually paid. This approach was agreed in November 2017 when the WEP was introduced, “to ensure that the level of assistance available in work remains higher than that available on an abated benefit (including the Winter Energy Payment) throughout the year” [IR2017/575 refers]. We note that the flat-rate “reduced WEP” option was included in the November 2017 advice, but was not agreed by Ministers because it did not support the above objective.

The flat-rate “reduced WEP” option

6. Under the flat-rate “reduced WEP” option, a single MFTC threshold would be set throughout the year. The formula would take the amount of WEP paid to beneficiaries over the five winter months and spread it evenly over 12 months.

Flat-rate "reduced WEP" MFTC threshold



7. The flat-rate "reduced WEP" option would increase the MFTC threshold to \$31,408 from 1 July 2021, and to \$33,488 from 1 April 2022. This would have a fiscal cost of \$23 million¹ over the forecast period; \$29 million less than the partial alignment option (\$52 million). The flat-rate "reduced WEP" option has the same fiscal cost as the two-rate "reduced WEP" option but avoids the \$42 per week, post-winter income drop families would face under the two-rate option [IR2021/124].
8. However, the benefits of a reduced fiscal cost and consistent level of support trade off work incentives for sole parents, particularly during the winter WEP period. The impact on work incentives will vary during the year:
 - 8.1 **WEP period:** Between 1 May and 30 September, when beneficiaries receive WEP, some MFTC recipients would be \$24 worse off under the flat-rate "reduced WEP" option than they would be working and remaining on an abated benefit (mainly those working 20 hours per week and earning at minimum or low wage rates). This may be a disincentive for families to move off benefit during these five WEP months and may result in families moving back onto the benefit during that period, as they would receive more from the combination of an abated benefit and WEP.
 - 8.2 **Non-WEP period:** For the remaining seven months of the year, families would be \$18 better off in work and receiving MFTC than on an abated benefit, which means the MFTC would be fulfilling its policy intent of incentivising people to move off benefit during these months.
9. For families who receive MFTC for an entire year, the flat-rate "reduced WEP" option would ensure they are marginally better off financially in work and receiving MFTC, rather than on benefit. On an annual basis, MFTC recipients would receive around \$2 more by staying off benefit. In comparison, under the partial alignment approach, families would be around \$23 per week on average better off, a difference of approximately \$1,250 over the year.
10. These issues could apply to sole parents and couples who are working a number of hours close to the MFTC threshold (20 hours per week for sole parents, and 30 hours per week for couples), and whose wages are close to the minimum wage. Officials do not have data on the average wage rates of MFTC recipients, so we are unable to quantify how many of these families would be affected.
11. For families who receive the MFTC for part of a year, their income support may be higher or lower than what they could receive on benefit, depending on the time of year. This may be considered inequitable. Officials do not have data on the number of MFTC recipients who receive the MFTC for the full year compared to those who receive the MFTC for shorter periods.
12. From an administration perspective, the flat-rate "reduced WEP" option would be relatively straightforward for Inland Revenue to implement. However, Inland Revenue anticipates that the flat-rate option could increase the number of families who shift between the MFTC and benefit because of the differing levels of support.

¹ Please note these fiscal costings may change if the proposed benefit rate increases are changed

This may negatively impact the accuracy of entitlements, which would in turn result in a potential increase in underpayments (less timely support) or overpayments (increased WFF debt).

13. It is difficult to estimate with confidence the behavioural effects that would arise if the MFTC threshold is lower or higher than the benefit rate during the year. The evidence on financial incentives to work indicates that financial incentives are only one of many factors that influence people's decisions on whether to work and how much to work.

Officials' recommended option

14. Officials recommend that if the Budget bid for the proposed benefit increases are progressed, then the MFTC threshold continues to be set using the partial alignment approach. This would ensure the MFTC would continue to work at least partly as intended, providing a better outcome for families regardless of when, and for how long, they receive MFTC.
15. Officials do not recommend the flat-rate "reduced WEP" option because of the negative impacts on work incentives particularly over the winter months, the reduced average level of support compared to the partial alignment option, and the potential impact on the accuracy of families' entitlements.

Recommended action

It is recommended that you:

1. **note** that the following MFTC options assume that main benefits will increase by \$25 per adult from 1 July 2021 and a further \$25 per adult from 1 April 2022 [IR2021/096 refers];
2. **note** that if there are changes to the parameters of the proposed main benefit increase, the MFTC will be recalculated in line with the approach agreed below in recommendations 3.1 or 3.2;

EITHER

- 3.1. **confirm** that the Budget bid continues to include a partial MFTC alignment option increasing the MFTC threshold to \$32,656 from 1 July 2021, and \$34,684 from 1 April 2022, at a fiscal cost of \$52 million over the forecast period (**recommended**)

Yes/No	Yes/No	Yes/No	Yes/No
Prime Minister	Minister of Finance	Minister for Social Development and Employment	Minister of Revenue

OR

- 3.2. **agree** to change the Budget bid to include the flat-rate "reduced WEP" option, increasing the MFTC threshold to \$31,408 from 1 July 2021, and to \$33,488 from 1 April 2022, at a fiscal cost of \$23 million over the forecast period (**not recommended**)

Yes/No	Yes/No	Yes/No	Yes/No
Prime Minister	Minister of Finance	Minister for Social Development and Employment	Minister of Revenue

- note** to increase the MFTC threshold from 1 July 2021 for either option, the relevant amendments to the Income Tax Act 2007 would need to be progressed under urgency through Budget night legislation.
- agree** that any changes to the MFTC threshold from 1 July 2021 will be progressed under urgency through Budget night legislation.

Yes/No	Yes/No	Yes/No	Yes/No
Prime Minister	Minister of Finance	Minister for Social Development and Employment	Minister of Revenue

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