December 2010

Fact sheet – Improving the integrity of social assistance programmes

Improving integrity of Working for Families and other social assistance programmes

The changes described below follow the Government's announcement in Budget 2010 to improve the integrity of certain social assistance programmes, namely Working for Families (WFF), Student Allowances and the Community Services Card.

The changes are intended to counter people structuring their affairs to inflate their entitlements. This will prevent people exploiting gaps in the current definition of family income.

The changes will ensure the rules achieve their original intention of targeting assistance to people in genuine need rather than providing it to people with sufficient means.

As a first step to addressing integrity concerns around social assistance programmes, the Government excluded investment losses such as rental losses for the purpose of determining WFF tax credits. This was included in the Taxation (Budget Measures) Act 2010.

The move to recognise different sources of income and exclude investment losses for WFF will reduce tax credit spending by $32 million a year from 2011–12.

Further changes will apply to WFF tax credits and the Community Services Card from 1 April 2011. The changes to the Student Allowances parental income definition will be made separately by Order in Council.

The changes outlined below refer to the definition of income for WFF tax credits. The Community Services Card and the parental income test for student allowances use the same definition of income. Therefore, any changes to this definition of income will also apply to these two other types of social assistance.

Trustee income

Family income for WFF already includes beneficiary income of a trust but does not include distributions of trustee income. Large amounts of trustee income can be distributed to a family to live on without affecting their WFF entitlements. Changes are being made to the way trustee income is treated to reflect the actual level of income a family has available to them. This includes the income from trust-owned companies.

- A trust-owned company will be defined as a company in which the trustees and their associates hold 50% or more of the voting interests (or market value interests).

- Trustee income will be attributed to a settlor of the trust. Trustee income will be the net income of a trust (less income distributed as beneficiary income) and the net income of trust-owned companies (less dividends from such companies).

- To avoid over-reach of this rule, the settlor for WFF purposes will exclude anyone who provides personal services for free for a trust's administration or the maintenance of the trust's property.

- If there is more than one settlor for a trust, the trustee income will be attributed to the settlors of the trust proportionally. However, if a settlor arranges for friends or relatives to be settlors to artificially dilute the attribution rule, the original settlor will be treated as the sole settlor of the trust. This is a result of the existing settlor definition (including nominee look-through rule) and anti-avoidance rule.

- Some trusts such as charitable trusts will be specifically excluded. Income from these trusts will not be attributed to the settlor for WFF purposes.

Fringe benefits

- Currently, fringe benefits are not included as income when determining WFF entitlements. In some circumstances, people can arrange a proportion of their remuneration to be paid as fringe benefits instead of wages, lowering income for WFF purposes. This may happen when the employee exercises control over the make-up of their remuneration.

- Significant fringe benefits that are easily substitutable for cash, such as motor vehicles or low-interest employee loans, will be counted as family income.

- This rule will apply only to shareholder-employees. A person will be a shareholder-employee of a company if they, together with associates, hold 50% or more of the shares in the company.

Passive income of children

Large amounts of income can be allocated to children via family trusts and companies or by investments being placed directly under their names, artificially lowering parents' income for WFF purposes.

- Under the new rules, any passive income over $500 per child per year will be counted as family income.

- Passive income for WFF purposes will include interest, dividends, royalties, rents, and a taxable Māori Authority distribution other than a retirement scheme contribution.

- Passive income will also include beneficiary income from a trust but will exclude certain types of income received such as income from certain testamentary trusts (consistent with the minor beneficiary rule).

- Wages of children will not be counted as family income.

Unlocked portfolio investment entities

- Income from unlocked portfolio investment entities (PIEs), that are easily accessible (such as cash PIEs), will be counted as family income because such income is akin to interest earned on bank accounts which are currently counted.

- Unlocked PIEs will be defined as all PIEs other than superannuation schemes that are registered with the Government Actuary, such as KiwiSaver schemes or retirement savings schemes. These schemes are excluded on the basis that the income is sufficiently locked-in until a person's retirement.

Income of non-resident spouse

- A person might live in New Zealand with their child while their spouse lives and works overseas. Because the non-resident spouse's world-wide income is available to meet the family's living expenses it will be counted as family income.

Tax-exempt salary and wages

- Tax-exempt salary and wages of people under specific international agreements will be counted as family income. Such salary and wages are available to meet the family's living expenses.

- An example would be salaries received by employees of international organisations such as the United Nations or the Organisation for Economic Co-operation and Development.

Main income equalisation scheme deposits

The main income equalisation scheme is intended to allow persons carrying on an agricultural, fishing or forestry business to smooth their income for tax purposes to address large fluctuations of income over several years. A deposit to a main income equalisation account, which is allowed as a deduction, lowers their taxable income and currently also lowers income for WFF purposes.

- Deposits entered in a person's main income equalisation account will now be counted as family income. To prevent double counting, refunds (excluding interest) from these accounts will not be counted.

Private pensions and annuities

- 50% of non-taxable private pensions and annuities will be included in family income.

Other payments

- A family may be receiving payments other than those already included in the definition of family income and that are used to meet the family's living expenses. These will also be counted, unless otherwise stated, if the total exceeds $5,000 a year. Examples of such other payments include distributions of trustee income from family trusts where the person is not the settlor of the trust and regular cash payments from family members.