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A special report from the
Policy Advice Division of Inland Revenue

Guide to the tax changes proposed in the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Bill 2008

Budget 2008 announced personal tax reductions that are to be phased in over three and a half years, and changes to Working for Families Tax Credits to take account of inflation. The Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Bill 2008, introduced on 22 May 2008, gives effect to those announcements. The bill also includes three sets of remedial amendments that require early enactment: the legislative changes the government announced on 14 May 2008 that are to give tax certainty for various entities in the lead-up to the deadline for registration with the Charities Commission; small but necessary remedial amendments to the portfolio investment entity (PIE) and KiwiSaver rules; and a number of drafting corrections mainly arising from the rewrite of the Income Tax Act. Finally, the bill confirms the annual rates of income tax for the 2008-09 tax year. This report describes those changes.

Tax cuts for individuals

The Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Bill 2008 provides for tax cuts for individuals from 1 October 2008. It reduces the bottom personal tax rate from 15% to 12.5% and raises the thresholds at which tax rates apply over a period of three and a half years. The bill also contains a number of consequential amendments to the tax legislation to give effect to the tax cuts.

KEY FEATURES

- The tax cut package will be rolled out progressively in three stages.
- The new tax rates and thresholds apply to income earned by individuals.
- Stage 1 changes will apply from 1 October 2008.
- Stage 2 changes will apply for the 2010-11 income year (meaning they generally apply from 1 April 2010).
- Stage 3 changes apply for the 2011-12 income year (meaning they generally apply from 1 April 2011).
- The bottom tax rate will be lowered from 15% to 12.5%.
- The thresholds will be raised for each of the three stages as shown in the following table:

Rate	*Thresholds*		
	Stage 1 (beginning 1 Oct 2008)	*Stage 2 (1 April 2010)*	*Stage 3 (1 April 2011)*
12.5%	$0 – $14,000	$0 – $17,500	$0 – $20,000
21%	$14,001 – $40,000	$17,501 – $40,000	$20,001 – $42,500
33%	$40,001 – $70,000	$40,001 – $75,000	$42,501 – $80,000
39%	$70,001 and above	$75,001 and above	$80,001 and above

- Consequential changes to other aspects of the tax legislation – such as PAYE tax and provisional tax, fringe benefit tax and employer superannuation contribution tax – will be made to coincide with the three stages.
- The existing resident withholding tax rates for interest income and the portfolio investment entity (PIE) tax rates have not been changed, although the government has announced that they will be reviewed.
- The low income rebate will be removed from the 2008-09 income year, to be replaced by the new 12.5% tax rate.

DETAILED ANALYSIS

Personal tax rate reductions

New composite tax rates for 2008-09 income year (clause 7(1))

Income tax is calculated based on a person's annual income. Because the tax rates and thresholds are changing part-way through the 2008-09 income year, the tax rates that apply for the whole of the 2008-09 income year are "composite tax rates" that reflect an average of the two income tax rates that are used during the year. The table below shows the income tax rates that will be used during the 2008-09 income year as well as the composite tax rates for the year. The new composite rates will be contained in proposed schedule 1, part A, table 1 of the Income Tax Act 2007.

	Old tax rates applying to PAYE for the period 1 April 2008 – 30 Sept 2008	*New tax rates applying to PAYE for the period 1 Oct 2008 – 31 March 2009*	*Composite tax rates for 2008-09 income year*
$0 – $9,500	15%*	12.5%	13.75%
$9,501 – $14,000	21%*	12.5%	16.75%
$14,001 – $38,000	21%*	21%	21.00%
$38,001 – $40,000	33%	21%	27.00%
$40,001 – $60,000	33%	33%	33.00%
$60,001 – $70,000	39%	33%	36.00%
$70,001 and higher	39%	39%	39.00%
*Including the low income rebate			

New tax rates for 2009-10 income year, 2010-11 income year and 2011-12 income year (clause 7(2) to (4))

Proposed schedule 1, part A, table 1 of the Income Tax Act 2007 provides for new tax rates for the 2009-10 income year, the 2010-11 income year and the 2011-12 income year. The new rates are shown in the table below:

2009-10

Income range	*Tax rate*
$0 – $14,000	12.5%
$14,001 – $40,000	21%
$40,001 – $70,000	33%
$70,001 upwards	39%

2010-11

Income range	*Tax rate*
$0 – $17,500	12.5%
$17,501 – $40,000	21%
$40,001 – $75,000	33%
$75,001 upwards	39%

2011-12 and subsequent years

Income range	*Tax rate*
$0 – $20,000	12.5%
$20,001 – $42,500	21%
$42,501 – $80,000	33%
$80,001 upwards	39%

New PAYE rates from 1 October 2008 – M and ML tax codes

The new tax rates and thresholds will apply for the first pay period that ends on or after 1 October 2008. For pay periods that span the 1 October date and are a month or shorter, PAYE should be deducted at the new rates. If the pay period spanning 1 October is longer than a month, then PAYE needs to be deducted at the old rate for the part of the pay period before 1 October and at the new rate for the part of the pay period after 1 October.

Tax rates on which PAYE will be based from 1 October 2008 to 31 March 2010

Income range	*Tax rate*
$0 – $14,000	12.5%
$14,001 – $40,000	21%
$40,001 – $70,000	33%
$70,001 upwards	39%

The new thresholds will be progressively raised from 1 April 2010 and 1 April 2011.

Inland Revenue's PAYE deduction tables will be updated to reflect the new rates and thresholds, so that the M and ML tax codes reflect the new rate and thresholds.

New PAYE rates from 1 October 2008 – secondary tax codes (clause 18)

Proposed section 24B(3) of the Tax Administration Act 1994 raises the thresholds for secondary tax codes to reflect the new thresholds. This applies from the first pay period that ends on or after 1 October 2008.

Employees can elect a new secondary tax code if they believe that their annual income will be below the new threshold.

The new thresholds will be progressively raised from 1 April 2010 and 1 April 2011.

From 1 October 2008 to 31 March 2010

Income range	*Tax code*	*Tax rate*
\$0 – \$40,000	S	21%
\$40,001 – \$70,000	SH	33%
\$70,001 upwards	ST	39%

From 1 April 2010 to 31 March 2011

Income range	*Tax code*	*Tax rate*
\$0 – \$40,000	S	21%
\$40,001 – \$75,000	SH	33%
\$75,001 upwards	ST	39%

From 1 April 2011

Income range	*Tax code*	*Tax rate*
\$0 – \$42,500	S	21%
\$42,501 – \$80,000	SH	33%
\$80,001 upwards	ST	39%

New rates for extra pay from 1 October 2008 (clauses 14 and 15)

Proposed sections RD 10(2)(a) and RD 17(2) and (3) of the Income Tax Act 2007 raise the thresholds at which tax rates of extra pay apply to reflect the new thresholds. This applies from the first pay period that ends on or after 1 October 2008.

The new thresholds will be progressively raised from 1 April 2010 and 1 April 2011.

Rates from 1 October 2008 to 31 March 2010

Income range	*Tax rate*
$0 – $40,000	21%
$40,001 – $70,000	33%
$70,001 upwards	39%

From 1 April 2010 to 31 March 2011

Income range	*Tax rate*
$0 – $40,000	21%
$40,001 – $75,000	33%
$75,001 upwards	39%

From 1 April 2011

Income range	*Tax rate*
$0 – $42,500	21%
$42,501 – $80,000	33%
$80,001 upwards	39%

New FBT rates (clause 8)

Proposed schedule 1, part C, table 1 of the Income Tax Act 2007 provides for new fringe benefit tax (FBT) rates and thresholds. These reflect the new bottom rate of 12.5% and the raised thresholds. Changes will apply to the 2008-09 income year, the 2009-10 income year, the 2010-11 income year and the 2011-12 income year. For the 2008-09 year, composite rates will apply to reflect the two sets of rates being used for that year.

2008-09

Income range	*Tax rate*
$0 – $8,194	0.1594
$8,195 – $11,940	0.2012
$11,941 – $30,900	0.2658
$30,901 – $32,360	0.3699
$32,361 – $45,760	0.4925
$45,761 – $52,160	0.5625
$52,161 upwards	0.6393

2009-10

Income range	*Tax rate*
$0 – $12,250	0.1429
$12,251 – $32,790	0.2658
$32,791 – $52,890	0.4925
$52,891 upwards	0.6393

2010-11

Income range	*Tax rate*
$0 – $15,312	0.1429
$15,313 – $33,087	0.2658
$33,088 – $56,537	0.4925
$56,538 upwards	0.6393

2011-12

Income range	*Tax rate*
$0 – $17,500	0.1429
$17,501 – $35,275	0.2658
$32,276 – $60,400	0.4925
$60,401 upwards	0.6393

New employer superannuation contribution tax rates (clause 16)

Proposed schedule 1, part D, table 1 of the Income Tax Act 2007 provides for new employer superannuation contribution tax (ESCT) rates and thresholds. These reflect the new bottom rate of 12.5% and the raised thresholds. The changes apply from the first pay period that ends on or after 1 October 2008.

The new thresholds will be progressively raised from 1 April 2010 and 1 April 2011.

From 1 October 2008

Income range	*Tax rate*
$0 – $16,800	0.125
$16,801 – $48,000	0.210
$48,001 upwards	0.330

From 1 April 2010

Income range	*Tax rate*
$0 – $21,000	0.125
$21,001 – $48,000	0.210
$48,001 upwards	0.330

From 1 April 2011

Income range	*Tax rate*
$0 – $24,000	0.125
$24,001 – $51,000	0.210
$51,001 upwards	0.330

Provisional tax (clauses 39, 40, 41, 42, 47 and 48(2))

New sections RZ 5B and RZ 5C amend provisional tax calculations to allow individuals who pay provisional tax to reduce their provisional tax payments from 1 October 2008.

To calculate the new provisional tax payments, a taxpayer's previous year's residual income tax (RIT) liability will be reduced by the dollar amount of the maximum tax cut that a person earning $70,000 would receive for the 2008-09 year (that is, $730) before applying the standard uplift. This applies to provisional tax payments that are made on or after 1 October 2008.

In subsequent income years, the same approach is taken to reduce the previous year's RIT, or the RIT from two years ago, by the maximum incremental amount of the tax cut before applying the 105% or 110% uplift.

Similarly, the RIT is reduced by the same amounts when calculating the GST ratio for a provisional taxpayer using the GST ratio method.

ACC attendant carers (clause 51)

Payments to ACC attendant carers are currently subject to a withholding tax rate of 15%, which reflects the bottom tax rate. Proposed schedule 4, part I, clause 1 reduces the withholding tax rate to 12.5% from 1 October 2008.

Consequential amendments

Low income rebate (clauses 24, 25, 27, 28, 29, 30, 34, 43, 49, 50(01))

The low income rebate (LIR) contained in sections LC 1 and LC 2 of the Income Tax Act 2007 will be repealed with effect from the 2008-09 income year. This is because the LIR will be replaced by a new low statutory tax rate of 12.5%.

Under the current rates the statutory tax rate on income under $38,001 is 19.5%. However, the LIR reduces this statutory rate by 4.5% for income under $9,501, resulting in an effective rate of 15%. The LIR is abated at 1.5% for income earned over $9,500, up to $38,000. This creates the 21% rate on income earned between $9,501 and $38,000.

Various cross-references to section LC 1 and 2 in the Income Tax Act 2007 will be consequentially repealed for the 2008-09 income year and subsequent income years.

Child taxpayer rebate (clause 26)

The child taxpayer rebate provides children with a tax rebate on income that is not interest or dividends. This allows an eligible child to earn income (less interest and dividends) up to $2,340 per annum tax-free.

The calculation of the child rebate in section LC 3 of the Income Tax Act 2007 is being consequentially amended, from the 2008-09 income year and subsequent income years, to reflect the reduction in the lowest tax rate from 15% to 12.5%.

Fund withdrawal tax (clause 13)

Fund withdrawal tax is a 5% tax on certain withdrawals of employer superannuation contributions from superannuation funds. The tax currently applies where the superannuation fund member's income is above $60,000. Section CS 1(7)(b) will be amended to raise the threshold to $70,000 from 1 October 2008, $75,000 from 1 April 2010, and $80,000 from 1 April 2011.

Filing tax returns (clauses 10 and 11)

Section 33A(1) of the Tax Administration Act 1994 provides that taxpayers do not have to file a tax return if they earn interest and dividends, income from Maori authorities, extra pays, or income from second jobs that has been taxed at an incorrect rate if the income that has been taxed incorrectly is $200 or less.

Section 33A(1) will be amended to reflect the new thresholds. These changes will apply from the 2008-09 and subsequent income years.

Section 33C of the Tax Administration Act 1994 ensures that a taxpayer who has received ACC attendant care payments that have had tax withheld at 15% does not have to file a tax return in certain circumstances. These circumstances are when he or she has earned $9,500 or under and is not otherwise required to file a tax return under section 33A(1).

Clause 11 provides that section 33C applies to ACC attendant care payments that have had tax withheld at 12.5% from the 2008-09 and subsequent income years. It also raises the threshold to $14,000 in 2008-09 and 2009-10, $17,500 in 2010-11, and $20,000 in 2011-12.

Working for Families Tax Credits

The bill makes changes to the Working for Families Tax Credit package to take account of movements in the Consumer Price Index (CPI). The changes increase the family tax credit entitlement amounts and raise the abatement threshold above which the family tax credit, in work tax credit and the parental tax credit abate.

The Working for Families legislation requires that the abatement threshold and the family tax credit entitlement amounts are adjusted for inflation when the CPI movement cumulatively reaches 5% after 1 April 2007. Although this would normally occur from 1 April 2009, the CPI adjustment is bring brought forward so that the new income threshold and family tax credit entitlement amounts will apply from 1 October 2008.

These changes apply from 1 October 2008 and subsequent years.

DETAILED ANALYSIS

New family tax credit entitlement amounts (clauses 5 and 33)

The Working for Families Tax Credit is calculated on the basis of a full tax year (1 April – 31 March). However, having the new entitlement amounts applying from 1 October 2008 will result in two sets of entitlement amounts applying during the 2008-09 tax year. The amounts before and after 1 October are outlined (shaded) in the table below. Proposed new sections MF 4B and 4C provide that these entitlement amounts will be used to calculate a family's entitlement if it wants its family tax credit entitlement paid during the year (either weekly or fortnightly).

Also outlined in the table are composite entitlement amounts that will apply for the whole of the 2008-09 year and reflect the combination of the entitlement amounts before and after 1 October. These composite amounts are used to calculate entitlements if a family waits until the end of the year to receive its family tax credit, or to square up a family's entitlement if it has received family tax credit payments during the year. These changes will be made by amending section MD 3(4).

Family tax credit amounts for the 2008-09 year

Children	*Current amount 1 April 2008*	*New amount 1 October 2008*	*Composite amount for the 2008-09 year*
First child if under 16	$4,264	$4,487	$4,376
First child if 16 or over	$4,940	$5,198	$5,069
Subsequent child if under 13	$2,964	$3,119	$3,042
Subsequent child if 13 to 15	$3,380	$3,557	$3,469
Subsequent child if 16 or over	$4,420	$4,651	$4,536

How much a family will gain from these changes depends on the number and age of children in the family and whether the family earns above the income abatement threshold.

The new entitlement amounts from 1 October 2008 will also apply for the 2009-10 and subsequent years.

Abatement threshold (clauses 6 and 52)

In addition, the income threshold above which the family tax credit, in work tax credit and parental tax credit abate will rise from 1 October 2008 to take account of inflation. The current abatement threshold is $35,000, and from 1 October 2008 it will increase to $36,827. As with the changes to the family tax credit entitlement amount, changing the abatement threshold part-way through the year (1 October) will result in a composite threshold applying for the 2008-09 year. The composite threshold for this year will be $35,914. These changes will be made by amending section MD 13(3).

For the 2009-10 and subsequent years the threshold amount will be $36,827.

Schedule 31 of the Income Tax Act 2007 will also be amended to reflect the new abatement threshold of $36,827. This schedule is used to increase the annual family income when determining the amount of family tax credit to pay during the year.

Future indexation (clause 35)

Section MF 7 of the Income Tax Act 2007 requires that the abatement threshold and the family tax credit entitlement amounts are adjusted for inflation when the CPI movement cumulatively reaches 5% after 1 April 2007. Because the CPI indexation has been brought forward, section MF 7 will consequentially be changed so that the abatement threshold and the family tax credit entitlement amounts will be adjusted for inflation if the CPI movement cumulatively reaches 5% after 1 October 2008.

Clarifying the tax law for entities in the lead-up to the charities registration deadline

The bill introduces several amendments to the Income Tax Act 2007, Tax Administration 1994 and the Estate and Gift Duties Act 1968 to resolve certain tax consequences that have emerged in the lead-up to the 1 July deadline for charities to register with the Charities Commission.

The amendments are intended to provide certainty to a number of different types of entities that were unclear about whether they had to register with the Charities commission to retain their tax-exempt status. Concerns had also been raised by Inland Revenue over how it would deal with charities that had not completed the registration process by the deadline and with international charities that are unable to register with the Charities Commission.

The amendments will apply from 1 July 2008, the date on which the tax provisions in the Charities Act 2005 come into force.

KEY FEATURES

The proposed amendments provide that:

- Tertiary education institutions and certain non-resident charities will not be subject to income tax.
- Those making gifts to state and state integrated schools, tertiary education institutions and certain non-resident charities will not need to pay gift duty on those gifts.
- Those making cash donations to state and state integrated schools or tertiary education institutions can claim a charitable rebate on the cash donation.
- The transitional changes allow Inland Revenue, in limited circumstances, to continue to treat an entity as tax-exempt as a charity if it has not completed the registration process by 1 July.

The proposed amendments will mean that tertiary education institutions and state and state integrated schools will not need to register with the Charities Commission to retain their current tax-exempt treatment. However, they may still choose to register as a charitable entity under the Charities Act 2005 to have access to other benefits that flow from registration – for example, registered charity status can be a prerequisite for securing funding from other charitable organisations or be a means of branding for some organisations.

DETAILED ANALYSIS

(Clauses 20 to 23, 31, 48(4), 48(5), 55 and 57)

State and state integrated schools

New tax provisions will apply to state and state integrated schools that are run by boards of trustees constituted under Part 9 of the Education Act 1989.

- Proposed new section LD 3(2)(bb) of the Income Tax Act 2007 includes state and state integrated schools in the entities that are donee organisations. Donations made to donee organisations qualify for the charitable donations rebate for individuals and tax deductions for companies and Māori authorities.
- New section 73 (2)(jb) of the Estate and Gift Duties Act 1968 exempts from gift duty gifts made to state and state integrated schools.
- New section 32E(2)(kb) of the Tax Administration Act 1994 allows state and state integrated schools to apply for a Certificate of Exemption for resident withholding tax purposes.

Tertiary education institutions

New tax provisions will apply to tertiary education institutions (universities, polytechnics, specialist colleges and wananga) that are established under Part 14 of the Education Act 1989:

- New section CW 55C of the Income Tax Act 2007 exempts from income tax the income derived by a tertiary education institution.
- New section LD 3(2)(bc) of the Income Tax Act 2007 includes tertiary education institutions in the entities that are donee organisations.
- New section 73(2)(jc) of the Estate and Gift Duties Act 1968 exempts from gift duty gifts made to a tertiary education institution.
- New section 32E(2)(kc) of the Tax Administration Act 1994 allows tertiary education institutions to apply for a Certificate of Exemption for resident withholding tax purposes.

Charities that need more time to complete the registration process

Proposed new section CW 41(5)(ii) of the Income Tax Act 2007 deals with transitional tax consequences for charities that need more time to complete the registration process. It applies to entities that:

- started, before 1 July 2008 to take reasonable steps in the process of preparing an application for registering as a charitable entity under the Charities Act 2005; and
- intend to complete the process of preparing an application in future; and
- have not been notified by the Inland Revenue that they are not a "tax charity".

Inland Revenue will develop administrative guidelines on what organisations will need to do to be eligible for the transitional relief.

Charities that qualify for this transitional relief will continue to be treated as income tax-exempt, and gifts made to them will not attract gift duty.

Non-resident charities

Proposed new section CW 41(5)(iii) of the Income Tax Act 2007 enables Inland Revenue to approve certain non-resident charities as income tax-exempt on grounds of their having charitable purposes. Gifts made to these approved charities will not attract gift duty.

To be eligible for the proposed treatment, a non-resident charity must carry out its charitable activities outside of New Zealand and must not have a strong connection to New Zealand such that the Charities Commission is able to exercise its monitoring and enforcement functions under the Charities Act 2005.

Inland Revenue will develop a set of administrative guidelines on how it will assess whether a non-resident charity is eligible for the exemptions.

Remedial amendments to PIE and KiwiSaver rules and drafting corrections

The bill makes the following remedial amendments to the portfolio investment entity (PIE) rules, which are consistent with the policy intention of the rules:

- Clause 44 amends section RE 2 of the Income Tax Act 2007 to ensure that resident withholding tax does not apply to PIE distributions.
- Clause 48 corrects a mistake in the definition of "portfolio investor rate" in section YA 1 of the Income Tax Act 2007 by replacing 33% with 30%.
- Clause 54 amends section 31B of the Tax Administration Act 1994 to require portfolio tax rate entities to request a tax file number from new investors as soon as is practicable. A related amendment to the definition of "portfolio investor rate" in section YA 1 of the Income Tax Act 2007 is contained in clause 48. This will ensure that the 19.5% "portfolio investor rate" is not available to investors unless they notify the portfolio tax rate entity of their tax file number.

The bill makes the following remedial amendments relating to KiwiSaver, which are consistent with the policy intention of the legislation:

- Clause 58 amends the definition of "salary or wages" in the KiwiSaver Act 2006 to ensure that an accommodation allowance is not treated as salary or wages for KiwiSaver purposes.
- Clause 59 amends the Taxation (KiwiSaver) Act 2007 to delay the repeal of section 216 of the KiwiSaver Act 2006 until 1 April 2009.

The bill also proposes a number of drafting corrections that mainly arise from the rewrite of the Income Tax Act. These corrections are being made as a matter of urgency to give certainty to taxpayers. They are contained in clauses 32, 36, 37, 38, 45, 46, 50(2) to (4), 56 and 60.

Most of these remedial amendments apply from the 2008-09 income year.

Confirmation of annual rates

Clause 61 confirms the annual rates of income tax for the 2008-09 tax year.