

The Treasury

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Tax policy report: Working for Families: update on Budget 2025 proposals

Date:	27 February 2025	Priority:	High
Security level:		Report number:	IR2025/073 T2025/480 REP/25/2/131

Action sought

	Action sought	Deadline
Minister of Finance	Agree to recommendations	6 March 2025
Minister for Social Development and Employment/Minister for Child Poverty Reduction	Agree to recommendations	6 March 2025
Minister of Revenue	Agree to recommendations	6 March 2025

Contact for telephone discussion (if required)

Name	Position	Telephone	Suggested first contact
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27 February 2025

Minister of Finance
Minister for Social Development and Employment
Minister for Child Poverty Reduction
Minister of Revenue

Working for Families: update on Budget 2025 proposals

Purpose

1. This report seeks Ministers agreement to a Working for Families Budget 2025 package, including cost offsetting options.

Context

2. This report provides further advice on the Working for Families Budget 2025 workstreams, following the update provided on 20 February 2025 [*IR2025/045, T2025/383, REP/25/2/095 refers*]:
 - 2.1 Workstream 1: changes to the Best Start Tax Credit (Best Start)
 - 2.2 Workstream 2: increasing the Working for Families abatement threshold and rate.

Workstream 1 and 2: changes to the Best Start Tax Credit and increasing the Working for Families abatement threshold and rate

3. Officials are seeking Ministers' agreement to a package that increases the abatement threshold for the Family Tax Credit and the In-Work Tax Credit components of the Working for Families scheme. The cost of the package can be primarily offset through income-testing the first year of Best Start.
4. Income testing the first year of Best Start would deliver cost savings of \$211 million over the forecast period. This proposal would involve using the abatement settings that are currently used for the second and third years of payment. This change would remove the universal component of Best Start, and entitlements would abate by 21% for income over \$79,000 for all three years. We note that, as a result of this change, the first year of Best Start would abate at the same time as other Working for Families tax credits. This abatement already occurs for the second and third years of Best Start.
5. Alongside the changes to Best Start, the Working for Families abatement threshold could be increased from 1 April 2026 to either:
 - 5.1 Option 1: \$44,900, if also combined with a 0.5% increase to the Family Tax Credit and In-Work Tax Credit abatement rate (to 27.5%), or
 - 5.2 Option 2: \$45,000, if also combined with a 0.5% increase to the Family Tax Credit and In-Work Tax Credit abatement rate (to 27.5%) *and* an increase to the Schedule 31 income bands from \$1,500 to \$3,000 (discussed in paragraphs 7-12).

6. The packages are effectively fiscally neutral. Another revenue raiser option is shifting the four+ child rate for the In-Work Tax Credit to five+ children (discussed in paragraphs 13-14). We do not recommend this option due to the drawbacks for larger families.

Increasing the Schedule 31 income bands (recommended as part of option 2)

7. Income bands are intended to provide customers with a buffer against overpayments and debt resulting from annual income estimations that are too low. A customer's income estimation is located within a particular income band and is then deemed to be at the top of that band. The increased estimation is used to determine entitlements that are received during a tax year.
8. The current bands are in \$1,500 increments. For example, if someone's income estimate is between \$48,500 and \$50,000, their in-year entitlement is calculated using income of \$50,000. The actual buffer varies from customer to customer, depending on where they are in the income band – someone could have an income buffer of \$1, whereas someone else could have one of \$1,499.
9. The Schedule 31 income bands have become a less effective buffer over time due to wage growth. Increasing the income bands from \$1,500 increments to \$3,000 increments would update this setting. For example, this means that people who estimate annual incomes between \$45,000 and \$48,000 would be treated as if they earned \$48,000 for the purpose of calculating their in-year entitlement. Exact income would still be used for the year-end square-up.
10. This change would provide some customers with a greater buffer against overpayments. This change is in line with Ministers' debt reduction objective. While it would decrease weekly payment amounts and could increase the size and number of underpayments, Inland Revenue research has found that customers generally prefer certainty of payments over debt. The resulting cost saving of \$9 million over the forecast period would be due to a reduction in debt write-offs.
11. Increasing Schedule 31 income bands does not change how the policy functions. Some income buffers for recipients will not change. The impact of the change in income bands is seen in the two examples below.

Example 1

Libby and Jack have two children. Libby is a full-time worker and Jack is a stay-at-home dad. Libby and Jack apply for Working for Families. They provide an estimate of their annual family income, which they've worked out to be \$66,400 per year from Libby's salary.

Under the current income bands (\$1,500 increments), Libby and Jack are in the \$65,000 to \$66,500 income bracket. Their income estimation is rounded up \$66,500 to calculate their payments during the year. This gives them a small income buffer of \$100.

If the income bands were increased (\$3000 increments), Libby and Jack would be in the \$65,000 to \$68,000 band. Libby and Jack's estimation would be rounded up to \$68,000. This gives them a buffer of \$1,600.

Libby and Jack will be squared up at the end of the year using their actual income but would receive slightly less week to week entitlements during the year because of their slightly higher income estimate.

Example 2:

Kate and Lio have two children. Lio works full time and Kate works part time. Kate and Lio apply for Working for Families. They provide an estimate of their annual family income, which they have worked out to be \$67,500 from their joint incomes.

Under the current income bands (\$1,500 increments), Kate and Lio are in the \$66,500 to \$68,000 band and their income estimation is rounded up to \$68,000 to calculate their entitlements. This gives them an income buffer of \$500.

If the income bands were increased (\$3,000 increments), Kate and Lio would be in the \$65,000 to \$68,000 band. Kate and Lio's estimation would be rounded up to \$68,000 – the same as before. This again gives them a buffer of \$500.

Kate and Lio will be squared up at the end of the year using their actual income.

12. We also considered replacing the Schedule 31 income bands with a "percentage uplift", whereby the debt buffer provided is calculated using a set percentage of a recipient's income estimation. We do not recommend this option at this stage. When compared to the income band changes, the percentage uplift changes the current policy approach to mitigating debt and has a higher administration cost to implement.

Shifting the four+ child In-Work Tax Credit rate to five+ children (not recommended)

13. Families receiving the In-Work Tax Credit with four or more children receive an extra \$15 per week per child for their fourth and subsequent children. This extra amount is on top of the base In-Work Tax Credit amount of \$97.50. In the 2023 tax year approximately 18,185 families with four or more children received the In-Work Tax Credit during the year.
14. Shifting eligibility for the extra amount to the fifth child and subsequent children in a family would deliver additional cost savings of \$36 million over the forecast period. This could be progressed as a revenue raiser in addition to options one or two. However, we do not recommend this option due to the negative impacts on larger families. Under this option, every family with four or more children would only be entitled to the base amount and therefore would receive less than under current settings.

Distributional impacts of workstreams 1 and 2

15. The Treasury has estimated the distributional impacts of the changes proposed under workstreams 1 and 2 in the 2027 tax year. In terms of packages of changes:
 - 15.1 Income testing the first year of Best Start, increasing the Working for Families abatement threshold to \$44,900 and changing the abatement rate to 27.5% is estimated to lead to:
 - Around 142,000 families receiving an average increase of \$14 per fortnight. Of these families, 85% have taxable income below \$100,000.
 - Around 61,000 families receiving an average decrease of \$43 per fortnight when compared to current policy settings. Of these families, 89% have taxable incomes over \$100,000.

- 15.2 Income testing the first year of Best Start, increasing the Working for Families abatement threshold to \$45,000 and changing the abatement rate to 27.5% is estimated to lead to:
- Around 142,000 families receiving an average increase of \$15 per fortnight. Of these families, 85% have taxable incomes below \$100,000.
 - Around 60,000 families receiving an average decrease of \$44 per fortnight when compared to current policy settings. Of these families, 90% have taxable incomes over \$100,000.
16. Inland Revenue has estimated that income testing the first year of Best Start will result in a 49% decrease in first year recipients (47,000 families become ineligible). This means that the total number of Working for Families recipients will decrease by 13% (from 324,000 to 282,000 families).
17. In addition, approximately 7,100 families with children aged 0-1 years would receive an abated amount of Best Start, reducing their Best Start payments by an average of \$33 per fortnight compared to current policy settings. Of these impacted families, approximately 4,300 families will be newly subject to Best Start abatement (i.e. they do not receive the second or third year of Best Start for any other children). Note that, under the status quo, these 4,300 families would have been subject to Best Start abatement once their child turned 1 year of age.
18. The Treasury have also estimated that income testing the first year of Best Start, increasing the Working for Families abatement threshold to \$45,000, changing the abatement rate to 27.5%, *and* shifting the four + child In-Work Tax Credit rate to five children would lead to:
- Around 130,000 families receiving an average increase of \$15 per fortnight. Of these families, 88% have taxable incomes below \$100,000.
 - Around 74,000 families receiving an average decrease of \$39 per fortnight when compared to current policy settings. Of these families, 80% have taxable incomes over \$100,000.
19. For all options, almost all families that receive less income are two-parent families. Families currently receiving Best Start would be unaffected by these changes.
20. The Best Start and abatement settings changes will have little to no direct impact on Ministry of Social Development (MSD) clients or MSD's administration of Working for Families entitlements. Modelling suggests these changes do not have a significant impact on child poverty when considering the two income poverty measures.
21. Removing the universal component of Best Start could have a small negative impact on material hardship, given that children in families in material hardship can be found higher up the income spectrum. However, we consider any overall impact on rates would be small.

Administrative implications for Inland Revenue and MSD

22. Both packages assume a 1 April 2026 implementation date. Implementation and ongoing administrative costs for Inland Revenue and MSD partially offset fiscal savings. Agency capacity to implement the package depends on final decisions for all Budget 2025 initiatives.

23. The table below sets out the administration costs for the Working for Families abatement threshold and rate changes (the changes to the Schedule 31 income bands can also be made within this cost envelope).

	\$ Million – increase (decrease)					
Abatement threshold and rate changes	2024/25	2025/26	2026/27	2027/28	2028/29 & outyears	Total
One-off implementation	-	0.300	-	-	-	0.300
Ongoing administration	-	0.140	0.320	0.160	0.120	0.740
Total operating	-	0.440	0.320	0.160	0.120	1.040
Capital injection	-	0.500	-	-	-	0.500
Total capital impact	-	0.500	-	-	-	0.500

24. The table below sets out the administration costs for the Best Start changes (including costs associated with updates to SmartStart).

	\$ Million – increase (decrease)					
Best Start changes	2024/25	2025/26	2026/27	2027/28	2028/29 & outyears	Total
One-off implementation	0.100	0.850	-	-	-	0.950
Ongoing administration	-	0.550	0.800	0.500	0.400	2.250
Total operating	0.100	1.400	0.800	0.500	0.400	3.200
Capital injection	0.100	1.400	-	-	-	1.500
Total capital impact	0.100	1.400	-	-	-	1.500

Financial implications

25. The table below sets out fiscal costs and savings for all options:

	June year fiscal cost / (fiscal saving) (\$m)				
Options	2025/26	2026/27	2027/28	2028/29	Total
Income test first year of Best Start	(14.000)	(58.000)	(68.000)	(71.000)	(211.000)
Increase Working for Families abatement threshold by \$2,200 to \$44,900, AND Increase Working for Families abatement rate to 27.5%	15.000	63.000	64.000	63.000	205.000
Increase Working for Families abatement threshold by \$2,300 to \$45,000, AND Increase Working for Families abatement rate to 27.5%	16.000	67.000	68.000	67.000	218.000
Reducing risk of WFF overpayments and debt: increase Schedule 31 bands from \$1,500 to \$3,000	-	[33]			
Change eligibility for IWTC payment of \$15 per week for an extra child from 4+ children to 5+ children	(3.000)	(11.000)	(11.000)	(11.000)	(36.000)

26. Taken together with the administration costs in the previous section, there are two effectively fiscally neutral packages for Ministers to consider:

Option	Package A	Package B
Components	Income test first year of Best Start; Increase WFF abatement threshold to \$44,900 and abatement rate to 27.5%	Income test first year of Best Start; Increase WFF abatement threshold to \$45,000 and abatement rate to 27.5%; Increase Schedule 31 band to \$3,000
Cost (saving) over forecast period	(\$2 million operating), \$2 million capital	\$2 million operating, \$2 million capital

Next steps

27. The Budget meeting on 5 March 2025 provides an opportunity to discuss this report.
28. Officials will also continue to provide updates on Budget 2025 initiatives including confirming final costings.

Recommended action

We recommend that you:

1. **note** that, following feedback from the Minister of Finance's office, officials have developed a Working for Families package for Budget 2025 that involves:
 - 1.1 income testing the first year of the Best Start Tax Credit,
 - 1.2 other savings from changes to Working for Families, such as a slight increase to the abatement rate, and
 - 1.3 using the savings generated to fund an increase in the Working for Families abatement threshold
2. **agree**, in combination with income testing the first year of the Best Start Tax Credit, to either

(PACKAGE A):

- 2.1 Increase the Working for Families abatement threshold by \$2,200 to \$44,900 and increase the abatement rate to 27.5%

Yes / No

Minister of Finance

Yes / No

Minister for Social Development and
Employment

Minister for Child Poverty Reduction

Yes / No

Minister of Revenue

OR (PACKAGE B):

- 2.2 Increase the Working for Families abatement threshold by \$2,300 to \$45,000, increase the abatement rate to 27.5%, AND increase the Schedule 31 income bands by \$1,500 to \$3,000

Yes / No

Minister of Finance

Yes / No

Minister for Social Development and
Employment

Minister for Child Poverty Reduction

Yes / No

Minister of Revenue

3. **indicate** whether you would like to progress with shifting the In-Work Tax Credit four-child rate to five children (not recommended)

Yes / No

Minister of Finance

Yes / No

Minister for Social Development and
Employment

Minister for Child Poverty Reduction

Yes / No

Minister of Revenue

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