Submission:

To the Tax Review Committee

The New Zealand Tax System

From: Child Poverty Action Group

We thank you for the opportunity to submit our views on this review. The Child Poverty Action Group comprises a group of academics and workers in the field dedicated to achieving better policies for children. We represent a wide network with over 100 recipients of our backgrounders and monographs. Our recent report Our Children: the priority for policy can be found with other background material at our web site http://thor.he.net/~cpanz/.

Our concern is that for too long children have been invisible in policy development. We would encourage the committee to consider the tax/benefit system from their perspective.

We request the opportunity to appear before the committee to speak to the submission. Contact details are:

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Background:

The Child Poverty Action Group believes impacts on the well-being of children and low income families must be given a higher priority in all macropolicy decision making (CPAG, 2001). Nowhere is this more important than in the case of the tax and benefit systems. This tax review gives the New Zealand government an opportunity to commit to social goals in tax design that prioritise our children as a matter of urgency.

While a deterioration in the economic position of children from low income families and the consequential social costs can be partially attributed to changes in demography and the labour market, regressive changes in taxes and benefits must carry their share of the blame. The degree of progressivity of the tax system, which perhaps once received some degree of social approval, has been allowed to decline through attrition and neglect. We believe that the fundamental role of the tax review committee must be to address the unfair shifting over time of the tax burden to the poor.

Income statistics show that between 1986 and 1996 average disposable household income rose, but only slightly, from $34,100 to $35,500 (constant 1996 dollars). Over the same time, median disposable household income actually fell 9%, from $31,100 to $28,400. Thus median income is only 80% of the average. Well over 50% of households have lower than the average incomes and have experienced falling living standards. The picture is unaltered when the figures are adjusted for family size, thus the deterioration in low income position cannot be explained by a change in average household size.

Children are over-represented in the bottom two quintiles of family income. In 1996, 49% of all children under 15 were in the two lowest quintiles of household income. We believe that through exclusion and attrition, the economic position of children in NZ has worsened unacceptably. Our concern is not absolute poverty, but rather the insidious and unfair effects of relative poverty (see appendix). Our investigations into poverty levels suggest that one third of children under the age of 15 in NZ are being raised in families that do not have sufficient disposable income to ensure their full development (CPAG, 2001)

Discussion:

The Welfare and Taxation system must be viewed together

We believe that it is most important to consider the tax and benefit systems together. Following the tradition of the Royal Commission on Social Policy (1988) who deliberated on the 'income maintenance' system, the tax review should also be examining the distributive impact of the combined benefit and tax systems.

The rationale, as the RCSP identified, is that there is a close interface between benefits and taxes. Benefits can be regarded as negative tax flows. People's overall financial position is what is important (Royal Commission on Social Policy, 1988)

In the case of those over 65, NZ superannuation is already equivalent to a tax credit and it would be a short step to explicitly treating it like this. Already tax credits are now the principal way that children receive state financial assistance and any tax review must be concerned with the basis on which these are accessed, their level, purpose and adequacy.

Criteria for reform of the tax system

The combined system should be judged against criteria of equity efficiency and administrative simplicity. These standard criteria are well known. The CPAG offer the following slants on the these criteria from the perspective of children

Equity:

> **Horizontal equity** requires that children in families with the same incomes receive the same per child assistance.
>
> **Vertical equity** requires that low income families are left with sufficient income after taxes and benefits to enable their children's full participation and development. The required revenue of the state is funded through a progressive system that is not allowed to be come less progressive over time, because of new policies, or through the failure to index for inflation.

Efficiency:

> Requires that parents of children do not face higher effective marginal tax rates than those faced by high income people. The range over which high effective marginal tax rates apply must be limited

Administrative simplicity

Parents must not face complex regimes for accessing their tax credits and entitlements.

Overall we agree with the Royal Commission on Social Policy who consulted widely in 1987 to determine the objectives of the tax/benefit system. These objectives were, in brief:

- The need for adequacy of income for belonging, participation and the development of human potential
- The relief of immediate need
- The well-being and development of all children

Targeting and high effective marginal tax rates

Overly strict targeting of benefits has lead to perverse incentives and severe efficiency distortions. High effective marginal tax rates arise as people move from welfare to the workforce. They can also arise for people in the workforce when they earn extra income. For example they will not only pay tax and ACC levies, but may also face an assortment of measures that further reduce the returns from work, such as student loan repayments, accommodation supplement reduction, child support payments and abatement of family support.

While in general social welfare benefits have been indexed to the rate of inflation, parameters such as the income thresholds for abatement of benefits and tax credits tend to be subject to the vagaries of one-off adjustments.

Both the amount of assistance that is abated and the abatement thresholds need to be moderated. A return to a better balance of targeting and universal payments is needed, especially for family tax credits. There are strong arguments to consider a universal benefit for children for part of the family assistance package.

Unit for the tax/benefit system

Anomalies abound in the different use of the unit for tax and benefit purposes. For example the amount that a couple on a benefit can earn before very high effective marginal tax rates apply is $80, the same as for an individual. This treatment of the couple is anachronistic and unfair. In line with changes that are being made in Australia (Dalsgaard, 2001), we need to be reducing the use of the couple as the unit for the benefit system as much as possible to make it compatible with the tax system. This will facilitate moves to a universal basic income over time such as already applies for people over 65.

Lower progressivity since 1986

The thrust of tax reform over the last decade or so has been to lower marginal tax rates on high income groups while flattening tax rates overall. This, combined with an increase in consumption taxes and the introduction and extension of user pays for many government services such as health and education, has contributed to the dramatic increase in inequality in NZ.

New Zealand is unusual in having no protection for low income families such as could be provided by having no GST on basic food, housing, operation, health, education, legal services, and children’s clothing. CPAG accepts that there are important reasons for having GST as broadly based as possible, but reminds the committee that:

- Compensation for the introduction of 10% GST in 1986 by increases in benefits was more than reversed in 1991 with the benefit cuts.

- The 1989 increase in GST to 12.5% was entirely without compensation.
- The lowest income threshold remains $9500 (set in 1986) while the threshold for payment of the top rate of 33% (until 2000 when a further top bracket was added) has been adjusted upwards by 23% to $38,000.
- The bottom rate of tax is internationally high at 15%. The UK rate is 10% and there is an effective zero tax band in many other countries, including Australia and the USA.
- There are very few personal deductions, or forms of tax relief for those with dependents.

The tax reductions of 1996 and 1998 were inappropriately designed. The Government of the time claimed that they would benefit low and middle income families, but in fact high income earners gained the most. For every dollar of extra expenditure or forgone revenue in the programme, 40 cents went to non-family groups, 31 cents went to families in the top two income quintiles, and only 29 cents went to the ‘target’ group of low and middle income families Dalziel P, 1999 #445]71. Single earner families gained far more than low income two-earner families, with many low income families gaining very little.

For high income persons, the tax burden on total income is low. New Zealand has no effective personal capital gains tax, no death duties or inheritance tax, a low top tax rate and company tax rate, and avenues for avoidance of the new top rate of 39% (eg superannuation contributions, tax paid funds, diversion to companies and trusts).

The CPAG believe the tax review must seek to restore the lost balance of horizontal and vertical equity.

The use of tax credits

In 1996 instead of properly adjusting Family Support for all children the ill-conceived Independent Family Tax Credit was introduced. Now called the Child Tax Credit, this payment has a maximum value of $15 per child per week and is a significant part of the budget of low-income families. But it does not go to many of the children who need it most. Instead, it is supposed to reward 'independence from the state'. Thus it acts as a further punishment by being withdrawn when families must rely on state assistance. This reinforces the perception that children whose parent/s are not working are less valued by society, and violates the requirement of horizontal equity.

The abolition of family benefit in 1991, began the current trend of delivering specific assistance for children via the tax system. There have been several major problems with this trend:

- The thresholds for the abatement of Family support have been inadequately adjusted for inflation.
- High effective marginal tax rates have impacted over long income ranges, especially for large families.
- Access to tax credits has been poor, with no effort made by IRD or WINZ to improve access or take-up rates.
- A discriminatory bias was introduced with the independent child tax credit.

Failure to adjust the system adequately for inflation

While many have enjoyed increases in income as a protection from inflation, children and low income parents have been the victims of slow attrition. Adjustments for past inflation that should be made immediately include:

- A lift in the first income tax threshold (unchanged since 1986) to $12,000,
- An adjustment of the amount that can be earned on a benefit ($80 unchanged since 1986) to $135,
- An increase to the community services card subsidies (largely unchanged since 1992), and
- An increase in the $20,000 and $27,000 thresholds for family support abatement.
- An increase in the rebate for voluntary donations

Then, at very least, a commitment to continue to adjust all parts of the system for future inflation must be made.

Revenue

Some of the recommendations below are costly, some can be accommodated in a fiscally neutral way. We believe that the tax system should deliver more revenue overall to meet the needs of the health, welfare and education systems. A separate Medicare levy for basic healthcare such as applies in Australia may make tax more acceptable.

Recommendations

In our view, reducing inequality and restoring the position of the lowest income groups to reduce poverty requires tax policies which are significantly more progressive than present. It also requires addressing the problem of the high effective marginal tax rates confronting low income families when they are trying to move off benefits and into the workforce.

Our recommendations are:

- Make children the new priority for tax policy
- View the welfare and taxation system together
- Apply a balance of universal and targeted provisions, with the focus on children, to avoid the poverty trap over long income ranges. Introduce a universal child benefit.
- Restore horizontal and vertical equity in the income distribution
- Over time, make the tax system more progressive:
  - Move towards introducing a bottom band of tax free income.
  - Make the top rate of 39% more than a voluntary tax, especially for the wealthy elderly.
  - Broaden the tax base through the introduction of an inheritance tax and a capital gains tax
- Where ever possible marginal tax rates must be lowered, especially for low income people and secondary earners - those most responsive to the signals given by after tax returns to work
- Recognise that GST and the imposition of user-pays component for public services including Health and Education impacts more heavily on lower income families. Take account of these in measure of disposable income and in designing the tax system. Fair compensation for GST must be a priority
- Raise benefits to levels which are adequate to cover basic living costs

- Abandon all aspects of the principle of the ‘deserving poor’ as is found in Family Plus.
- Extend the child tax credit to all low income children
- Place an obligation on IRD to ensure families access their tax credits.
- Redress the inequity in all parts of the system that have not been indexed for inflation. These include raising the bottom threshold to $12,500, raising the $80 income threshold in the benefit system to $135 and adjusting the thresholds for Family Support. Increase the rebate for voluntary donations.
- Make tax system and compliance simple, but ensure that individuals retain control and information. Control and knowledge may be lost with the current system of no tax returns for the majority of earners. People must be able to understand their tax position clearly, and are entitled to the opportunity of an annual tax return.
- Introduce a Medicare type levy for health to improve the acceptability of the tax system, and provide dedicated revenue for health especially for the young. Also increase GP’s subsidies and introduce subsidies for specialists.
- Broaden the tax base and increase the progressivity of the tax system by introducing an inheritance tax and a capital gains tax. The extra revenue raised could be used to offset the cost of the measures outlined above.

Appendix:

The nature of relative poverty

Being poor in New Zealand does not mean absolute destitution: the reality for children living on the streets in Jakarta or Bangladesh. Being poor in New Zealand means being excluded from the mainstream of New Zealand life. A child in relative poverty is denied the opportunity for development of their potential. Relative poverty means living without security, in temporary, overcrowded, and damp housing. It means moving house regularly, from one rented dwelling to another, and having to learn the new environment. It means changing schools often, and having to get to know new teachers, new schoolmates, and new expectations. It means not having enough money for proper dental and health care. It means parents choosing between a trip to the doctor, or proper meals for the week, or paying the electricity bill. Relative poverty means not going on the school camp with your friends because there is no money to pay for the $60 or more private cost of camp. It means either using foodbanks, or increasing debt, to have the essentials. It means not having a telephone. It means not having access to reliable or efficient transport. CPAG 2001

References

CPAG (2001). Our Children; the priority for policy. Child Poverty Action Group: Auckland

Dalsgaard, T. (2001). The tax system in New Zealand: an appraisal and options for change, Economics Department working paper no 281, OECD: Paris.

Royal Commission on Social Policy (1988). The April Report. Wellington, The Royal Commission on Social Policy: Wellington.