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In this Budget Report

"No surprises" Budget — well, mostly

The big tax headlines were made earlier in the week, with pre-Budget announcements extending the tax rules for residential property sales.

Budget 2015 sees some additional, albeit minor, tax measures announced:

- repeal of the $1,000 KiwiSaver incentive payment
- reductions in ACC levies

- an increase of the Working for Families in-work tax credit and the abatement rate
- a clarification that payments made by the Ministry of Social Development to providers of social housing are GST-exempt
- more flexibility in dealing with penalties for child support debt, and
- "modest" tax cuts are signalled for 2017 "should fiscal and economic conditions allow".

Repeal of $1,000 KiwiSaver incentive

Effective immediately (ie from 2 pm on 21 May 2015), the $1,000 kick-start incentive for people newly enrolling in KiwiSaver has been removed.

Reductions in ACC levies

ACC levy cuts of $375 million are forecast for 2016 and an additional $120 million in 2017. If cut as forecast, the average ACC motor vehicle levy could fall to around $120 in 2016.

Working for Families scheme

Both the Working for Families (WFF) in-work tax credit and the WFF tax credit abatement rate will be increased:

- Low-income working families earning $36,350 or less a year, before tax, will get $12.50 extra a week from WFF, and some very low-income families will get $24.50 extra.
- Working families earning more than $36,350 will get extra from WFF, but it will be less than $12.50 a week, with the exact amount dependent on their family income.
- Families earning more than $88,000 a year will get slightly lower WFF payments, with the average reduction being around $3 a week.

These changes take effect from 1 April 2016.

Social housing providers — GST-exempt

The Government proposes to amend the Goods and Services Tax Act 1985 to clarify that payments made to social housing providers are GST-exempt (consistent with existing GST rules for providing residential accommodation).

More flexibility for child support debt

Inland Revenue is adopting a more flexible approach to liable parents with child support debt — with the aim of ultimately achieving greater compliance. From 1 April 2016:

- the ability to write off monthly incremental penalties will be extended to more parents, and
- the test for writing off penalties will be changed to a more pragmatic "fair and reasonable" test.

Budget 2015 tax changes announced earlier this week

Two-year window for sales of residential property

Sales of residential property will be subject to tax if bought and sold within two years. Exemptions apply for:

- taxpayers selling their family home
- inherited property, and
- property that is being transferred as part of a relationship property settlement.

An issues paper with more detail on the measures will be released in July. The new rules will apply to properties bought on or after 1 October 2015.

IRD numbers required for land transactions

Anyone buying or selling land — both New Zealand residents and non-residents — will have to provide an IRD number as part of the land registration process. All sales of land — other than sales of the main family home — will be subject to this requirement.

In addition to providing a New Zealand IRD number, non-residents will also have to:

- provide their country's equivalent of an IRD number, and
- open a New Zealand bank account.

These measures will apply from 1 October 2015.

Inland Revenue's compliance budget bolstered

Inland Revenue receives, over the next five years, an additional $74 million for compliance and enforcement on aggressive tax planning and hidden economy initiatives. $29 million is earmarked for focusing on property investment.

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Overview

Budget 2015 conveys the impression of a balanced, carefully thought out statement of the Government's financial position and priorities. There are no dramatic revelations. Instead, there is a mixture of relatively low-key business and social policy measures with no weighting in favour of any particular sector. Budget 2015 may be regarded as a "steady as we go" document.

The Budget naturally incorporates the announcements made in the lead up to its presentation. It includes a proposed reduction in ACC levies and the promise of some income tax reductions in 2017. Extension of the tax base to encompass residential property sales within two years of acquisition is also included. A fresh announcement, however, is the removal of the $1,000 kick-start for new members of a KiwiSaver scheme.

On the social policy front, there is an adjustment to the Working for Families tax credits for the benefit of low-income families. A significant write-off of child support penalty debt is also foreshadowed.

The Government has not managed to achieve its promised fiscal surplus in 2014/15, instead posting a $684 million deficit. However, the Government's operating position has continued to improve, with the fiscal deficit down by $2.2 billion from last year and a forecast surplus of $1.5 billion in 2016/17. The economic outlook is promising, with annual real GDP growth expected to average 2.8% over the next four years.

Budget night legislation

A range of legislative Bills were introduced on Budget night in order to pass some of the measures mentioned above. These include:

- Support for Children in Hardship Bill, which contains amendments to Working for Families tax credits and beneficiary obligations
- KiwiSaver Budget Measures Bill, which will repeal the $1,000 kick-start payment with effect from 2 pm on Budget day, and
- Border Processing (Arrivals and Departures) Levy Bill, which will impose the new border clearance levy on passengers.

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Fiscal and economic update

Ministerial statement

"Our fiscal strategy has been to support the economy in the short term by running deficits, but to reduce these deficits over time through tight control of spending and a strong focus on value for money.

This approach has succeeded. Core Crown expenses, for example, have fallen from 34.1 per cent of GDP in 2008/09 and are expected to drop to 30 per cent next year. The Crown's books are now in good shape, showing operating balances growing over time and debt reducing.

...

As I've said previously, the Government has no intention of making spending cuts simply to chase a surplus in a particular year.

The surplus target has been successful in applying greater discipline to government spending.

That discipline has turned the Government's books around, and the fiscal outlook remains very positive."

Editorial comment

Another National Budget has come and gone, and another promised fiscal surplus has failed to materialise.

The estimated $372 million surplus in 2014/15, as forecast in Budget 2014, has instead turned into a deficit of $684 million. Although $2.2 billion better than last year's deficit, it is nonetheless a weaker result than the Government had previously anticipated. Lower than expected tax revenues are primarily to blame.

The Government has now emphasised that the promised surplus is, in fact, merely a target to apply greater discipline to government spending. In his Budget speech, Minister of Finance Bill English argued that spending cuts will not be made simply to achieve a surplus in a particular year. However, a cynic could note that the unexpected removal of the $1,000 KiwiSaver kick-start subsidy may have been included in the Budget to help bring the deficit down.

Despite missing its target this year, the Government's fiscal position has continued to improve and its outlook for the next four years is looking healthy. The fiscal surplus is expected to grow to $1.5 billion in 2016/17, although we have of course heard such rosy assertions before.

The strengthening fiscal position will be supported by solid economic growth and a significant expected upturn in the number of jobs available. The Government estimates that a further 150,000 people will be employed by 2019, with the unemployment rate falling from the current 5.8% to an estimated 4.5% in 2017/18.

Real GDP growth was 3.3% in the year to December 2014 and is forecast to average a healthy 2.8% per annum over the next four years. In spite of strong growth, inflation was a miniscule 0.1% in the year to March 2015 and is expected to remain subdued for some time. It is well under the Reserve Bank's inflation target of 1-3%. Low inflation is expected to impact nominal wage growth, which in turn supresses growth in tax revenues. The Budget estimates core tax revenue will reach $80.5 billion (28% of GDP) in 2018/19, up from $74.9 billion (30% of GDP) in 2015/16.

A side effect of the estimated GDP growth is that the current account deficit is forecast to more than double from $6 billion in 2013/14 to a much larger $15.1 billion deficit in 2018/19 (5.3% of GDP). With net foreign liabilities expected to grow significantly over the forecast period, Bill English understandably did not highlight this feature of the economic outlook in his Budget speech.

So yet again the Budget is full of promise for a stronger fiscal future without quite delivering in the here and now. The long-awaited surplus is at risk of forever being simply a mirage in the distance, always in sight but never attained. And the saga continues, with the forecast surplus for next year dangerously thin at $176 million, which raises the question as to whether Budget 2016 will fall just short as well.

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ACC and income tax cuts

Ministerial statement

"The Government has already reduced annual ACC levies for households and businesses by $1.5 billion since 2012.

The Budget allows for further levy cuts of $375 million in 2016 and an additional $120 million in 2017.

Final decisions on the levies will be made after public consultation, but we anticipate the cuts will cover all levied accounts and therefore reduce annual costs for businesses, workers and motor vehicle owners.

As an illustration of how levies are falling, the average motor vehicle levy, including the annual licence fee and petrol levy, could fall to around $120 in 2016, which is about a third of what it is now."

"The healthy state of the books means the Government is keeping operating allowances unchanged.

These remain at $1 billion for Budgets 2015 and 2016 before rising to $2.5 billion in 2017. The higher allowance in 2017 provides options for modest income tax reductions should fiscal and economic conditions allow."

Editorial comment

The announced reduction to ACC levies is not accompanied by any detail. The detail is left to a public consultation process. It may be observed that annual reductions of $375 million and $120 million in 2016 and 2017 are unlikely to go far. To spread these amounts over the entire workforce is unlikely to result in any perceptible change for the self-employed and for employees. Under the current rate structure, employees are levied on earnings up to $118,191 and the self-employed on income up to $116,089 at a rate of $1.226 per $100 of earnings. To be meaningful to the workforce, the reduction to the thresholds and the rate would need to be far greater than the total projected reduction of $495 million over 2016 and 2017.

The indication of a possible reduction in income tax in 2017 might be seen by some as being more in the nature of a political gesture. With the adoption of any such measures being two years away, and then only if fiscal and economic conditions allow, the statement perhaps simply signals that income tax reductions, and not tax increases, is the underlying policy objective.

Nonetheless, the statement should connote that the Government recognises that fiscal discipline needs to be maintained in order to achieve the announced objective.

The Budget statement suggests one further thought: that the reference to modest income tax reductions is directed at reducing personal tax rates. The possibility of a reduction in the company rate of income tax does not appear to be contemplated. Any such reduction is likely to be very modest regarding that taxpaying sector.

The company tax rate can be expected to be important in any planning of the country's tax rate structures. To attract foreign investors to invest in New Zealand, maintaining an internationally competitive rate of corporate income tax is desirable. There is always downward pressure on the corporate tax rate, as national governments use this as a tool to facilitate foreign investment.

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Confirmation of the two-year rule for property sales

Ministerial statement

"As previously announced, the Budget contains measures to bolster and enforce the tax rules on property.

This is to ensure that people buying and selling properties for a profit — including foreigners — are paying their fair share of tax.

In particular, some people will now have to provide an IRD number when they buy and sell property.

This requirement will apply to all non-residents, and to New Zealanders who are buying and selling a property that's not their main home.

In addition, if someone sells a residential property within two years of purchase they will now have to pay income tax on any profit they make from the sale.

There will be some exceptions, including for a person's main home.

The Government will consult on these changes, and implement them from 1 October. The Budget also contains a funding boost of $74 million over five years for extra tax compliance and enforcement, of which $29 million is focused on property investment. The new tax measures we are introducing will help to take some of the pressure off Auckland's housing market."

Editorial comment

The Budget confirms the prior announcement of the measure aimed at trying to reduce house price inflation in the Auckland residential property market. By this measure the income tax base will be extended to include residential property sold within two years of purchase if the property is not the taxpayer's main home. Exceptions for testamentary and relationship property breakdown scenarios will apply.

The accompanying press release states that the proposed measure will apply to property purchased after 30 September 2015. In other words, properties purchased prior to the commencement date are subject to the existing rules providing for taxation on the limited scenarios of purchase with the intention of resale or other exploitation of the land.

Prophecies on the likely success of the measure have tended to overshadow one important aspect. This is the proposal that a purchaser of residential property from a non-resident vendor will be required to withhold tax from the purchase price. The circumstances in which withholding will be required are not articulated in the Budget press releases, but presumably the withholding circumstances will refer to possible breach of the two-year retention rule and other scenarios where the sale proceeds may be subject to income tax.

The sense of a proposal of this kind would seem to warrant further scrutiny. The area of particular sensitivity is whether it is appropriate to expose purchasers of residential property to a withholding regime, and New Zealand's accompanying harsh penalty regime, in relation to obligations that purchasers are likely to be ill-equipped to assess. It seems onerous to require, say, young first-home buyers to make judgments on withholding tax questions. Withholding regimes are typically applied in the business sector, where a working familiarity with taxing concepts can be expected. Imposing a tax collection responsibility on those unlikely to faithfully meet the obligations could perhaps be considered as taking the zeal to collect taxes too far. There is, after all, an elusive logic to increasing the funding for Inland Revenue audit activities but at the same time expecting the general public to act as tax collectors.

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KiwiSaver kick-start ended

Ministerial statement

"The KiwiSaver scheme has been successful in attracting 2.5 million members.

It also has considerable costs, with the Government spending over $850 million this year on two subsidies — the annual subsidy of up to $521, and the $1,000 kick-start payment for new members.

To reduce this cost, the Government has decided to remove the kick-start payment, which has cost taxpayers a total of $2.5 billion since the scheme began.

This change is effective immediately, but I want to stress that it does not affect existing KiwiSaver members in any way.

The other incentives in the scheme — matching employer contributions and the annual government subsidy — will remain as they are.

These incentives also provide a strong reason to join KiwiSaver. Removing the kick-start payment for future enrolments will save over $500 million over the next four years, with little or no effect on the number of people expected to join the scheme."

Editorial comment

Removal of the KiwiSaver kick-start payment is perhaps one area of genuine surprise in the Budget. Such a significant change was not signalled in the pre-Budget release of changes Ministers had indicated would be announced in the Budget.

The rationale for removal of the KiwiSaver kick-start raises an interesting dynamic with other Budget changes. The rationale is premised on the assumption that this particular government subsidy does not influence behaviour (ie that members of the workforce and other persons in all likelihood will continue to join KiwiSaver despite absence of the kick-start contribution).

A contrast may be seen with the measure to extend the income tax base to gains on the sale of residential property, not being the main home, if sale is within two years of purchase. This strategy could be seen as using a taxation lever to try to cool an over-heated residential property market.

It seems to be thought that the Government cannot influence the uptake in KiwiSaver membership but that it is possible to influence the investment levels in residential housing.

Removal of the kick-start payment may prompt some concern about long-term government support for the KiwiSaver system. Government support now consists of the annual subsidy of $521, the exemption for Australasian share sale profits and the top tax rate of 28%. Should the current sentiment that people will always join KiwiSaver regardless become further entrenched, the areas of concession may well be further whittled away. The concern would be that over time KiwiSaver may become a comprehensively taxed savings system that does not enable members to accumulate significant balances for retirement.

One additional dimension to removal of the kick-start contribution could be the implications for the voluntary membership feature of KiwiSaver. In the past, compulsory membership of KiwiSaver was resisted on the ground of excessive fiscal cost. That perspective loses its force when removal of the kick-start contribution significantly diminishes the fiscal cost.

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New border clearance levy

Ministerial statement

"The Government will introduce a new levy to fund passenger-related biosecurity and customs activities at our border. Currently, the cost of these activities — which protect New Zealand from imported pests, diseases, illegal drugs and other threats — are met by taxpayers.

The Government considers it fairer for the cost to fall on travellers, as happens in many other countries. A per-passenger levy also helps ensure that border services are funded to meet future demand.

The new Border Clearance Levy is expected to take effect from 1 January 2016 and, subject to consultation, will be around $16 for arriving passengers and around $6 for departing passengers. It will raise around $100 million a year.

At the same time, the Budget expands some border activities, including an additional $25 million over four years for more biosecurity services such as x-ray machines and detector dogs.

The Budget also provides $33 million over four years for more immigration staff at a time of record-breaking visitor numbers."

Editorial comment

This proposal appears to be relatively self-explanatory. As part of the user-pays approach to the provision of government services, incoming and outgoing passengers will have to pay for the privilege of customs officers checking that their papers are in order. Some passengers in the queue may be able to draw comfort from the thought that this measure is all for a good cause.

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Working for Families credit adjustments

Ministerial statement

"While two-thirds of children in more severe material hardship live in beneficiary families, the other third live in low-income working families.

So on 1 April next year, there will also be changes to Working for Families, to give more financial support to lower-income working families not on a benefit. As a result:

- Low-income working families earning $36,350 or less a year, before tax, will get $12.50 extra a week from Working for Families, and some very low-income families will get $24.50 extra.
- Working families earning more than $36,350 will get extra from Working for Families, but it will be less than $12.50 a week, with the exact amount dependent on their family income.

- Families earning more than $88,000 a year will get slightly lower Working for Families payments, with the average reduction being around $3 a week.

In total, these changes to tax credits will benefit around 200,000 lower-income working families who are not dependent on benefits. Around 50,000 of these families earn $36,350 or less a year, and will therefore get the full $12.50 a week increase."

Editorial comment

These proposals appear to be directed at more sharply focusing the Working for Families tax credit. Noticeable increases in the tax credit are to be made available for those on a low income, with a shaving of the credit for those at the other end of the income scale. The adjustments are scheduled for introduction on 1 April 2016.

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Child support penalty write-off

Ministerial statement

"The Budget includes measures to tackle child support debt and encourage parents to pay what they owe for their children.

Currently, large penalty debts are discouraging many parents from paying any child support at all.

This penalty debt, or a portion of it, will now be forgiven in certain circumstances, including where liable parents are meeting their payment requirements.

If maximum discretion is applied, this will result in $1.7 billion of penalties being forgiven over four years.

The cost to the Crown is an estimated $47 million over four years, as most of the penalty debt is already reflected as an impairment in the Government's books.

There will continue to be no tolerance for parents who deliberately avoid responsibility."

Editorial comment

The Budget statement may be taken as acknowledging that the penalty settings for the child support regime are incorrect. It was never clear thinking to take the penalty regime that applies for business taxpayers and transplant it into a social policy area such as child support.

There appears to be some recognition that a harsh penalty regime is not confined to child support. The Government 2015/16 tax policy work programme contains a component for encouraging better compliance with tax obligations. The detail of that work is said to be to review the interest, penalty and debt rules together with a consideration of the options to better encourage the filing of returns and payment of tax. It is to be hoped that a loosening, rather than a tightening, of the screws is envisaged.

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Non-tertiary education receives a further $687 million

Ministerial statement

"Educational achievement is improving, supported by government investment that is focused on getting better results.

In Budget 2015, early childhood, primary and secondary education together receive an additional $443 million of new operating funding and $244 million of capital."

Editorial comment

The Government has allocated $443 million of new operating funding for early childhood, primary and secondary education.

Additional operating funding of $75 million over four years will be specifically for early childhood education, in addition to the extra $156 million funding over four years for early childhood education announced in Budget 2014. The extra funding will enable more children to attend early childhood education facilities for more hours.

School operating grants will receive an additional $42 million, which the Government estimates will boost the operational grants by 1%. School operating grants also received an $85 million funding boost over four years in Budget 2014.

Children with special education needs will receive an extra $63 million over four years, which includes more teacher aid support. This is expected to be able to support a further 1,500 special needs students.

On top of the extra operating funding, $244 million has been earmarked from the Future Investment Fund to provide an additional 240 classrooms by building new schools and expanding existing schools.

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Health boost for specialist services

Ministerial statement

"Despite fiscal challenges, a priority in every Budget has been to increase funding for health and education.

This year's Budget invests $1.7 billion of operating funding in health over the next four years.

As a result, District Health Boards will have around $320 million available next year for extra services and to help meet cost pressures and population growth."

Editorial comment

National health spending will amount to $15.6 billion in 2015/16, being 21% of core Crown expenses of $74.9 billion. This is the second largest component of spending after social security and welfare. Budget 2015 continues to invest further in health, with specialist areas in particular benefiting from an increase in government funding.

The greatest allocation of spending, some $1.3 billion, will go towards district health boards to help relieve cost pressures from a growing and ageing population. A further $98 million will be used to address the backlog in elective surgeries and to assist those with orthopaedic conditions.

The bowel cancer screening pilot, which was established in October 2011 to run for four years, will be extended at a cost of $12 million. The screening is available for persons aged 50 to 74 who qualify for publicly funded healthcare and live in the Waitemata District Health Board area.

$76 million in funding will be directed towards providing better care services for people with serious illnesses and their families. The funds will support hospices and 60 new palliative care nurses. Lastly, very high-needs students with disabilities will benefit from an extra $4 million per year over four years, which will be used to provide support after they leave school.

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Future Investment Fund allocates $939 million

Ministerial statement

"New capital investment of $939 million is provided from the Future Investment Fund.

This includes a contingency of up to $210 million for additional investment to bring Ultra-Fast Broadband to 80 per cent of New Zealanders.

The Telecommunications Development Levy is also being extended to provide $150 million for major improvements in rural broadband.

The Budget includes a contingency of up to $52 million to replace the Waitangi Wharf on the Chatham Islands, which is a critical lifeline for one of New Zealand's most remote communities.

KiwiRail receives $210 million in new capital next year, and a further $190 million as a pre-commitment against Budget 2016. This support gives KiwiRail a two-year window to identify savings, as this level of on-going support is not sustainable.

As previously announced, the Budget also provides $97 million in capital for regional highways and $40 million for urban cycleways."

Editorial comment

The Future Investment Fund is the name given to earmarked proceeds from the partial privatisation of Air New Zealand, Genesis, Meredian Energy and other power companies, which in total amounted to $4.7 billion.

Previous Budgets have already consumed $3 billion of this amount on various priority infrastructure projects, such as hospitals, schools and the Canterbury rebuild.

Budget 2015 continues this approach by allocating $939 million to new capital investments. A significant proportion will be spent on transport, with $137 million directed towards new regional roads and urban cycleways and $210 million to prop up KiwiRail and assist in maintaining some form of national rail network.

Internet connectivity gets a boost with a $210 million contingency towards the roll out of ultra-fast broadband to more New Zealanders.

The Canterbury region continues to benefit from the Fund, with $100 million to be used for rebuilding science facilities at Lincoln University.

After Budget 2015 there will be $726 million remaining in the Fund, of which $190 million has already been committed to KiwiRail. Budget 2016 will see the last of the proceeds from the share sales being used. Future priority infrastructure investments will no doubt need to be funded from general Budget spending.

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Research assistance

Ministerial statement

"Budget 2015 increases the Government's investment in tertiary education, research and innovation, which are important drivers of economic growth.

The Budget provides up to $25 million over three years to support the establishment of new, privately-led Regional Research Institutes, to support increased innovation in regional areas outside of Auckland, Wellington and Christchurch.

As announced previously, the Budget will also give an $80 million boost over four years to R&D growth grants, which support innovative businesses by contributing 20 per cent of their R&D costs.

The additional funding announced in Budget 2015 will bring the Government's total investment in science and innovation to over $1.5 billion in 2015/16."

Editorial comment

The Budget papers do not add any detail to these proposals: it is to be hoped that once the detail is finalised it reflects a sensible deployment of public moneys.

The Government no doubt has some responsibility for job stimulation, and it is to be hoped that the proposed measures sensibly direct resources towards that end.

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Forestry grant scheme

Ministerial statement

"A new grant scheme has been established to encourage the planting of new forests, and the Budget provides $22 million for this scheme over the next six years."

Editorial comment

The Budget did not make clear which new forest plantings could expect to be the beneficiaries of the $22 million spending.

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