Submission

By

Business NZ

to the

Inland Revenue Department

on

An Income Splitting Tax Credit for Families with Children

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AN INCOME SPLITTING TAX CREDIT FOR FAMILIES WITH CHILDREN
SUBMISSION BY BUSINESS NEW ZEALAND[1]
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1. INTRODUCTION

1.1 Business New Zealand welcomes the opportunity to again comment on the issue of income splitting being introduced in New Zealand. We acknowledge that the issues paper entitled *An Income Splitting Tax Credit for Families with Children* (referred to as 'the paper'), released by the Inland Revenue Department (IRD), follows on from a similar document in 2008 that we submitted on. This second paper has come about as a confidence and supply agreement with UnitedFuture to support the introduction of legislation for income splitting through to its First Reading in Parliament.

1.2 Paragraph 4.12 of the paper outlines a series of questions that they welcome comments on. These are very much a *fait accompli* in terms of income splitting as a policy being introduced. However, this is not a surprise given the confidence and supply agreement mentioned above. Business New Zealand did not support income splitting when it was first raised in 2008 and we continue to take that position. Therefore, we still believe there are better opportunities for Government to offer financial relief for families where warranted, and we reiterate and elaborate our view that income splitting as not a policy that is the best step forward, especially in light of recent steps to examine the possibility of significant changes to New Zealand's tax system.

2. SUMMARY OF RECOMMENDATIONS

2.1 Business New Zealand makes the following **recommendations** with regard to the paper, namely that:

(a) **Income splitting as a policy is not adopted, notwithstanding the introduction of income splitting legislation (p.2);**

(b) **The explanatory note of the relevant Bill outlines where the majority of representative bodies aligned themselves regarding support for income splitting (p.3);**

(c) **The IRD include in the explanatory notes of the relevant Bill an updated range of cost estimates for income splitting based on any tax rate/threshold changes announced in 2010 (p.6); and**

(d) **The systems and mechanisms used to administer income splitting (if introduced) should use existing administrative structures where possible to minimise administrative costs (p.6).**

2.2 The IRD has invited views on the final policy design of the scheme before the introduction of legislation. While we have taken the opportunity to submit on some issues raised in the paper, we also believe it is important to raise other

[1] Background information on Business New Zealand is attached in the appendix.

relevant issues, given more pressing matters regarding the core question of whether income splitting should be introduced at all. It is also necessary to ascertain where income splitting sits given current policy and economic developments.

2.3 With this in mind, the sections below examine Business NZ's overall views on income splitting (section 3), and outcomes of the previous round of consultation (section 4), taking into account current policy work and the economic climate (section 5).

3. A RECAP ON BUSINESS NEW ZEALAND'S PREVIOUS SUBMISSION

3.1 Business New Zealand's submission in 2008 was broken into three main sections:

1. Existing policies such as Working for Families and other social assistance policies to help families suffering financially, expressing doubts whether income splitting would make any significant strides in slowing the number of skilled employees (and their families) moving offshore for work;

2. The significant administrative costs associated with income splitting and the extra layer of complexity it would create for New Zealand's tax system; and

3. Identifying and proposing an alternative way forward via changes to personal tax rates and thresholds.

Business New Zealand continues to stand by these views, and believes they are just as relevant today despite the recession we have recently experienced. In fact, our view of a better way forward involving personal tax changes on top of those announced in the 2008 Budget has been taken up by a Government appointed Taskforce and is discussed later in this submission.

3.2 Therefore, as a starting point, our main recommendation is that income splitting as a policy not be adopted, notwithstanding the introduction of income splitting legislation.

Recommendation: That income splitting as a policy not be adopted, notwithstanding the introduction of income splitting legislation.

4. WEIGHT OF SUBMISSIONS VERSUS SUBMISSIONS WITH WEIGHT

4.1 Chapter 2 outlines the policy process to date, and in particular discusses the issues, consensus and concerns associated with the previous income splitting paper. Paragraph 2.18 notes that there were 205 submissions received, with Paragraphs 2.19 and 2.20 going on to outline the main views of both supporters and opponents of income splitting.

4.2 What is interesting to note is that the paper mentions that supporters (around 90% of those who submitted) tended to be individuals, while opponents to income splitting tended to be institutions. This is a critical point of difference that should not be overlooked. When examining the public's view on proposals, it is crucial to weigh up the representation behind the submission. For instance, Business New Zealand has a membership of over 76,000 private sector businesses, easily making it the largest business representative voice in the country.

4.3 This representative view of the public is important when tables such as Table 1 of the Document are considered. If the weight of representation is ignored, observers/policy makers could deduce that the first four features were supported by the majority of the public, which is simply not true. In short, when account is taken of the weight of representation, it is most probably the case that income splitting was not supported by the public.

4.4 This key factor should not be forgotten. Therefore, we recommend that the details of support behind income splitting be outlined in the explanatory notes of the relevant Bill.

Recommendation: That the explanatory note of the relevant Bill outlines where the majority of representative bodies aligned themselves regarding support for income splitting.

5. INCOME SPLITTING AND THE TAX WORKING GROUP

5.1 While the discussion document was released as part of a confidence and supply agreement with UnitedFuture, one cannot examine this tax proposal in isolation. The main issue that needs to be taken into account is the work and subsequent policy announcements that will come out of the Tax Working Group (TWG).

5.2 The work of the TWG becomes even more relevant given any significant changes to New Zealand's tax system would most probably to phased in over a few years. We note that if income splitting is to be introduced, this would be in the tax year beginning 1 April 2012.

The possible outcome of a flat tax rate structure

5.3 The Government has regularly discussed the aim of achieving a 30-30-30 tax rate structure as a medium term goal, which the TWG has taken into account when examining possible tax policy reforms going forward. Obviously, any change to personal tax rates would have an effect on an income splitting proposal, both in terms of the benefits family units would receive as well as on the total fiscal cost of the package.

5.4 To illustrate this, the outcome of a flat tax structure of 30-30-30 is represented in the tables below. Table 1 replicates the table on page 18 of the paper, showing the combinations of the income levels for the primary and secondary earner. Table 2 shows the revised figures once the top personal tax rate is reduced to 30%. Since only the top tax rate is affected, only the figures highlighted are different from Table 1. Table 3 then shows the monetary difference between the two sets of figures.

5.5 The changes should not be a surprise, given the flattening of the tax rate structure leading to less difference between the tax paid by low and high income earners. It should also not be a surprise that the biggest changes involve the extreme of income earners, particularly the primary earner earning well into the top income bracket and the secondary earner earning very little, if nothing at all. As one example, for a primary earner earning $140,000 and the secondary earner earning nothing, the tax credit more than halves from $10,450 to $4,850.

5.6 The other point to note is that the change in the tax structure would now provide no benefit at all for secondary income earners earning figures up to $50-60,000, while secondary earners on $40,000 would now all only benefit by values between $60-$960 a year.

5.7 While Business NZ is not in a position to ascertain what this would mean to the cost of the regime on a macro level (currently estimated to cost around $450m in terms of tax credits as outlined in paragraph 1.8 of the Document), costs would obviously decrease. If we simply used the numbers in the tables as an example, the total tax credit outlaid for table 1 came to $222,410. For table 2 it came to a total of $116,410, a decrease of $106,000, or 47.7%. Obviously, primary earners above $100,000 are certainly not the standard family situation in New Zealand. However, it does show that there would most likely be a significant cut to the cost of the scheme.

Table 1: Income Splitting Tax Credit per Couple (per tax year)

		Secondary earner income ($000)							
		$0	**$10**	**$20**	**$30**	**$40**	**$50**	**$60**	**$70**
Primary earner income ($000)	**$0**	0							
	$10	0	0						
	$20	510	340	0					
	$30	1190	340	0	0				
	$40	1190	340	0	0	0			
	$50	1430	580	240	240	240	0		
	$60	2630	1780	1440	1440	960	0	0	
	$70	3830	2980	2640	2160	960	0	0	0
	$80	5530	4680	3860	2660	1460	500	500	0
	$90	7230	5900	4360	3160	1960	1000	500	0
	$100	8450	6400	4860	3660	2460	1000	500	0
	$110	8950	6900	5360	4160	2460	1000	500	0
	$120	9450	7400	5860	4160	2460	1000	500	0
	$130	9950	7900	5860	4160	2460	1000	500	0
	$140	10450	7900	5860	4160	2460	1000	500	0

Table 2: Revised Income Splitting Tax Credit per Couple (per tax year) – 30-30-30 Tax Rate Scheme

		Secondary earner income ($000)							
		$0	$10	$20	$30	$40	$50	$60	$70
Primary earner income ($000)	$0	0							
	$10	0	0						
	$20	510	340	0					
	$30	1190	340	0	0				
	$40	1190	340	0	0	0			
	$50	1430	580	240	240	240	0		
	$60	2630	1780	1440	1440	960	0	0	
	$70	3830	2980	2640	2160	960	0	0	0
	$80	4730	3880	3060	1860	660	0	0	0
	$90	5630	4300	2760	1560	360	0	0	0
	$100	6050	4000	2460	1260	60	0	0	0
	$110	5750	3700	2160	960	60	0	0	0
	$120	5450	3400	1860	960	60	0	0	0
	$130	5150	3100	1860	960	60	0	0	0
	$140	4850	3100	1860	960	60	0	0	0

Table 3: Net Change to Income Splitting Tax Credit per Couple (per tax year)

		Secondary earner income ($000)							
		$0	$10	$20	$30	$40	$50	$60	$70
Primary earner income ($000)	$0	0							
	$10	0	0						
	$20	0	0	0					
	$30	0	0	0	0				
	$40	0	0	0	0	0			
	$50	0	0	0	0	0	0		
	$60	0	0	0	0	0	0	0	
	$70	0	0	0	0	0	0	0	0
	$80	-800	-800	-800	-800	-800	-500	-500	0
	$90	-1600	-1600	-1600	-1600	-1600	-1000	-500	0
	$100	-2400	-2400	-2400	-2400	-2400	-1000	-500	0
	$110	-3200	-3200	-3200	-3200	-2400	-1000	-500	0
	$120	-4000	-4000	-4000	-3200	-2400	-1000	-500	0
	$130	-4800	-4800	-4000	-3200	-2400	-1000	-500	0
	$140	-5600	-4800	-4000	-3200	-2400	-1000	-500	0

Changes to New Zealand's tax system & associated policy effects on income splitting

5.8 The possible reduction in the top personal tax rate raises fundamental questions.

5.9 First, what would be the revised total cost of the scheme if there are significant changes to the tax rate/threshold structure after the 2010 Budget? Given the next steps for income splitting policy will most likely be in a Bill, submitters require an updated cost estimate of the regime, including the administrative costs once the structure of the income splitting policy takes shape. Therefore, we request IRD to include in the explanatory notes of the relevant Bill an updated range of cost estimates for income splitting based on any tax rate/threshold changes announced in 2010.

Recommendation: That IRD include in the explanatory notes of the relevant Bill an updated range of cost estimates for income splitting based on any tax rate/threshold changes announced in 2010.

5.10 Second, how does the current and revised total fiscal cost of the scheme fit within the Government accounts? If there are trade-offs to be made in much the same way as the TWG had to consider (i.e. revenue neutrality), should Working for Families for instance be restricted to free up taxpayer dollars for the cost of income splitting?

5.11 Last, but probably most important of all, if a flatter tax structure is introduced that significantly reduces the tax rate between the highest and lowest rates paid within a family, is income splitting still required? While there are some families who would continue to receive the same amount from income splitting irrespective of the earnings of the primary and secondary earner, the monetary amounts many others receive may fall to such a level that even more questions are asked regarding whether income splitting should be introduced (i.e. paragraph 5.6 above).

5.12 Also, could the funds allocated for income splitting instead be used for further tax rate reductions? This could remove further distortions between the levels of taxes paid. These types of questions represent additional issues that the Government needs to take into account when deciding whether income splitting as a policy is best for New Zealand. Business New Zealand looks forward to discussing these issues in the Bill is introduced.

6. SIMPLICITY & ADMINISTRATIVE COSTS

6.1 Notwithstanding our views above, the paper asks for feedback on a number of questions relating to simplicity and administrative costs regarding income splitting. Paragraph 1.9 mentions that administrative costs would constitute an initial capital cost of $2-3 million, with annual operating costs averaging $3-4 million in the first five years. These are not insignificant costs, and therefore we would support steps that minimise such costs, if income splitting were to be adopted.

6.2 Specifically, paragraph 3.18 of the paper asks whether registration for income splitting online through the system used to provide Working for Families tax credits should be used. If income splitting is to be introduced, then we would support any and all measures that ensure existing mechanisms are used, and especially if the technology used provides minimal problems/costs for IRD.

Recommendation: That the systems and mechanisms used to administer income splitting (if introduced) should use existing administrative structures where possible to minimise administrative costs.

APPENDIX

7. About Business New Zealand

7.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

7.2 In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

7.3 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.