The Treasury

Budget 2024 Information Release

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[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Interaction between IETC and WFF changes and implications for tax calculator

Date:	17/05/2024	**Report No:**	T2024/1356	IR2024/214
		File Number:	SH-13-5-2-5-1-M105447	

Action sought

	Action sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Note** the content of this report **Agree** to the recommendation in this report	22 May 2024
Hon Simon Watts **Minister of Revenue**	**Note** the contents of this report. **Agree** to the recommendation in this report	None

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Jean Le Roux	Manager, Tax Strategy, The Treasury	[39]	[35]	
Claire Hubert	Senior Analyst, Tax Strategy, The Treasury			✓
Maraina Hak	Policy Lead, Inland Revenue			
Paul Young	Principal Policy Advisor, Inland Revenue			✓

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: Annex A – Tax calculator wireframe; Annex B – additional information for students and beneficiaries

Treasury Report: Interaction between IETC and WFF changes and implications for tax calculator

Executive summary

1. This report explains an interaction between tax credits which leaves a very small number of families worse off (if their circumstances haven't changed) after the Budget 2024 tax package changes.

2. Current legislation states that, where an individual's family is eligible for Working for Families (WFF) tax credits, they then become ineligible for the Independent Earner Tax Credit (IETC). In practice, this leaves a very small number of families receiving WFF receiving slightly less than they would otherwise if they had received the IETC. This is a historic and pre-existing issue, however additional families have become in scope due to the tax package changes, and a small number of them are forecast to end up worse off than they are currently.

3. This report explains how we plan to handle communications relating to this issue through the tax calculator and provides a further update on the progress of the tax calculator.

4. This report also briefly explains the impact of the Budget 2024 tax package on part-year transfer recipients, which we have reported to you about previously.

Treasury Report: Interaction between IETC and WFF changes and implications for tax calculator

Purpose of Report

1. This report seeks to inform you on our communications approach to families that end up worse off from the tax package, due to an interaction between the Independent Earner Tax Credit (IETC) and Working for Families (WFF) tax credits.

2. It is not possible at this point in time to address the potential impacted families, though officials recommend scoping further work on this issue.

3. This report also briefly explains the impact of the Budget 2024 tax changes on part-year transfer recipients.

Background

4. There is an existing interaction between the Independent Earner Tax Credit (IETC) and the Working for Families (WFF) tax credits.
   - The **IETC** is a tax credit of $20 per fortnight that is currently available to individuals earning between $24,000 and $48,000 per annum who do not receive other Government support such as WFF, main benefits and New Zealand Superannuation. Recipients can either use a special tax code which allows them to pay less tax each payday or they can receive the IETC as a lump sum as part of the end of the year "square-up" process. As part of the Budget 2024 tax package, the top threshold of eligibility for the IETC will be extended from $48,000 to $70,000 per annum.
   - **WFF** is a package made up of a number of different tax credits. The In Work-Tax Credit (IWTC) is one part of this package, and is for families normally in paid work who have children. The Family Tax Credit (FTC) and the IWTC are added together and abated at a rate of 27% from a family income of $42,700. As the FTC is paid per child, the family income level at which WFF tax credits fully abate changes depending on how many children a family has (with the FTC abating first, followed by the IWTC). As part of the Budget 2024 tax package, the IWTC base rate will be increased by $50 per fortnight (from $145 per fortnight to $195 per fortnight).[1]

5. The IETC is applied on an individual income basis, and WFF is applied on a family income basis.

6. Under current legislation, if a person is entitled to WFF, they are not able to receive the IETC in the same month (Section LC 13 of the Income Tax Act 2007). This rule is designed to maximise family support, as most families are better off receiving WFF due to the maximum credit being higher. The exclusion is also stated on Inland Revenue's website.

[1] The IWTC is currently paid at a maximum rate of $145 per fortnight for a family of up to three children, with an additional $30 for each child. This proposal will not adjust the subsequent child rate.

7. If an individual qualifies for the IETC, they will automatically receive it as part of their end of year "square-up" calculations, which occurs as part of Inland Revenue's annual auto-calculation process.[2] [40]

8. As the IETC is calculated monthly, people can and do receive both the IETC and WFF in an income year (although not in the same month). This could happen in cases where, for example, someone's pay rise causes their WFF to abate to zero. In this case, they will receive the IETC for the month(s) they do not receive WFF, provided they fall within the IETC income band (currently between $24,000 and $48,000). This would also happen in cases where entitlement changes – for example, someone is no longer deemed to have a dependent child.

9. A person who was registered for WFF and is subsequently de-registered could receive IETC if they fall within the IETC income band. A person will automatically be de-registered if they have not received WFF for two years. [40]

10. This existing interaction between IETC and WFF arises due to the underlying tension between WFF policy settings, which use a family unit of entitlement, and its interaction with the tax system (including IETC), which is based on individual units of entitlement. The interaction currently creates an equity issue amongst types of families, particularly those with and without children. For example, a couple without children could receive more IETC than a couple with children receiving abated WFF. This reflects the way the IETC was originally designed in 2009, and income inflation has increased the prevalence of this interaction.

Pre-existing issue

11. Prior to the commencement of the Budget 2024 tax package, there are already a few families who would currently gain more by at least one adult in the family receiving IETC than they would from their family receiving WFF. There are potentially up to 600 families that we are aware of whose situation means they would currently be better off receiving IETC than WFF. This happens where a family's WFF entitlement is less than $10 per week when one parent would otherwise be entitled to IETC, or less than $20 per week where two parents would otherwise be entitled to IETC.

12. Resolving the interaction by allowing families to choose between the IETC and WFF (i.e., to opt into the regime which results in a better outcome) has both administrative and policy implications. Administratively, this would require Inland Revenue to know all of a family's details, including any arrangements for shared care of children. This increases the complexity when determining whether a parent is better or worse off under either payment. This would be exacerbated for families whose relationships change during the year.

[2] Unless they give their employer a special tax code that allows them to 'receive' the IETC as part of their regular salary and wages.

13. More significantly, allowing families to choose between WFF and IETC highlights the issues with setting policies using a family unit of entitlement. For example, a family with two parents could be better off not registering for WFF because they can each receive IETC using their individual incomes. This raises the question of whether entitlement settings for WFF (or any other family-based transfer payment) should be reconsidered. This would be a significant undertaking.

Issue in relation to Budget 2024

14. This is an existing issue, but as a result of the Budget 2024 tax package reforms, the number of known families which could be better off if they could choose to receive the IETC rather than WFF will increase from a total of around 600 families to around 1,800 families. However, given their eligibility for WFF, these 1800 families would not be entitled to receive the IETC.

15. The majority of these – 1,600 families, or 89% of this cohort – will still be better off overall as a result of the tax package due to other changes such as the increase to personal income tax thresholds.

16. However, fewer than 200 families will be worse off overall as a result of the tax package, as their family will receive less in WFF and less from the personal tax threshold changes than the IETC that their family would otherwise receive if no changes occurred.

Example

Mike and Aroha are a family with one school aged child. Mike and Aroha both work part-time and earn $44,000 per annum.

Before 31 July 2024
Before the personal income tax changes, Mike and Aroha both receive the Independent Earner Tax Credit. They receive $1,040 per annum of government support.

After 31 July 2024
After the personal income tax changes, Mike and Aroha are now entitled to Working for Families. This is by virtue of the cut-out point (for one child) being increased to $89,344.44 following the increase to the In-Work Tax Credit.

Mike and Aroha will receive $224 per annum from the personal income tax changes, and $363 per annum of abated Working for Families.

They will therefore be $453 worse off per annum.

17. There is not an exact set of specific income and family characteristics shared by all of the 200 or fewer families that would be worse off overall from the tax changes. Any scenario where this occurs involves receipts of an abated WFF payment that is less than $10 per week when one parent would otherwise be entitled to IETC, or less than $20 per week when two parents would otherwise be entitled to IETC.

18. The net loss is most pronounced when both partners have incomes around $44,000 (equivalent to 36.5 hours per week at minimum wage) and have one child (as in the example above).

19. The Treasury TAWA model is based on a large sample of individuals and households. The Treasury TAWA modelling that was used to inform the tax package design did not discover this situation, not because the modelling was incorrect, but because the data used did not include any sample households with these very specific characteristics. This is because the population size is so small (0.01% of households) that it was not captured by the model. However, this situation was discovered during stress testing of the tax calculator. Following discovery of this situation, Inland Revenue has used its more granular data on the entire WFF population to confirm that there are fewer than 200 families with these characteristics in the country.

20. These families will be worse off by $8/fortnight on average. The theoretical maximum potential loss would be $30/fortnight (for a family that had two earners in the IETC eligible income range).

[33]

Policy

25. In the longer-term, we recommend further work on whether the relevant legislation should be amended, so that an individual is able to claim whichever is higher – the IETC or WFF. We will follow up with further advice on this after Budget, noting our comments above that resolving the interaction between the two regimes is not a straightforward issue, and could result in a broader piece of work for consideration on the Tax and Social Policy work programme.

Communications

26. For those families that are worse off as a result of the existing interaction between IETC and WFF, the suggested approach is to display the loss in the calculator results and for some text to appear underneath for these people to explain the existing historic issue that results in this outcome to the user.

27. If there is a net loss then the suggested text to display is: *"Note these results include a loss of income due to historical interactions between IWTC/IETC."*

28. [40]

29. The code behind the calculator can be accessed relatively easily by someone proficient with coding. This means that, even if none of the 200 families use the calculator and find out they would be worse off, it would be relatively easy for someone to identify that the calculator has provisions for such families.

General update on calculator

30. You have received a video showing the look and feel of the calculator. Some amendments have since been made:

    a the wording has been refined following feedback from your Office and review by Inland Revenue. Annex A provides the wireframe with updated text and colour. Scenarios 3 and 4 in the wireframe illustrate how some of the 200 families' results will be displayed by the calculator.

    b As mentioned in previous advice on the calculator (T2024/1050), although recipients of New Zealand Superannuation are captured by the calculator, beneficiaries and students are not in scope. However, additional information for these user groups will be accessible from the calculator – draft content has been provided to your Office and is included in Annex B. We propose that this additional information takes the format of webpages on the Budget Treasury site, with a link from the calculator. They could also be contained within the disclaimers below the calculator itself.

    c The deadline to amend the code of the calculator – i.e., the way the results are calculated – has passed, and we are no longer able to amend this. This means it is not possible to add further questions.

    d However, the deadline to amend the wording of the calculator or additional information for beneficiaries and students is Wednesday 22 May. This is the remaining avenue to amend the content of the calculator. We therefore need to receive any feedback on the attachments by this time.

31. The overall cost of the calculator (including the updated wording of the 200 families being worse off) is now estimated to be around [25]

Part-year transfer recipients

32. As indicated in previous advice (T2024/668 refers), approximately 9,000 households will be slightly worse off after the personal income tax (PIT) changes, specifically in cases where they receive a main benefit for part of the year only. This is because beneficiaries will receive the same net (or take-home) rate, so for part year beneficiaries, their annual gross (or adjusted for tax) benefit may be less under the PIT change. If they do not receive a benefit for the whole year, but do not earn any other income, then they may be eligible for a tax refund. When the end of year tax refund is calculated, it could result in some part year beneficiaries receiving a smaller tax refund, due in part to the smaller gross benefit amount that they receive under the PIT changes. This is an unintended interaction between the changes to the PIT thresholds and the way tax on part year benefits is calculated.

33. Treasury modelling compares what individuals would receive under a policy reform compared with the status quo. In practice, part-year beneficiaries may be worse off than they would be under status quo policy settings, but this does not mean that individuals will be worse off than they were in a previous year.

34. Those receiving a benefit for some or the whole year will not be in scope of the tax calculator, so these results will not be an issue for calculator communications.

Recommended Actions

We recommend that you:

a **note** that as a result of the Budget 2024 tax package, the number of known families which could be better off receiving IETC than WFF will increase from around 600 families to around 1800 families;

b **note** that fewer than 200 of these 1800 families will be worse off overall as a result of the tax package;

c **note** that the tax calculator will provide a negative result in these cases;

d **note** that the tax calculator will provide some explanatory text for these families under the negative result;

e **note** the deadline to provide comments on the text included with the calculator is Wednesday 22 May;

f **agree** that officials will provide advice after Budget 2024 on the scope of further work to consider the interaction between IETC and WFF.

Agree / Disagree
Minister of Finance

Agree / Disagree
Minister of Revenue

Jean Le Roux

Manager, Tax Strategy
The Treasury

Maraina Hak

Policy Lead
Inland Revenue

Hon Nicola Willis
Minister of Finance

_____/_____/_______

Hon Simon Watts
Minister of Revenue

_____/_____/_______