CHiLD POVERTY ACTION GROUP

Lessons from the Tax Working Group

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Summary

The TWG were constrained by lack of time and resources. In contrast to another high profile taskforce that reported in 2009, its funding was minimal. Inevitably this led to a report whose scope and ambitions had to be modest. Yet this was New Zealand's one chance to influence a receptive government in mid-electoral cycle reform mode. When will the chance for a dispassionate review come again?

The TWG report highlighted the inequities of many higher income people being able to avoid their fair share of tax by the use of companies, trusts, loss making properties, and tax-paid managed funds. Some apparently qualify for Working for Families tax credits as a result of generating rental losses. Instead of closing these avenues of avoidance, the TWG proposed aligning the company, trustee and top tax rate, perhaps at 30% or lower. While this would remove the opportunities for avoidance, the price is a far less progressive tax system.

A major limitation of the TWG was the implicit value judgement that the criterion of efficiency was more important than that of equity. While they modelled the impact of different scenarios of tax cuts and base broadening on child poverty and inequality, their concern was limited to ensuring that these did not get noticeably worse. The questions not asked were "is the current level of inequality and poverty acceptable? If not, how can taxes be redesigned to improve equality and reduce poverty? The TWG either implicitly accepted that the prevailing distribution was optimal or else that distributional aims were best achieved by other tools outside of the tax system.

Yet sadly, New Zealand's after-tax distribution is one of the most unequal in the OECD, and according to the latest information from MSD in 2008 19% of New Zealand children lived in 'serious hardship'. The 2010 Salvation Army report "Road to Recovery' suggests the picture is now much worse due to the recession in 2009 and weak recovery in 2010. The design of the income tax system, including tax credits for children, is a crucial influence on these outcomes. However to address key distributional questions the tax/transfer system needed to be considered as a whole.

Another limitation of the TWG exercise, was the requirement for their suggested reforms to be revenue neutral. The revenue from tax cuts had to be found from base-broadening or another source such as GST. In the context of the global financial crisis when the government is continually reminding us that it has to borrow $250 m a week this seems odd. If the government raises GST and lowers tax rates it has no leverage left to halt the rise in debt in a protracted downturn or weak recovery. Unable to raise GST further or return to the top tax rate, the danger is that there will be inevitable spending cuts that further hurt the social fabric.

Distortions of the tax/welfare interface were identified as of concern to the TWG but they did not have the mandate to consider the system as a whole. While a family on an income over $48,000 might face an effective marginal tax rate of 51 to 58% due to Working for Families, more serious problems are faced by those on benefits whose effective marginal tax rates may exceed 90%.

Foodbanks and Budgeting Services report that families are going further into debt just to meet the basic costs of food, rent, and electricity. For many, full-time work is a total impossibility but they are penalised severely when they work part-time. Moreover there is a range of other quasi-welfare income tested provisions that may the affect work incentives of particular people such as child support, student allowances, childcare subsidies and the accommodation supplement.

While claiming that such ‘welfare’ transfers were outside its brief, the TWG had to take Working for Families into account as it is the key way taxes are adjusted for family size. It is a very complex package made up of the Family Tax Credit, the Parental Tax Credit, the In Work Tax Credit and the Minimum Family Tax Credit. The Tax Working Group did not ask whether the the various parts of WFF achieved their original purpose.

For example, the child-related In Work Tax Credit has two objectives - to encourage sole parents to work and to reduce child poverty. It is exceptionally expensive at around $600 million annually, and is paid not just to those earning the minimum wage but way up the income scale, even to some families earning over $100,000 annually who do not need an incentive to work nor a payment to prevent poverty. Yet this expensive tax credit manages to exclude the poorest children, in families on benefits, whose poverty has simply been left to deepen.

Because the tax group did not analyse the detail of Working for Families their suggested changes to reduce effective marginal tax rates are problematic. For example, one scenario modelled universalising the last $2000 a child of Working for Families Tax Credits. At a further cost of $700 million annually, this would, in practice pay the In Work Tax Credit (because it abates last), to the very wealthiest families. Surely they don’t need a payment to a payment to ‘make work pay’ or ‘address child poverty’. Remarkably, this extra $700 million expenditure would not increase family payments at all at the lower end where they are so desperately needed.

The tax/welfare interface is a mess. The system is inequitable, inefficient, and administratively complex. To their credit, the Tax Working Group recognised the problem and asked government for a comprehensive review. But government has not responded. The 2010 budget will probably shift taxes around a little by raising GST to 15% and compensating wage earners by a reduction in the bottom tax rates leaving them at best, no worse off. The top rate is likely to reduce to 33% with modest increases to taxes on property, suggestion gains to the top end, despite revenue neutrality aims. Meantime the lower end of the income distribution will be left to struggle with the seemingly intractable problems of an archaic and badly integrated tax and welfare system and possible social services cuts to spending.

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