Taxation (Income-sharing Tax Credit) Bill

Commentary on the Bill

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OVERVIEW

Couples with children often face a choice between both parents working full-time, employing others to care for their children, and one parent working full-time and the other staying home to care for the children, possibly on a part-time basis. For most people, financial considerations play a large role in the decision. Introducing an income-sharing tax credit is a way of enabling parents to have greater choice in their work and caring roles and more choice around their work and home-life balance.

The Taxation (Income-sharing Tax Credit) Bill introduces a new tax credit for couples with dependent children, based on sharing their incomes equally and paying tax based on half of the shared income.

The tax credit will provide additional financial support for couples where one partner is on a higher tax rate than the other. Different couples on the same level of combined income will effectively pay the same combined amount of personal income tax, regardless of how much each partner earns. The changes proposed in the bill will also mean some couples have greater choices to work fewer or more flexible hours of paid work in order to care for children, by increasing their combined after-tax income.

Eligible couples with dependent children will be able to apply for the tax credit, if they want, at the end of each tax year. The amount they receive will depend on the relative amounts of tax payable by each partner on their individual income. The tax credit will be the difference between the tax that is payable by each partner on their own incomes, and the amount of tax they would have paid if they each had an equal share in the couple's combined income. The tax credit could be used to meet any tax owing or be refunded to the couple.

The income-sharing tax credit is similar to the Working for Families tax credit and has been designed to share many of the same rules and requirements to help keep administration and compliance costs down. The bill sets out who is eligible, how the tax credit is calculated, and rules around application and payment.

Background

The topic of income sharing[1] was canvassed in April 2008 in a discussion document, *Income splitting for families with children*. Options on how to deliver the policy were discussed in an issues paper, *An income splitting tax credit for families with children* released in December 2009.

The tax credit proposed in the bill closely follows the description of the tax credit in the issues paper. Some changes have been made to reflect concerns people raised in submissions, and to simplify administration of the tax credit.

Income sharing is a key part of United**Future**'s tax policy and formed part of the Confidence and Supply agreement with the National-led Government. The objectives of the income-sharing tax credit, as stated in United**Future's** policy are to:

- give parents greater choice in their work and caring roles;

[1] Originally referred to as "income splitting" in published documents.

- acknowledge the contributions of those who forego paid work to care for children; and
- give families with children additional financial support.

ELIGIBLITY FOR THE INCOME-SHARING TAX CREDIT

(Clause 15)

Summary of proposed amendment

The bill defines who is eligible to apply for an income-sharing tax credit, and describes the treatment of the credit when couples have separated or who share care.

Application date

The new provisions will apply from 1 April 2012.

Key features

New subpart MG is being inserted in the Income Tax Act 2007 to deal with the income-sharing tax credit. Section MG 2 defines who is eligible for the credit. A person applying for the credit must be:

- in a "couple relationship" (that is, they are married, in a civil union or in a de facto relationship) for the whole of the tax year;
- both partners must be New Zealand tax-residents for the whole of the tax year; and
- either they or their partner is the principal caregiver of a dependent child. A dependant child must be:
  - aged 18 years or under; and
  - part of the applicant's family; and
  - financially dependent on the couple; and
  - not married, in a civil union or a de facto relationship; and
  - in school or tertiary education (if 18 years old).

If a couple is caring for a dependent child who is from a previous eligible relationship and there is a shared-care arrangement in place between the former partners, a former partner can still qualify as a principal caregiver if they have exclusive care of the child for at least one-third of the year (section MG 6). This is a simpler test than the one that applies to Working for Families tax credits which can apply the one-third test to four-month periods. If both former partners and their new partners meet the requirements of being in a couple relationship, are tax-resident and have at least one-third shared care of the dependent child, both new couples can apply for the tax credit. The tax credit will not be apportioned to reflect the percentage of time each former partner cares for the child. (See Example 2 later in this commentary.)

Background

The requirements for the income-sharing tax credit are similar to the eligibility requirements for the Working for Families tax credit in that a person must be resident in New Zealand and caring for a dependent child. The key difference is that the person must be in a couple relationship for the whole of the tax year, as the income-sharing tax credit is based on the sharing between partners of income earned during the tax year. The residence test must also be met by both partners for the whole of the tax year, rather than just a portion of it. However, no residence test applies to the child.

CALCULATION OF THE INCOME-SHARING TAX CREDIT

(Clause 15)

Summary of proposed amendment

The amount of the tax credit is the difference between the combined amount of tax the couple pays on their income, and the combined amount of tax they would pay if they had each earned half the couple's combined income.

Application date

The new provisions will apply from 1 April 2012.

Key features

Calculating of the tax credit amount is based on the couple sharing their income on a 50/50 basis and calculating the tax payable accordingly, as set out in section MG 3. If the tax they individually pay on their own income is greater than the tax they would pay on the notional sharing of their income, they can claim a tax credit for the difference. This notional sharing applies only for the purpose of the income-sharing tax credit – it will have no impact on any other tax requirements or payments such as child support payments or student loan repayments.

If a dependent child starts or stops being a dependent child during the tax year, then the level of the tax credit will be adjusted accordingly as outlined in section MG 5. For example, if a child turns 18 and leaves school at the end of December they will cease to be a dependent child at that point. As they qualified as a dependent child for 75% of the tax year (April to December) the couple would qualify for 75% of the tax credit.

Background

New Zealand has a progressive marginal tax rate system for income tax. This means that as an individual's income increases, the rate of tax they pay increases.

The table below shows the tax rates for different income brackets for the tax year from 1 April 2011 to 31 March 2012.

Income	Tax rate
0 – 14,000	10.5%
14,001 – 48,000	17.5%
48,001 – 70,000	30%
70,001 and over	33%

Not every eligible couple will receive an income-sharing tax credit. They will be eligible for a tax credit only if the partners face a different marginal tax rate on the income they earn. If the partners have different income levels but are still in the same tax bracket and face the same marginal tax rate, they will not benefit from the income-sharing tax credit.

Under the current tax rates and thresholds, the maximum amount of an income-sharing tax credit would be $9,080.

Special rules apply: if a partner has a tax loss, it will be ignored for the purpose of the calculation and they will be treated as if they earned no income. Other special rules apply for people who are in a transition year where the income they have earned and the tax they have paid is based on a period that is greater or less than a full 12 months – for example, when the income relates to an 18-month period.

Example 1

Stacey and Glen are eligible for an income-sharing tax credit as they have been a couple for the whole of a tax year and are both tax-residents. Glen is the principal caregiver of their four-year-old child.

Stacey earns $50,000 and pays income tax of $8,020. Stacey's marginal tax rate is 30%. Glen has had no income for the year and has paid no tax.

Their combined income is therefore $50,000 and the combined tax they paid is $8,020. Under the proposed rules, sharing their income means they each have a notional income of $25,000 and would have paid $3,395 each in tax, a combined $6,790. They would qualify for an income-sharing tax credit of $1,230 ($8,020 less $6,790).

If instead Stacey earned $30,000 and Glen earned $20,000 they would pay income tax of $4,270 and $2,520 respectively. Their combined income would be $50,000 and their combined tax would be $6,790. While eligible for an income-sharing tax credit, they would not receive any benefit from the tax credit as they are already each paying tax at the same marginal tax rate (17.5%). Sharing their income equally would not reduce the amount of tax payable.

Example 2 – When both partners are entitled to an income-sharing tax credit in a shared-care arrangement

Andy and Catherine have six-year-old twins. The couple separate in December 2012 and each enters into a new relationship in March 2013. They will not be entitled to an income-sharing tax credit for the 2012–13 tax year, the year in which they separated.

For the whole of the following tax year, Andy and Catherine care for the children in alternate weeks. As they each meet the basic requirements and are caring for their children for at least one-third of the time, both are entitled to an income-sharing tax credit for the 2013–14 tax year.

Andy is in full-time employment and earns $100,000, on which $23,920 is paid in tax. His new partner is not employed. Catherine's new partner earns $60,000, on which $11,020 is paid in tax, but she is not employed.

Splitting Andy's and his new partner's combined taxable income of $100,000 in half gives $50,000. Tax on taxable income of $50,000 is $8,020. If each were to pay this amount, their combined total would be $16,040 in tax paid.

The difference between both partners' tax on combined taxable income and the tax they would pay under income sharing is: $23,920 – $16,040 = $7,880.

As for Catherine and her new partner, splitting their combined taxable income of $60,000 in half gives $30,000. Tax on taxable income of $30,000 is $4,270. If this was paid by each, they would pay a total of $8,540 in tax.

The difference between their tax on combined taxable income and the tax they would pay under income sharing is: $11,020 – $8,540 = $2,480.

PAYMENT OF THE INCOME-SHARING TAX CREDIT

(Clause 15)

Summary of proposed amendment

When they apply for an income-sharing tax credit, couples must nominate who will receive the tax credit or whether it is to be equally shared. The Commissioner of Inland Revenue may retain some or all of the tax credit to offset other tax liabilities that the couple has, such as unpaid tax or overpayments of Working for Families tax credits.

Application date

The new provisions will apply from 1 April 2012.

Key features

Section MG 4 sets out that couples will be required to nominate if the full amount of the tax credit should be paid to one of the partners, or whether half the amount is to be paid to each of the partners.

The Commissioner of Inland Revenue may, under proposed section MG 7, also retain all or some of the tax credit under certain circumstances – for example, if the couple has an unpaid tax liability.

Background

People who qualify for Working for Families tax credits have the option of instalment payments during the year based on estimated combined family income, with an end-of-year square up process, or they can apply for an annual tax credit at the end of the tax year based on actual combined family income. Sections LA 2 to LA 7 of the Income Tax Act 2007 refer to the treatment of tax credits and the ability to use tax credits to meet unsatisfied income tax liabilities or for them to be transferred for another purpose.

The income-sharing tax credit will be available in one payment at the end of the tax year, rather than as an instalment payment throughout the year. Instalment payments are available for Working for Families tax credits because of their focus on income adequacy for low-income families. There are compliance and administration issues associated with estimating income, including incurring and repaying debt. This can be justified for Working for Families tax credits given the scheme's focus on ensuring families have adequate income.

The Commissioner of Inland Revenue will have the ability to use the amount of the tax credit to meet unpaid obligations to Inland Revenue, such as recovering an overpayment of Working for Families tax credits, an overpayment of an income-sharing tax credit from a prior year, and meeting unpaid tax liabilities. A partner could also choose to transfer their portion of the tax credit for another purpose.

CONSEQUENTIAL CHANGES

(Clause 8)

Summary of proposed amendment

A person who receives an income-sharing tax credit, or a portion of it, will not be eligible for the Independent Earners Tax Credit as this would undermine the purpose of both policies.

Application date

The provision will apply from 1 April 2012.

Key features

Section LC 13 (Tax credits for independent earners) will be amended so a person cannot claim an Independent Earners Tax Credit (IETC) if they also receive an income-sharing tax credit.

If a person had received an IETC during the year and then applied and received an income-sharing tax credit at the end of the tax year, they would no longer meet the eligibility requirements for an IETC.

Background

The IETC was introduced in 1 April 2009 to provide a tax credit to people earning between $24,000 and $48,000 in circumstances where they do not receive any other form of Government assistance such as an income-tested benefit or pension, and where they are not entitled to a Working for Families tax credit.

The income-sharing tax credit is similar to the Working for Families tax credit in that it is a tax credit to provide additional support for couples with dependent children. Therefore, a person will not be able to receive both the new income-sharing tax credit and an IETC. They would need to pay tax equivalent to the amount of IETC they had received.

TECHNICAL CHANGES

(Clauses 1 to 12, 14, and 16 to 23)

The new tax credit will require minor and technical changes to other parts of the Income Tax Act 2007 and the Tax Administration Act 1994.

To claim an income-sharing tax credit, couples will need to confirm their taxable incomes or submit a tax return for the year. An application will be required to claim the tax credit.

Definitions in the Income Tax Act 2007 are being updated to take into account the new tax credit. Provisions in these Acts that relate to tax credits are being updated to include the new income-sharing tax credit, where relevant.

The changes will apply from 1 April 2012.