

# A TAX SYSTEM FOR NEW ZEALAND'S FUTURE

1 December 2009

## Morning Session 2

### Tax and Transfers

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To address the questions raised

“What is fair/ how much income  
tax progression is *desirable*?”

“How much is *feasible*?”

Must consider the *tax/transfer* system

**As a whole**

# Tax/welfare interface is becoming more obvious

*More use of IRD in delivering social goals*

Working for Families

In Work Tax Credit

Minimum Family Tax Credit

Independent Earner's Tax Credit

Student loans

Child Support

Paid parental leave

KiwiSaver

Abatement benefits/student allowances

Accommodation subsidy

Income splitting? Tax rebates?

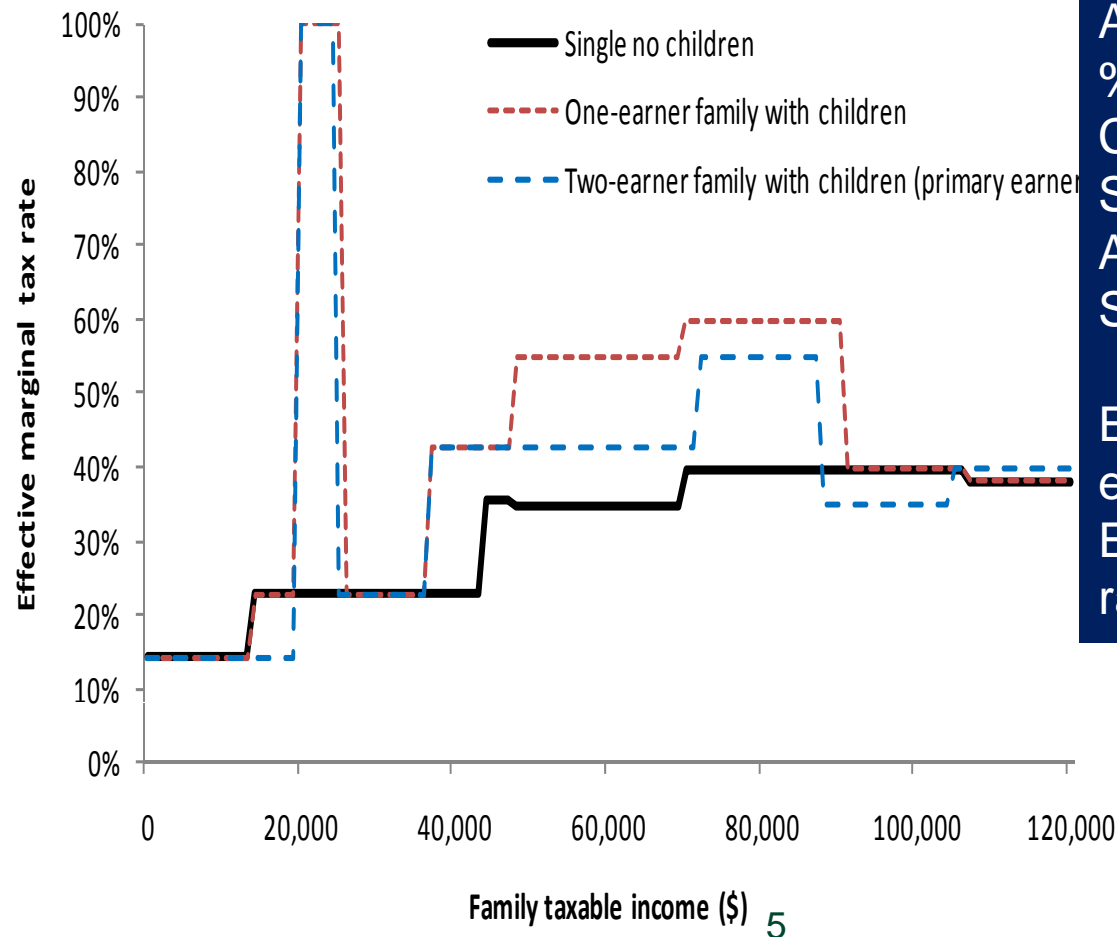
Tax expenditures- charities rebate /KiwiSaver

Where does it all  
end?

## TWG Session 2 Summary

“The group agreed that taxes and transfers are inextricably linked ... In particular, social assistance where entitlement or abatement is linked to income is within the scope of the group.”

# Effective marginal tax rates



FTC and IWTC= 20%  
 Student loan= 10%  
 KiwiSaver = 2%  
 ACC = 1.7  
 % and rising!  
 Child Support =18-30%  
 Student allowances= 25%  
 Accommodation  
 Supplement =25%

Easy for a middle income  
 earner to face high  
 EMTRs over long income  
 ranges

**But when have we ever reviewed the  
combined welfare / tax system?**

The Royal Commission Social Policy 1988  
“Income Maintenance and Taxation” report

Effectively, the **TWG methodology**

- locates the equity decision to the political process
- re-organises taxes to improve efficiency.

***But also***

- shows equity implications of any changes to inform decision-making

**It is very important therefore to have a full range of options**

## The alignment goal 30/30/30

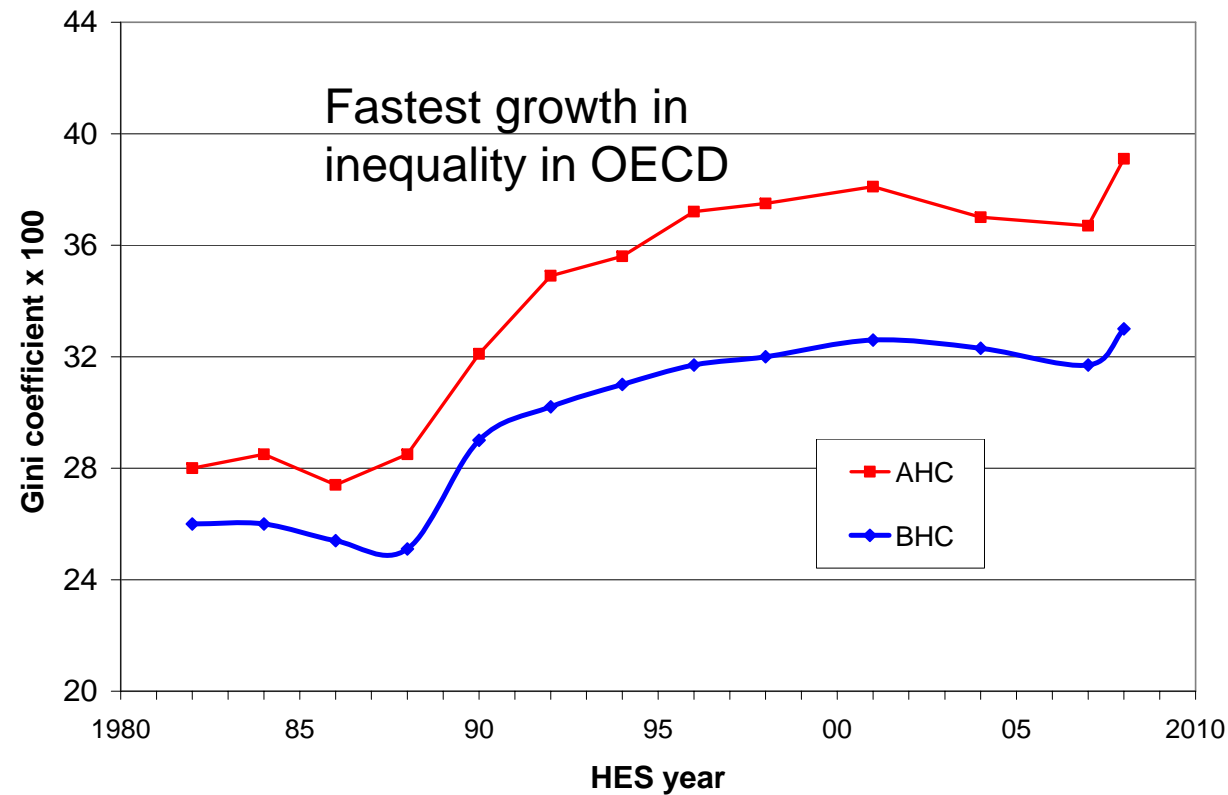
- Aims to improve efficiency while not making equity any worse



# Is 'not making equity worse' an appropriate equity goal?

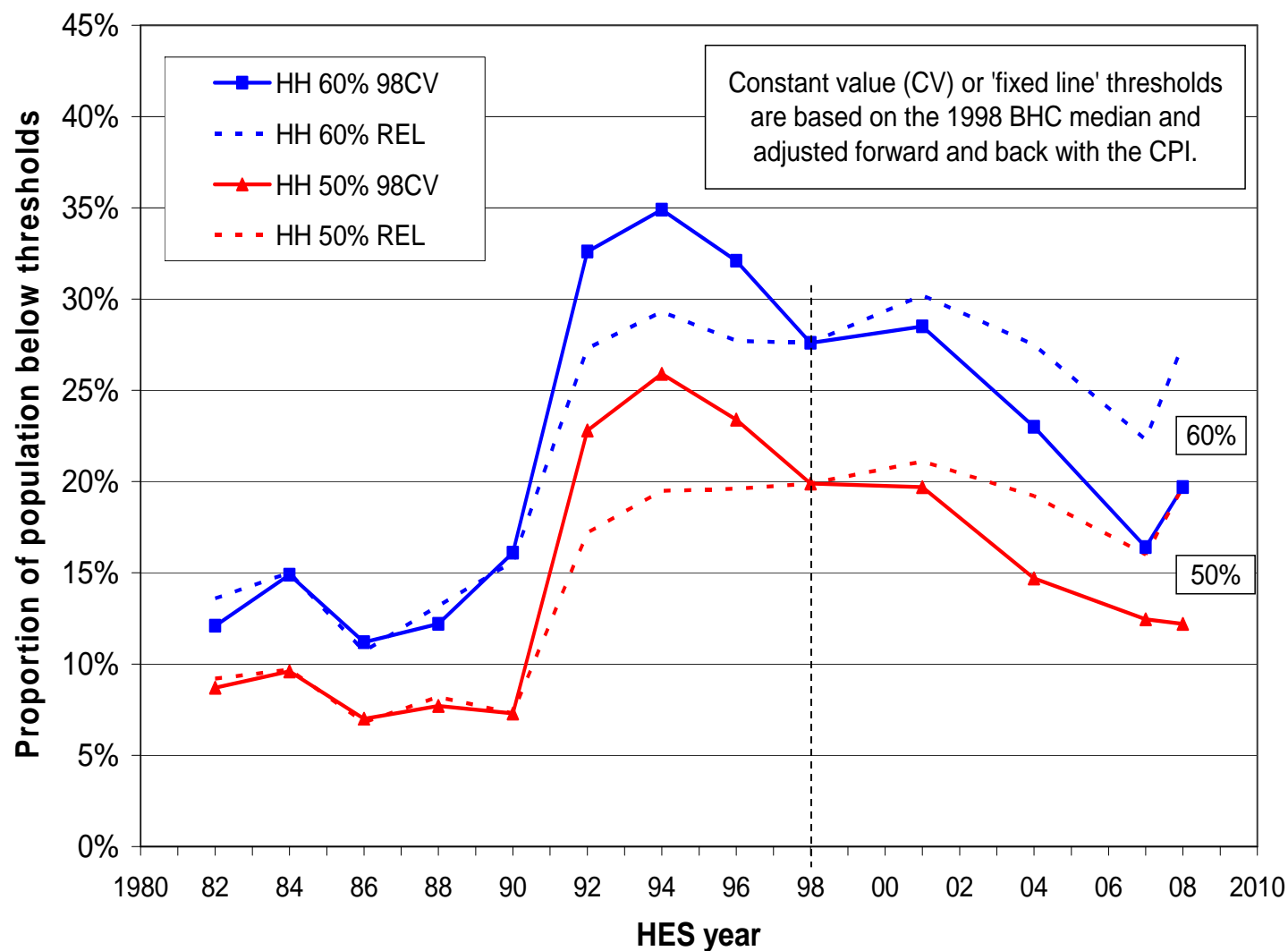
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Figure D.15  
Inequality in New Zealand: the Gini coefficient



(Perry 2009)

**Figure F.4**  
**Proportion of children below selected thresholds (AHC):**  
**fixed line (CV) and moving line (REL) approaches compared**



(Perry, 2009)

# Why worry about the effect of net taxes/transfers on overall distribution?

- Labour market does not solve poverty problem
- EMTRs matter for the poor
- Social costs of getting it wrong are high
- Poverty impacts on growth
- Inequality impacts on social wellbeing

# Choices and trade-offs

- Can broaden tax base and compensate the top end with lower taxes on income
  - No impact on poverty
  - No impact on inequality
  - Improve efficiency and horizontal equity at top end

***But if top end judged to be under-taxed***

- Base broaden and lower taxes at lower end
  - Improve poverty
  - Reduce inequality
  - Improve efficiency at lower end
  - Still gain on horizontal equity and efficiency top end

# WFF is a mess



“Working for Families has several aims. It aims to provide assistance to families in need, but was also designed to encourage people into work.

These objectives may not fit together, and there are questions about how well the four tax credit components making up WfF were designed to work together. **Therefore it is critical that WfF, as well as other assistance delivered through the tax system, has clear objectives.”**

(TWG Session 2 Summary)

# Lost sight of simplicity

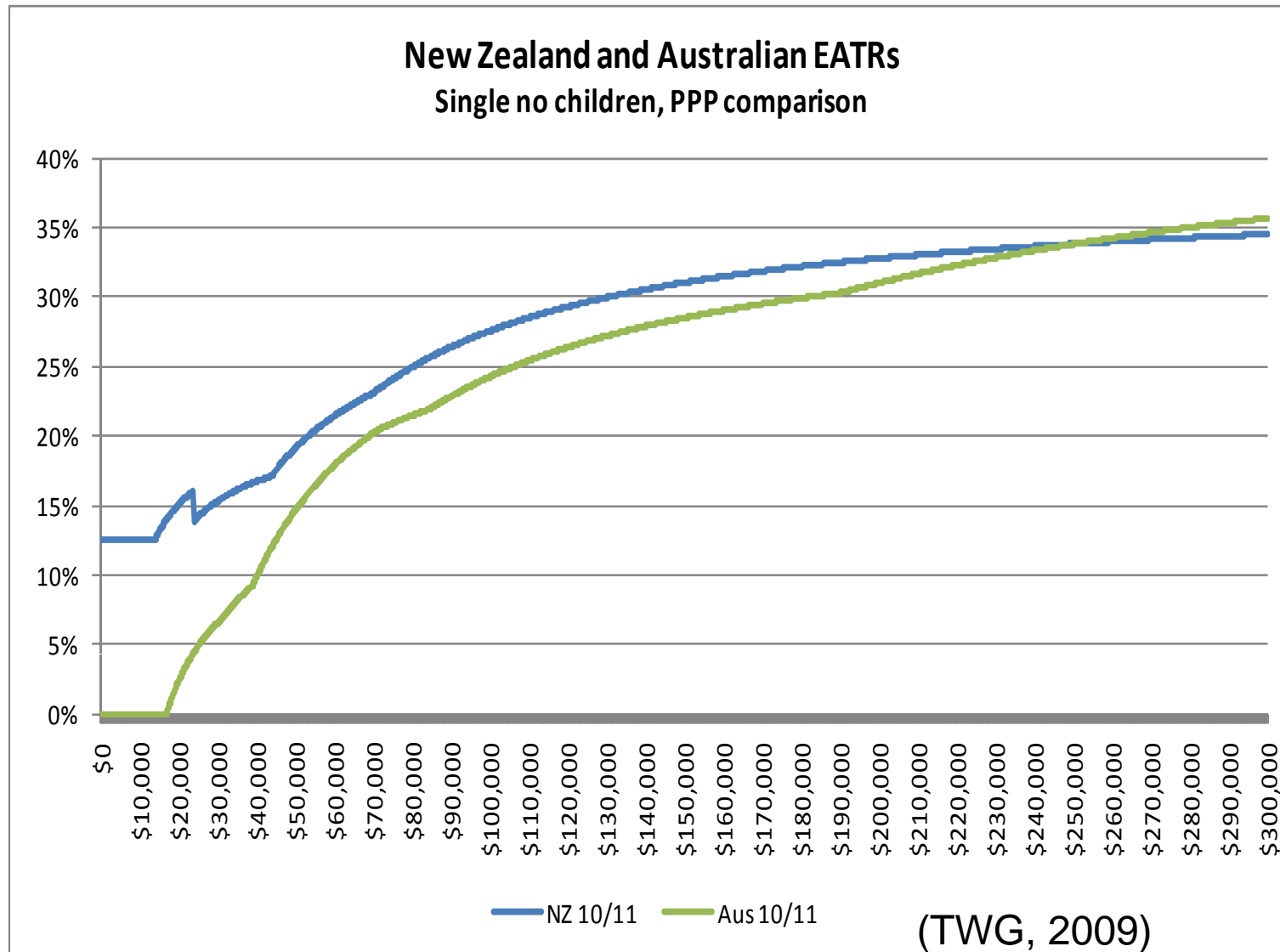
- Requires a complete rethink
- Does WFF achieve poverty objectives?
  - Leaves the poorest children behind
- What are the IWTC and MFTC for?
  - Clumsy design, unclear objectives
- Why the IETC?
  - Patches up WFF

Revenue from base broadening could help the 20-28% of children below the poverty line who have been left out

# Catching Australia?

- Australia income tax system is much more progressive
  - Top rate of 45% and
  - Broader base (capital gains tax)
- Australia is much kinder to the lower end of the distribution
  - Tax-free \$15000 rising to \$16000
  - Much more generous to families

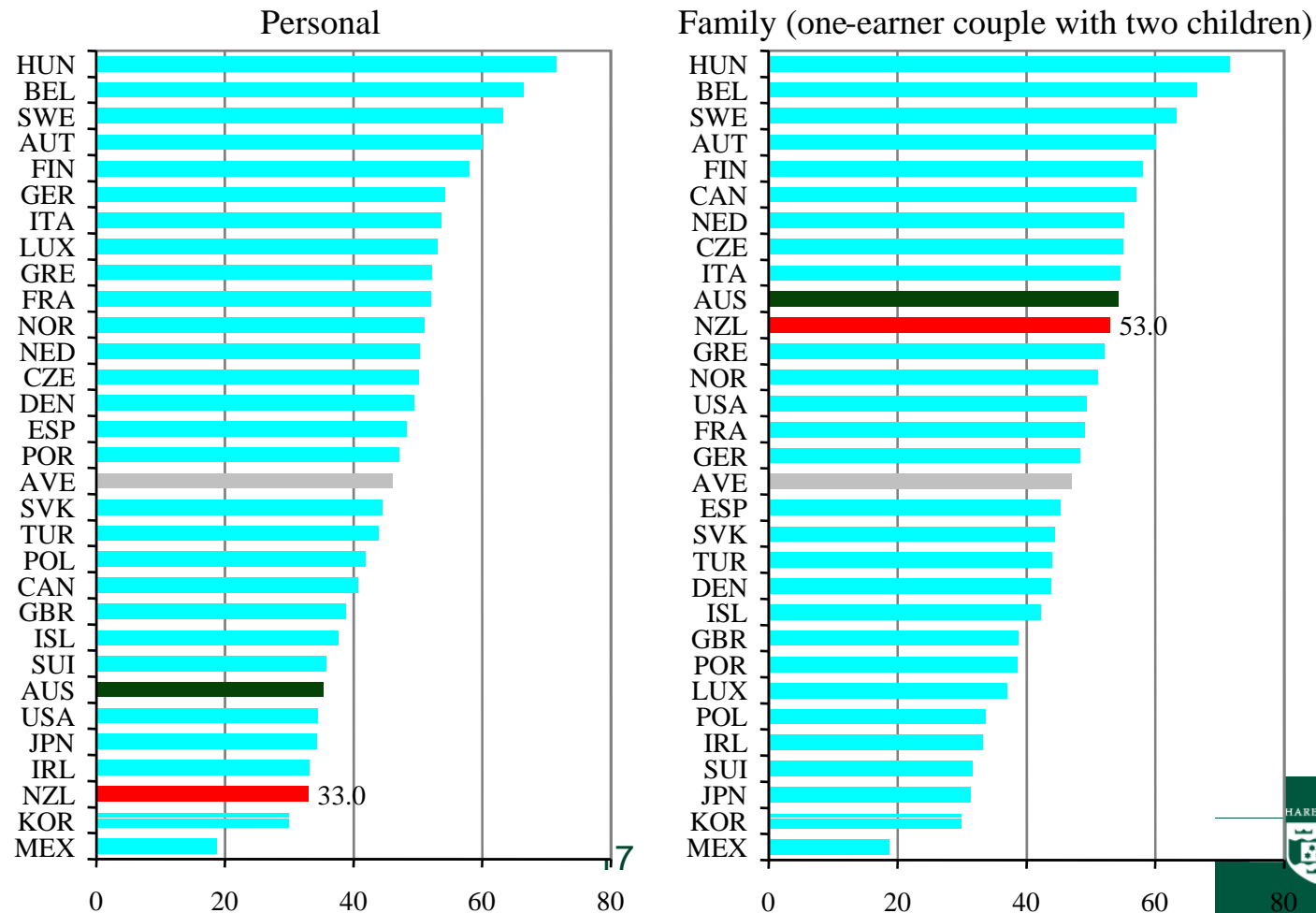
# Average tax rates rise more steeply in Australia





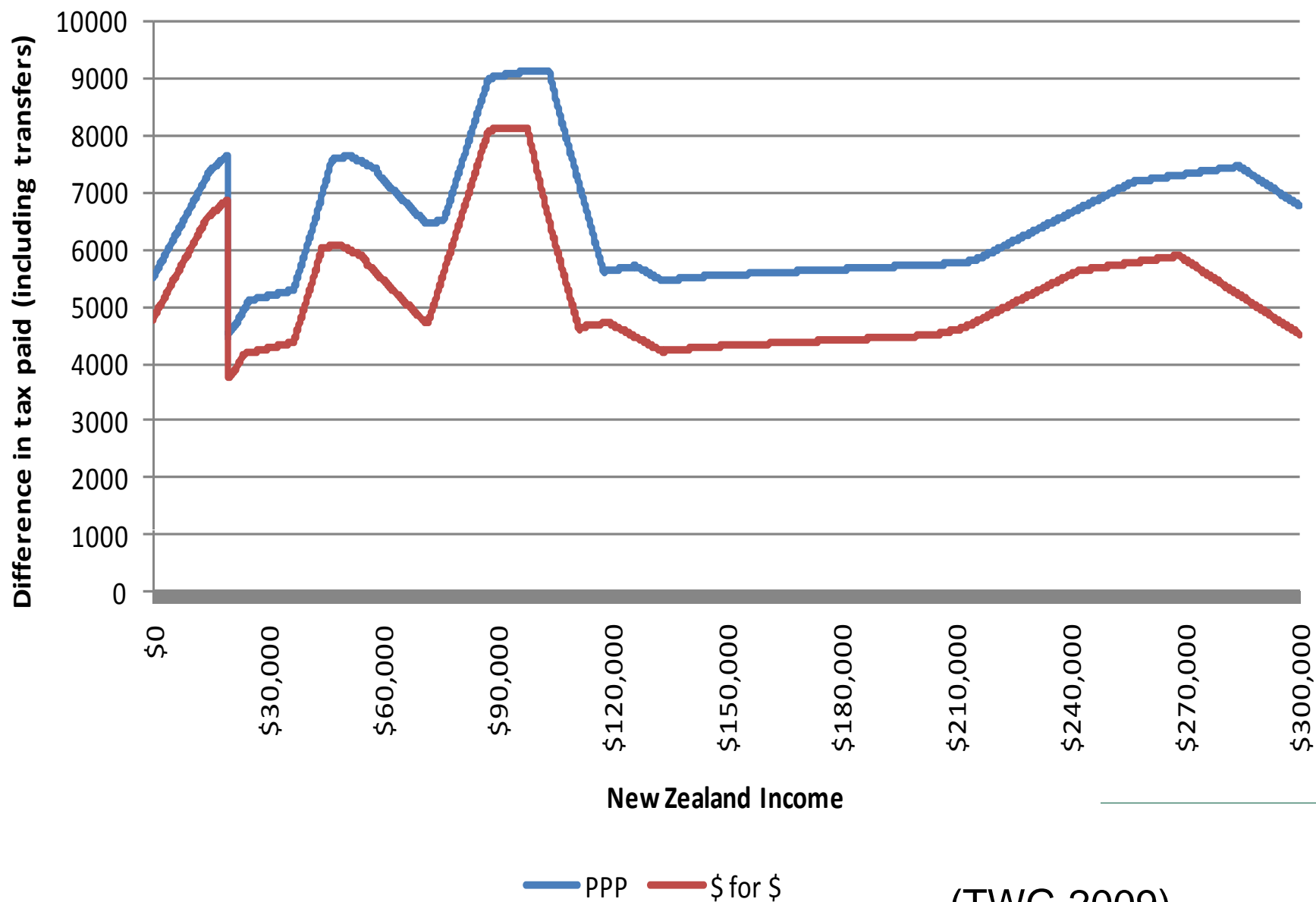
# Are NZ's MTRs high? (at average wages)

Effective marginal tax rates (as a percent of labour costs)



# Taxes paid in New Zealand less taxes paid in Australia

Two-earner family, two children 5-12



(TWG,2009)