New Zealand's Family Assistance Tax Credits: Evolution and Operation

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Abstract

The Family Assistance Tax Credits provide income-tested (and in some cases work-tested) financial assistance for families with financially dependent children who are living at home. This paper describes the evolution and operation of the Family Assistance programmes. This description clarifies how these programmes have evolved and operate and provides a basis for future research.

The topics discussed in this paper are as follows: the programmes that preceded the Family Assistance programmes; the changing levels of assistance, abatement regimes and eligibility criteria for each of the Family Assistance programmes; the roles of the Inland Revenue Department and the Ministry of Social Development in administering the Family Assistance programmes; the definitions of income in operation in the social welfare and tax systems, the calculation of the taxation and abatement of social welfare benefits and the calculation of Family Assistance entitlement; the calculation of the impact of the Family Assistance programmes on the financial rewards from work; and the fiscal cost to the government of the social assistance system in general and the Family Assistance programmes in particular.

JEL CLASSIFICATION H55 (social security and public pensions), I38 (government programmes; provision and effects of welfare programmes)

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New Zealand's Family Assistance Tax Credits: Evolution and Operation

1 Introduction

The Family Assistance Tax Credits provide income-tested (and in some cases work-tested) financial assistance for families with financially dependent children who are living at home. Although these programmes are referred to as tax credits, they are instead refundable tax rebates. Thus where the value of a family's entitlement exceeds its tax liability, the family receives a cash payment.

This paper describes the evolution and current operation of New Zealand's Family Assistance Tax Credits. The purpose of a descriptive paper such as this is to clarify how these programmes have evolved and operate and to provide a basis for future research.

In the period between the enactment of the Pensions Act 1898 and the 1984 election of the fourth Labour government, the evolution of New Zealand's social assistance system was guided by social and political desires to alleviate poverty and hardship. After 1984 an increased emphasis on controlling fiscal costs was seen in the increased targeting of programmes, declining real levels of assistance and more active encouragement of work and independence from the state [McClure, 1998, pp. 1-9; Stephens *et al*, 2001, pp. 77-78]. The Family Assistance Tax Credits were established in the period after 1984. In 1999 a Labour-Alliance coalition government was elected. This government embarked on a search for a new social policy direction in New Zealand and released a discussion document entitled *Pathways to Opportunity: From Social Welfare to Social Development* [Clark *et al*, 2001]. One issue identified by this discussion document was the need to review the role that the Family Assistance Tax Credits have played and can play in New Zealand's social assistance system [Clark *et al*, 2001, p. 15].[1]

The structure of the paper is as follows. Section 2 describes programmes that preceded the Family Assistance Tax Credits. Section 3 discusses the changing levels of assistance, abatement regimes and eligibility criteria for each of the Family Assistance programmes. This discussion is followed by a summary of the current programmes. Section 4 describes the roles that the Inland Revenue Department and the Ministry of Social Development play in administering the programmes. This section also discusses the process of registering for assistance, accuracy of payments, indexation of thresholds and take-up of assistance. Section 5 explains the different definitions of income in operation in the social welfare and tax systems. The calculation of the taxation and abatement of social welfare benefits and the calculation of Family Assistance entitlement are also explained in section 5. Section 6 discusses the consequences of the Family Assistance programmes for the financial rewards from work, and demonstrates these incentives through calculating Effective Marginal Tax Rates and a Budget Constraint. Section 7 discusses the fiscal cost to the government of the social assistance system in general and the Family Assistance programmes in particular. This section also discusses the distribution of the expenditure on Family Assistance among household deciles and comparisons between expenditure through the tax system in New Zealand, the United States and the United Kingdom. Section 8 contains a general conclusion. Figures on the

[1] Changing the role of tax assistance in the social security system has been a prominent feature of recent welfare reform in countries such as Australia, the United Kingdom, Canada and the United States.

levels of assistance and abatement regimes at the dates of policy change are included as an appendix to this paper.

2 Antecedents to the Family Assistance Programmes

The Family Benefit was a key antecedent to the Family Assistance Tax Credits. A system of family allowances was introduced in 1926. These allowances were limited to large families on low incomes. During the 1930s and 1940s these family allowances were extended in scope. In 1946 the universal Family Benefit was established. This programme was designed to redistribute income to all families with children, not only to alleviate poverty [Royal Commission on Social Policy, 1988, pp. 5-6]. The level of the benefit was not indexed for inflation. The real value of the benefit was therefore vulnerable to erosion. The Royal Commission on Social Policy [1988, p. 5] estimated that by 1988 the real value of the benefit was 35 percent of its 1979 value. The operation of the benefit is described in Table 1.

Table 1: Antecedents to the Family Assistance Programmes

The Family Benefit	Established in 1946. Paid to principal caregivers. The benefit was universal (not targeted by income). In 1976 the value of the payment was $3 per week ($156 per annum) per child. The value increased to $6 per week ($312 per annum) in 1979 and remained at this level until 1991, when the benefit was merged with Family Support. Between 1976 and 1989, eligibility was automatic for children sixteen years or under. The benefit could also be received for older children undertaking schooling. Between 1 January 1989 and 1 April 1991 the automatic qualifying age was lowered to fifteen.
The Young Family Rebate	Established in 1976. Paid to principal income earners of low-income families with a child under five. In 1976 the maximum value was $6 per week ($312 per annum). The value was increased to $9 per week ($468 per annum) in 1977. Abated against the principal income earner's income in excess of $13,7100. The level of the rebate did not vary with the number of children.
The Spouse Rebate	Established in 1976 (replacing the Dependent Spouse Tax Exemption). Paid to principal income earners. The maximum value was $3 per week ($156 per annum). Abatement began once secondary earners' incomes reached $10 per week ($520 per annum). The level of the rebate did not vary with the number of children.
The Single-Income Family Rebate	Established in 1977. Paid to income earners of low- and single-income families with a child under ten. Extended to qualifying families with a child under twelve in 1978. The value of the payment was $4 per week ($208 per annum). The level of the rebate did not vary with the number of children.
The Low-Income Family Rebate	Established in 1981 (replacing the Single-Income Family Rebate). Paid to principal income earners and sole parents. The rebate abated against total family income. Abatement began once the family income reached $9,800.
The Family Rebate	Established in 1983 (replacing the Spouse Rebate, the Young Family Rebate and the Low-Income Family Rebate). Paid to principal income earners of working families with a dependent child. The maximum value was $27 per week ($1,404 per annum). Abatement began when joint household annual income reached $9,800. The level of the rebate did not vary with the number of children.
The Principal Income Earner Rebate	Established in 1983. Paid to principal income earners of families without children and families with children (if the level of this rebate exceeded the value of the Family Rebate). Families could not receive both the Principal Income Earner Rebate and the Family Rebate. Abatement began when the individual assessable income of the principal earner reached $6,118.
Family Care	Established in 1984. Paid to principal caregivers of working families. The maximum value was $10 per week ($520 per annum) per child. Abatement began once family income exceeded $20,470.

As well as the Family Benefit, a number of small tax rebates that aimed to assist low-income families with the cost of children preceded the introduction of the Family Assistance Tax Credits [Koopman-Boyden *et al*, 1984, pp. 63-65, 144-145]. Table 1 also describes the tax rebates that were in operation during the ten years prior to the introduction of Family Assistance. These rebates were limited to working families and (with the exception of Family Care) were paid to principal income earners and did not vary according to the number of children in the family. Families with children but who received social welfare benefits, and thus were not eligible for these rebates, could receive supplementary assistance in the form of the Family Maintenance Allowance.

3 Evolution of the Family Assistance Programmes

The changing levels of assistance, abatement regimes and eligibility criteria for each of the Family Assistance programmes are discussed below. This discussion is followed by a summary of the current programmes. These refundable tax rebates can be paid either at the end of the income tax year or in fortnightly instalments during the year. In some years policy changes to annual figures came into effect during the income tax year. Figures on the levels of assistance and abatement regimes are provided as annual amounts for the income tax year (1 April to 31 March) in the body of this paper. Where policy changes came into effect during the income tax year composite rates (composites of the proportion of the year at the old rate and the proportion at the new rate) are provided. Figures on the levels of assistance and abatement regimes at the dates of policy change are included as an appendix to this paper.

3.1 Family Support

Family Support replaced Family Care, the Family Rebate, the Principal Income Earner Rebate and the Family Maintenance Allowance on 1 October 1986. Family Support is a refundable tax rebate available to low-income families irrespective of their work status. The level of the unabated entitlement is based on the number of children in the family. The entitlement for the eldest child in a family is greater than the entitlement for additional children. Further, since 1 April 1988 entitlement has reflected children's ages, with entitlement for older children being greater than that for younger children.[2]

From 1 October 1986 to 1 April 1991, families qualified for Family Support if they qualified for the Family Benefit (see Table 1). The Family Benefit was merged with Family Support on 1 April 1991. With the discontinuation of the Family Benefit, new eligibility criteria for Family Support were introduced. These new criteria were based on responsibility for the day-to-day care of dependent children.

Between 1 October 1986 and 1 April 1990, Family Support payments were split equally between spouses in two-spouse households. Since 1 April 1990, Family Support payments have been paid to principal caregivers only. A principal caregiver is a person who is deemed to have responsibility for the day-to-day care of a dependent child other than on a temporary basis.

[2] Where a child's age group changes during the income tax year, the annual Family Assistance entitlement is a weighted average reflecting the proportions of the eligible period the child is at the younger and older ages.

Table 2: Family Support Unabated Entitlement and Abatement Regime (Year to 31 March)

Income Tax Year (1 April to 31 March)	Age of Child	Unabated Entitlement: Annual Entitlement – Eldest Child	Unabated Entitlement: Annual Entitlement – Additional Children	Abatement Regime: Abatement Threshold – Annual Family Income (Gross)	Abatement Regime: Marginal Abatement Rate
1986-87π	0 to 18	$1,872.00	$832.00	$14,000.00	18%
1987-88	0 to 18	$1,872.00	$832.00	$15,000.00	18%
1988-89	0 to 18	$1,872.00	$832.00	$15,000.00	9%
				$16,000.00	18%
				$27,000.00	30%
1989-90	0 to 15	$1,872.00	$832.00	$16,750.00	18%
	16 to 18	$1,872.00	$1,872.00	$27,000.00	30%
1990-91	0 to 15	$1,872.00	$832.00	$17,500.00	18%
	16 to 18	$1,872.00	$1,872.00	$27,000.00	30%
1991-92	0 to 15	$2,184.00	$1,144.00	$17,500.00	18%
	16 to 18	$2,184.00	$2,184.00	$27,000.00	30%
1993-94	0 to 12	$2,184.00	$1,196.00*	$17,500.00	18%
	13 to 18	$2,184.00	$1,482.00*	$27,000.00	30%
	**	$2,184.00	$2,184.00		
1994-95	0 to 12	$2,184.00	$1,326.00*	$18,125.00*	18%
	13 to 18	$2,184.00	$1,820.00	$27,000.00	30%
	**	$2,184.00	$2,184.00		
1995-96	0 to 12	$2,184.00	$1,404.00	$20,000.00	18%
	13 to 18	$2,184.00	$1,820.00	$27,000.00	30%
	**	$2,184.00	$2,184.00		
1996-97	0 to 12	$2,281.50*	$1,501.50*	$20,000.00	18%
	13 to 18	$2,281.50*	$1,917.50*	$27,000.00	30%
1997-98	0 to 12	$2,411.50	$1,631.50	$20,000.00	18%
	13 to 15	$2,411.50	$2,047.50	$27,000.00	30%
	16 to 18	$2,580.50	$2,307.50		
1998-99	0 to 12	$2,444.00	$1,664.00	$20,000.00	18%
	13 to 15	$2,444.00	$2,080.00	$27,000.00	30%
	16 to 18	$3,120.00	$3,120.00		

π Only applied for the six months of the 1986-87 income tax year for which Family Support was in place

* Composite annual rate based on the proportions of the income tax year for which the old and the new rates applied

** Provision for those born on or before 30 September 1977 (aged sixteen at the time of the change in policy)

Before 23 June 1987, where spouses were separated, only one spouse could receive the Family Benefit and thus Family Support. After this date provision was made for the Family Benefit and thus Family Support to be split between spouses. With the discontinuation of the Family Benefit from 1 April 1991, new criteria for the splitting of Family Assistance Payments were established. Between 1 April 1991 and 1 April 1993, spouses were eligible for these payments provided they were the principal caregiver for four out of every twelve weeks. On 1 April 1993 this provision changed to one third of the income-tax year.

Table 2 describes changes in the level of the unabated entitlement and the abatement regime of Family Support. For two-spouse families this programme abates against the combined income of both spouses. This income is adjusted for the proportion of the income tax year that the family is eligible for the programme (the eligible period). For sole-parent families, Family Support abates against the income of the principal caregiver adjusted for the eligible period. What is counted as income for the purposes of calculating Family Support entitlement and abatement differs from the definitions of income used to calculate social welfare benefit entitlement and abatement and income tax liability. The marginal abatement rates listed in Table 2 apply for each dollar of gross income for Family Assistance purposes above the corresponding threshold until the entitlement is fully abated.

3.2 Child Tax Credit (formerly Independent Family Tax Credit)

The Independent Family Tax Credit was introduced on 1 July 1996. The Independent Family Tax Credit was renamed the Child Tax Credit on 1 April 1999. This refundable tax rebate is one of the Family Plus Tax Credits (along with the Parental and Family Tax Credits), which are only available to working families. The rebate is paid to low income families that are independent from state assistance (not receiving an income-tested benefit).[3] Families are eligible for the Child Tax Credit only for the proportion of the income tax year for which they are independent from state assistance. The rebate is paid to principal caregivers. If custody is shared, the rebate may be split according to the proportion of the income tax year that each spouse is the principal caregiver. To be eligible for a payment a spouse must be the principal caregiver for at least one third of the income tax year.

Table 3: Child Tax Credit Unabated Entitlement

Income Tax Year (1 April to 31 March)	Annual Entitlement Per Child
1996-97π	$390.00
1997-98	$682.50*
1998-99	$780.00

π Only applied for the nine months of the 1996-97 income tax year for which the Child Tax Credit was in place

* Composite annual rate based on the proportions of the income tax year for which the old and the new rates applied

The levels of the unabated entitlement are listed in Table 3. For abatement purposes, the Child Tax Credit is added to Family Support and the Parental Tax Credit (if applicable). This total amount abates following the thresholds and rates in Table 2 and using the same definition of income as Family Support.

3.3 Parental Tax Credit

The Parental Tax Credit was introduced on 1 October 1999. This refundable tax rebate is one of the Family Plus Tax Credits (along with the Child and Family Tax Credits), which are only available to working families. The rebate is paid to low income families that are

[3] Income-tested benefits include the domestic purposes, widow's, transitional retirement, invalid's, independent youth, emergency, community wage benefits. Recipients of assistance under the public accident compensation scheme (ACC) only become ineligible for the rebate once they receive ACC payments for three months or more.

independent from state assistance (not receiving an income-tested benefit) for the first eight weeks after the birth of the child. Families are only eligible for the Parental Tax Credit for the proportion of the eight-week period that they are independent from state assistance. The rebate is paid to principal caregivers. If custody is shared, the rebate may be split according to the proportion of the eight-week period that each spouse is the principal caregiver. To be eligible for a payment a spouse must be the principal caregiver for at least one third of the eight-week period. Where the eight-week period occurs over two income tax years the rebate is split between the two years, and each instalment is assessed against the specified income for the appropriate year [Income Tax Act 1994 *s* KD 2 (6)]. The unabated rebate provides an end-of-year sum of $1,200 (or $150 per week for the eight weeks following the birth of a child).[4] For abatement purposes, the Parental Tax Credit is added to Family Support and the Child Tax Credit. This total amount abates following the abatement thresholds and rates in Table 2 and using the same definition of income as Family Support.

3.4 Family Tax Credit (formerly Guaranteed Minimum Family Income)

The Guaranteed Minimum Family Income was introduced on 1 October 1986. The Guaranteed Minimum Family Income was renamed the Family Tax Credit on 1 October 1999. This refundable tax rebate is one of the Family Plus Tax Credits (along with the Child and Parental Tax Credits), which are only available to working families. This rebate ensures a minimum net income (before Family Assistance) for working families with dependent children. For two-parent families, the rebate is paid in equal parts to both spouses. From 1 April 2003 the rebate will be paid to the principal caregiver only [Inland Revenue Department, 2001, p. 25].

Between 1 October 1986 and 1 April 1991, to be eligible for the rebate a family needed to satisfy the conditions for the receipt of the Family Benefit (see Table 1), have a family income below the guaranteed minimum income and satisfy a work test. As well as requiring independence from state assistance, eligibility required sole-parents to work at least twenty hours per week and two-parent families a combined total of at least thirty hours. Families were eligible for the rebate only for the proportion of the year for which they satisfied this work test.

With the removal of the Family Benefit from 1 April 1991, additional eligibility criteria for the rebate were introduced based on principal responsibility for the day-to-day care of dependent children.

The Family Tax Credit abates dollar-for-dollar against the combined net income of both spouses or, for sole-parent families, the income of the principal caregiver adjusted for the eligible period. What is counted as income for the purposes of calculating the Family Tax Credit entitlement and abatement differs from the definitions of income used to calculate social welfare benefit entitlement and abatement and income tax liability. The guaranteed minimum income is the net income before the payment of Family Support, the Child Tax Credit and the Parental Tax Credit. Table 4 shows the guaranteed minimum family income.

[4] Parliament's Social Services Committee recently recommended that the Parental Leave and Employment Protection (Paid Parental Leave) Amendment Bill be amended to provide that the entitlement to paid parental leave is no greater for a multiple birth or adoption than for a single birth or adoption [Inland Revenue Department, 2002, p.1].

Table 4: Family Tax Credit Guaranteed Minimum Family Income

Income Tax Year (1 April to 31 March)	Annual Guaranteed Minimum Family Income (Net before Family Assistance)
1986-87π	$10,816.00
1987-88	$11,856.00
1988-89	$13,416.00
1989-90	$13,936.00
1990-91	$14,456.00
1996-97	$14,690.00*
1997-98	$14,768.00
1998-99	$15,002.00*
1999-2000	$15,080.00

π Only applied for the six months of the 1986-1987 income tax year for which the Family Tax Credit was in place

* Composite annual rate based on the proportions of the income tax year for which the old and the new rates applied

3.5 Summary of the current Family Assistance Programmes

The current Family Assistance programmes are summarised in Table 5.

Table 5: Current Family Assistance Programmes

Family Support Tax Credit	Entitlement depends on number and ages of children. Entitlement per child ranges from $32 to $60 per week. The entitlement abates against gross specified family income.
Child Tax Credit	Entitlement is $15 per child per week. Only families who are independent from state assistance are entitled. The entitlement abates together with Family Support.
Parental Tax Credit	Payment for the first eight weeks after the birth of a child. Entitlement is $150 per baby per week. Only families who are independent from state assistance are entitled. The entitlement abates together with Family Support and the Child Tax Credit.
Family Tax Credit	Guarantees a minimum after-tax income for families with children and who are independent from state assistance and working more than 30 hours per week if a couple or 20 hours per week if a sole-parent. The entitlement abates dollar for dollar against increases in net specified income above the guaranteed minimum family income.

With the exception of the Family Tax Credit (which is split equally between spouses in a two-parent family), assistance is paid to the principal caregiver rather than the principal income earner. Legislation has, however, recently been passed that will mean the Family Tax Credit will also solely be paid to the principal caregiver from 1 April 2003. A principal caregiver is a person deemed to have responsibility for the day-to-day care of a dependent child other than on a temporary basis. A dependent child is someone who is 15 years or younger, 16 or 17 and not working full-time (more than 30 hours per week) or receiving a benefit, student allowance or other government assistance, or 18 years of age and still at secondary school or a tertiary institution.

The principal caregiver does not have to be the child's parent [Income Tax Act 1994 *s* OB1]. In a shared custody arrangement there can be more than one principal caregiver. For instance, both parents of a dependent child can qualify as a principal caregiver if they are living apart, they are both qualifying persons and they care for the dependent child for at least one third of the time throughout the year (or eligible period) [Income Tax Act 1994 *s* KD2AA]. For Family Assistance purposes the concept of care is based on having responsibility for the child.

To be a qualifying person, a person has to be aged 16 years or over, a principal caregiver of a dependent child and satisfy residency requirements. The residency requirements can be met in two ways. Firstly, a person can satisfy these requirements if he or she has been in New Zealand continuously for at least 12 months at any time, is a tax resident and is resident in New Zealand when he or she applies for a payment. A person can also satisfy these residency requirements by caring for a dependent child who is both resident and present in New Zealand.

4 Policy on the Administration of the Family Assistance Programmes

As well as the levels of assistance, abatement regimes and eligibility criteria, the outcomes of social assistance programmes reflect the operation of their delivery mechanisms. Policy on the administration of the Family Assistance programmes is discussed below. The emphasis is on the formal policy on administration, which may differ from the administration of these programmes in practise. The Inland Revenue Department has overall administrative responsibility for the four Family Assistance refundable tax rebates.[5] The Inland Revenue Department and the Ministry of Social Development are, however, both responsible for making Family Support payments. The discussion below first delineates the responsibility of the Inland Revenue Department and of the Ministry of Social Development for making Family Support payments to different family types. This discussion then turns to the registration process, payment periods, under- and over-payments, indexation of thresholds and rates of take-up of assistance.

4.1 The Agency for Payment

The Child, Parental and Family Tax Credits are only paid to recipients by the Inland Revenue Department. Recipients of the Family Support Tax Credit can be paid either by the Inland Revenue Department or the Ministry of Social Development. On an accrual basis, total Family Support payments are roughly equally split between the Inland Revenue Department and the Ministry of Social Development. The entire Family Assistance Vote (annual budgeted appropriation) goes to the Inland Revenue Department. The Ministry of Social Development makes a weekly request to the Inland Revenue Department for a cash transfer to fund their Family Support payments.

People whose income is only from an income-tested benefit are only eligible for Family Support. These people are paid Family Support by the delivery arm of the Ministry of Social Development – Work and Income – as part of their benefit payment. It is necessary, however, for beneficiaries to register to receive Family Support from the Inland Revenue Department if their income (including the gross benefit) is more than $20,000 gross per year (excluding Family Assistance) or if they are required to file an IR3 tax return (relating to business, rental or overseas income).

Work and Income can generally only pay the maximum rate of Family Support.[6] To be eligible for the maximum rate of Family Support, beneficiaries must have gross family

[5] Providing assistance in the form of refundable tax rebates increases the ability of the tax system to provide assistance to low-income individuals in comparison to non-refundable programmes. This is because low-income individuals usually pay very little tax and the level of a non-refundable rebate is constrained by the amount of tax that the recipients pay . Further, in comparison to tax rebates, tax deductions tend to benefit higher income earners under a progressive personal income tax scale (as higher income earners receive a greater reduction in their tax liability from the reduction in their assessable income) [Pallot, 1993, p. 127].

[6] An exception to this rule was made during 2002. Social welfare benefits are increased annually with inflation. In 2002 the increase raised the level of some gross benefits above the $20,000 threshold (not adjusted for inflation) at which Family Support starts abating.

incomes (including gross benefit income) of less than $20,000 per annum (excluding Family Assistance). When family incomes exceed $20,000, beneficiaries are generally required to receive abated payments from the Inland Revenue Department.

Families who leave an income-tested benefit to return to work or commence full-time study may receive Family Support Extension Payments from Work and Income. Extension payments may be necessary to align the Work and Income payment schedules (weekly) and the Inland Revenue payment schedules (fortnightly) or to allow payments to continue while the Inland Revenue Department establishes entitlement. Generally Work and Income can continue to pay Family Support for up to 56 days after a social welfare benefit is stopped.

4.2 Registering for Assistance

Families whose income is only from an income-tested social welfare benefit may have their Family Support entitlement established during the year along with their benefit entitlement. Beneficiaries whose family income is likely to exceed $20,000 or who are required to file an IR3 tax return are directed to the Inland Revenue Department to undertake the Family Assistance registration process.

Families not receiving an income-tested social welfare benefit need to register with the Inland Revenue Department to receive Family Assistance. Families who have previously received the rebates from the Inland Revenue Department are sent Family Assistance registration (FS1) forms automatically. Advertising campaigns are conducted to inform those families who are newly eligible for the rebates. Only one application form is required for all the Family Assistance programmes.

A Family Assistance registration form is used to register to receive Family Assistance from the Inland Revenue Department. This form collects information on the child's Inland Revenue Department number, the child's date of birth and the date the child has started living with the principal caregiver (if not before the beginning of the income tax year). Family Assistance can only be paid for a child who has an Inland Revenue Department number. To receive an Inland Revenue Department number for a child it is necessary to submit the Inland Revenue Department Number Application – Children (IR594) form and a copy of a birth certificate or other identification (such as a copy of a New Zealand or overseas passport or a certificate of New Zealand citizenship). Information on attendance at an education institution (which is an eligibility requirement for children over 16) is not collected directly. The child's attendance at an education institution and the date the child started living with the principal caregiver are not audited separately from the general taxpayer audit process.

The Family Assistance Registration form collects information on whether the principal caregiver has a partner or spouse and, if this is the case, the partner's name, Inland Revenue Department number and the date the principal caregiver started living with the partner (if after the start of the income tax year). A person is said to be a partner or spouse if they are in a relationship in the nature of marriage with the principal caregiver. This does not include same sex relationships. In the case of a defacto relationship, the Inland Revenue Department does not automatically audit whether a person claiming not to have a partner is correct. This information is only audited as part of the general taxpayer audit process.

Where the partner of the person receiving an income-tested benefit is the principal caregiver of a dependent child, Work and Income obtain written verification from the couple that the partner is the principal caregiver and that the Family Support should be

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As a result of this, Work and Income are now paying abated rates of Family Support to some married beneficiaries with dependent children who receive the Invalid's Benefit or the Transitional Retirement Benefit as their only source of income.

paid to this person. To receive Family Assistance from the Inland Revenue Department, the principal caregiver is required to have an Inland Revenue Department number.

In a shared custody arrangement there can be more than one principal caregiver. In such an arrangement a person is entitled to Family Assistance only if the time they spend caring for a child totals on average one third of the income tax year. For Work and Income to split the payment of Family Support in shared custody cases, the caregivers must have a formal custody agreement and supply a copy of either the signed custody agreement or the court order stating the agreement. In cases where there is an informal custody agreement, split Family Support payments can be made through the Inland Revenue Department. These payments must reflect the time a dependent child spends in the exclusive care of the qualifying person during the eligible period [Income Tax Act 1994 *s* KD 2AA].

Where there is a dispute between separated caregivers (such as over the length of time for which a person is the principal caregiver), the Inland Revenue Department bases the payment to the caregivers on the allocation of responsibility under a custody order or the previous allocation of the payment to the caregivers. It is the responsibility of the caregiver who contests this split of the payment to provide additional factual information to the Inland Revenue Department that demonstrates that the previous allocation no longer applies.

Each fortnightly payment by the Inland Revenue Department can be split to reflect the proportion of the time that each caregiver has custody of the child. Alternatively, where there is a custody order that states discrete periods of custody, Inland Revenue can provide start and stop dates for provision of the total fortnightly payment to each of the caregivers for the periods of their custody.

The Family Assistance Registration form asks the family to estimate their family income for the whole of the tax year. However, if the family opts for a lump sum at the end of the year they do not have to estimate family income as the details on the registration form will be held in the Inland Revenue Department's records and used to calculate the entitlement at the end of the income tax year. If the family opts for payments during the year, once their entitlement is established they will be paid fortnightly and a certificate will be sent to them stating their entitlement. This certificate may be used in determining entitlement for other social security programmes, such as the Community Services Card for health subsidies or Income Related Rentals for tenants of state houses.

The Family Assistance registration form also collects information on the receipt and payment of child support payments. Child support payments include both payments made via the Inland Revenue Department and payments made by private arrangement. The Inland Revenue Department checks child support payments made via the Inland Revenue Department automatically. Payments made by private arrangements are not audited separately from the general taxpayer audit process. Child support payments made are subtracted from income for Family Assistance abatement purposes. Child support payments received are added to income for Family Assistance abatement purposes. Income for Family Assistance abatement purposes is also adjusted for business adjustments (with the IR214 form). Inland Revenue data for part of the 2000-01 income tax year indicated that business adjustments accounted for a large majority of the adjustments (76.2 percent of the total net adjustments), followed by child support (13.6 percent) and maintenance payments (9.9 percent) [Inland Revenue Department, 2002b].

Families are only eligible for the Family Plus Tax Credits for the proportion of the income tax year that they are independent from state assistance. The Family Assistance Registration form collects information on benefit income and, if applicable, the dates of receipt (entry and exit dates) of an income-tested benefit, New Zealand Superannuation or Veteran's Pension or Student Allowance. The form also collects information on receipt of Accident Compensation Corporation payments (ACC recipients only become ineligible for Family Plus once they receive ACC payments for three months or more). This information on state assistance is checked automatically at the end of the income tax year.

If it is possible that a family may be entitled to some Family Tax Credit (if they have a gross income excluding Family Assistance under $18,368), the applicant is asked to state the number of hours each week they and their partner (if applicable) expect to work and the number of weeks in the year that they and their partner (if applicable) expect to work these hours. Information on hours and weeks of work is not audited independently of the general taxpayer audit process.

The Family Assistance registration form also collects information on the residency status of the principal caregiver and children. Applicants have to provide a copy of their residency certificate to the Inland Revenue Department and are required to have Inland Revenue Department numbers for themselves and their children.

4.3 Payment Periods and Under- and Over-Payments

Payments can be received during the year or as a lump sum at the year-end. Around half of the Family Support payments made by the Inland Revenue Department (a quarter of the total Family Support payments) are paid at year-end. Payment during the year can be by cheque or bank transfer. An end-year payment can take the form of a cheque or bank transfer or through a reduction in the tax payable by the recipient.[7] The taxpayer may also elect for any end of year payment to be offset to another taxpayer.

The assessment period for the programmes is the income tax year, adjusted for the proportion of the year that the recipient is eligible for the programmes. This allows taxable income to be used for calculating entitlement and abatement. People receiving their entitlement from the Inland Revenue Department have their entitlement reconciled when their taxable income is known at year-end. Beneficiaries who receive their entitlement from the Ministry of Social Development can have their Family Assistance entitlement reconciled at year-end by requesting an income tax reconciliation.

Over- and under-payments of Family Assistance can arise for families paid during the year because the entitlement is based on income at time of application and then projected forward until the end of the tax year. Taxpayers can be overpaid Family Assistance during the year if, for example, they lose eligibility for Family Support or Family Plus or change their income or circumstances and do not inform the Inland Revenue Department. The Inland Revenue Department will continue to pay Family Assistance according to the information they hold unless the recipient tells the department of any changes in their circumstances during the year. Taxpayers who are overpaid during the year incur a debt with the Inland Revenue Department. Taxpayers who are underpaid during the year can receive their additional entitlement in a year-end payment.

To reduce the extent of overpayments, legislation contains an uplift factor, whereby the previous year's income is increased to account for the likely increase in the family's income. The uplift factors are contained in schedule 12 of the Income Tax Act 1994. Table 6 shows that the numbers of recipients that are underpaid and overpaid during the income tax year are roughly equal. However, a qualification to these figures is the lack of information on recipients paid during the year by the Ministry of Social Development. This lack of information is due to both the failure of some of these people to file tax returns and to the incomplete nature of the information on these people provided to the Inland Revenue Department when tax returns are filed. Table 6 also shows that a significant number of recipients choose to take-up assistance at year-end only.

[7] Although they may be offset against personal income tax liabilities, these programmes tend to be presented to recipients as an entitlement rather than a tax offset.

Table 6: Numbers of Recipients of Family Assistance (Year to 31 March 2001)

Numbers of Recipients	Payment accurate to within $100	Underpaid during the year (more than $100)	Overpaid during the year (more than $100)	Total
Front-End MSD – Non-Filer	117,450π	0	0	117,450
Front-End MSD – Filed	31,260	12,960	9,780	54,000
Front-End IRD – Filed	9,490	28,660	28,780	66,930
Front-End Both – Filed	2,120	6,440	12,400	20,960
Total Filed – Front End	160,320	48,060	50,960	259,340
Year-End Only – Filed	46,100	0	0	46,100
Total	206,420	48,060	50,960	305,450
Percentages				
Front-End MSD – Non-Filer	100.0	0.0	0.0	100.0
Front-End MSD – Filed	57.9	24.0	18.1	100.0
Front-End IRD – Filed	14.2	42.8	43.0	100.0
Front-End Both – Filed	10.1	30.7	59.2	100.0
Total Filed – Front End	57.0	18.5	19.7	100.0
Year-End Only – Filed	100.0	0.0	0.0	100.0
Total	67.6	15.7	16.7	100.0

π Includes 12,510 recipients whose entitlements could not be reconciled at year-end due to insufficient information

Source: Inland Revenue Department estimates (based on a sample of March 2001 tax returns, personal tax summaries and IR348s)

4.4 Indexation of Thresholds and Take-Up of Assistance

Neither the value of the rebates nor the abatement thresholds are automatically indexed for wage or price inflation. If the value of the rebates in real terms decreases, some families are shifted into higher marginal abatement zones and other families cease to remain eligible for assistance. Further, as social welfare benefits are indexed for inflation difficulties can arise from the interaction between increasing social welfare benefit levels and unchanging thresholds for Family Assistance abatement. For instance, annual increases in benefit levels to protect beneficiaries' incomes against increases in prices over time are less effective if such benefit increases reduce these families' Family Assistance entitlement.

Measures such as eliminating the need for the majority of personal taxpayers to file annual tax returns (IR5 forms) reduced the costs facing taxpayers of complying with the tax system. However, the annual tax returns process also played a role in indicating Family Assistance entitlement to potential recipients and to the Inland Revenue Department. Reducing the Inland Revenue Department's contact with personal taxpayers has therefore potentially increased the importance of the Family Assistance application process for the take-up of the rebates. Non take-up occurs when, for some number of people, the amount they receive from social assistance programmes is less than the amount they are entitled to receive.[8] Non take-up has implications for both the design and evaluation of social assistance programmes [Creedy, 2002, p. 151; Riphahn, 2001, p. 379; Stephens *et al*, 2001, p. 86]. Non-take-up influences how effectively Family Assistance reduces poverty and social exclusion, targets resources to the poor, controls fiscal cost and supports participation in the labour market. There are no recent estimates of the level and causes of non-take-up of Family Assistance.

5 Definitions of Income

A clear understanding of the definitions of income in operation is a prerequisite for calculating the extent that social assistance programmes alter, for instance, the financial returns from work. Different definitions of income are used for determining liability for personal income taxes, entitlement to social welfare benefits and entitlement to Family Assistance programmes in New Zealand. Income tax liability is assessed on the basis of taxable income. Social welfare benefits are assessed on the basis of a social welfare definition of income. The definition of income for family assistance purposes is a compromise between taxable income and the social welfare definition of income [Inland Revenue Department, 2001, p. 27]. The following discussion explains these definitions of income as they relate to the taxation and abatement of social welfare benefits and the calculation of Family Assistance entitlement.

5.1 Taxation and Abatement of Social Welfare Benefits

Social welfare benefit levels are set (and paid to recipients) as net amounts and then personal income tax on the benefit income is calculated to give gross benefit levels. Income tax is calculated on benefits to ensure that the full costs of benefits are reported in the government's accounts and that beneficiaries face the same tax rate on additional earnings as low-income earners not receiving a benefit.

When beneficiaries receive non-benefit earnings their net unabated benefit (b) abates against gross non-benefit earnings (e_G). Abatement of the net benefit (b_A) is based on gross earnings and equals the net benefit abatement rate (r_B) multiplied by the level of the gross non-benefit earnings above the gross threshold at which abatement begins (or the level of the earnings disregard (d_B) or free zone where non-benefit earnings do not reduce the net benefit).

$$b_A = (e_G - d_B)\, r_B \qquad (1)$$

Subtracting benefit abatement from the net unabated benefit results in the net benefit after abatement (b_N).

$$b_N = b - b_A \qquad (2)$$

The net benefit after abatement is then increased for personal income tax on the benefit (t_B) to give the level of the gross abated benefit (b_G).

$$b_G = b_N / (1 - t_B) \qquad (3)$$

[8] There are also a number of people who receive more than their entitlement (due to factors such as administrative error and taxpayer fraud).

The gross non-benefit earnings (e_G) are reduced by personal income tax on non-benefit income (t) and the ACC earners' account levy (ACC) to give the net non-benefit earnings (e_N).

$$e_N = e_G (1 - (t + ACC)) \quad (4)$$

For beneficiaries, non-benefit earnings are taxed under the secondary tax regime at 21 percent.[9] The tax on the gross abated benefit and the non-benefit earnings are calculated separately as the tax rate applying to the benefit income may differ from the tax rate applying to non-benefit earnings. Differences in the tax rates applying to benefit and non-benefit income occur when a beneficiary's annual gross benefit income is below a personal income tax threshold and non-benefit earnings increase total gross income to above the threshold. For instance, under the current personal income tax scale, such a difference would occur if a beneficiary receives a gross benefit below $9,500 along with non-benefit income that increases total gross income to above $9,500.

5.2 Calculating Entitlement to the Family Assistance Programmes

Net income before Family Assistance (y) equals the net benefit after abatement (b_N) plus net non-benefit earnings (e_N).

$$y = b_N + e_N \quad (5)$$

For Family Assistance purposes a number of income adjustments (y_F) are made to net income before Family Assistance. Some income that is exempt from income tax is not exempt for Family Assistance purposes (such as child support transfers and maintenance payments). Conversely, some deductions that are allowable under the general income tax rules are not allowed for Family Assistance purposes (such as business adjustments). The income adjustments are made on application for Family Assistance and are also part of the end-of-year square-up process [Inland Revenue Department, 2001, p. 27]. Inland Revenue data for part of the 2000-01 income tax year indicated that business adjustments accounted for a large majority of the adjustments (76.2 percent of the total net adjustments), followed by child support (13.6 percent) and maintenance payments (9.9 percent) [Inland Revenue Department, 2002b].

Amendments to these income adjustments under the Taxation (Relief, Refunds and Miscellaneous Provisions) Bill 2001 will bring Family Assistance more into line with general income tax rules. These amendments aim to reduce compliance and administration costs, increase the accuracy of the adjustments and reduce the risk of overpayments (and end-of-year tax debt) resulting from the incorrect application of adjustments [Inland Revenue Department, 2001, p. 27].

These income adjustments lead to net specified income for Family Assistance purposes (y_S).

$$y_S = y - y_F \quad (6)$$

Both entitlement for and abatement of Family Assistance is adjusted for the number of days of eligibility during the income tax year. There are two periods of the income tax year (which may or may not differ) for Family Assistance purposes. The specified period is an unbroken period where the recipient is eligible for some form of Family Assistance. The eligible period is an unbroken period where the applicant meets all four of the following criteria. Firstly, the applicant is a qualifying person. Secondly, the applicant is a principal caregiver. Thirdly, the applicant has an unchanging marital status during the

[9] The secondary tax is a withholding tax, so any excessive tax withheld during the year is returned at the end of the income tax year.

period. Fourthly, the applicant is making the claim in relation to a dependent child or dependent children [CCH, 2000, p. 495]. For example, the specified period for a family that is eligible for some form of Family Assistance during the full income tax year would be the full income tax year. However, if the nature of the family's entitlement changes during the year, due to, for example, a change in the number of dependent children in the family, the specified period will be made up of more than one eligible period. For instance, if a family with one child adopts an additional child during the year they will have two eligible periods; one period where entitlement is based on one child and one period where entitlement is based on two children.

The criteria used to calculate the eligible period (p_F) differ among the four Family Assistance programmes. For Family Support purposes, the eligible period is based on the four standard criteria above. As well as these four standard criteria, for Child and Parental Tax Credits purposes the eligible period is also based on the number of weeks the recipient's family is independent from state assistance. Further, for Family Tax Credit purposes, the eligible period is based on the four standard criteria, the number of weeks the recipient's family is independent from state assistance and the number of weeks the recipient's family satisfies a work test.

The full year abatement rate (r_F) is adjusted for the eligible period (p_F) to give the abatement rate for the eligible period (r_P).

$$r_P = r_F \, (p_F / 365) \tag{7}$$

Implications of basing abatement rates, as well as the level of entitlement, on the eligible period are that the programmes are received by higher income earners who are eligible for short periods of the income tax year (if, for example, a child is born late in the year) and the entitlement can vary significantly from year to year.

There are two Family Assistance entitlement and abatement regimes; that applying to the Family Tax Credit and that applying to the Family Support, Child and Parental Tax Credits. The Family Tax Credit pays the difference between the net specified income and the net guaranteed minimum income. The rebate abates dollar for dollar against increases in net specified income. The Family Support, Child and Parental Tax Credits abate against gross specified income. Family Support, the Child Tax Credit and the Parental Tax Credit entitlements equal the unabated rebates minus abatement. This abatement is the abatement rate multiplied by the level of the gross specified income (which is the net specified income increased for personal income taxes) above the gross abatement threshold. The four abated rebates are added together to give the total Family Assistance (*FA*) entitlement.

$$FA = FS + CTC + PTC + FTC \tag{8}$$

This Family Assistance entitlement is then added to net specified income, giving a net income including Family Assistance (y_N).

$$y_N = y_S + FA \tag{9}$$

Income from the Family Assistance Tax Credits does not increase gross taxable income for the person to whom the rebate is allowed [Income Tax Act 1994 *s* KD8]. Thus the marginal tax rates applying to additional benefit income and non-benefit earnings are those applying to gross income excluding Family Assistance.

6 Family Assistance Programmes and the Financial Return from Work

The provision and abatement of social assistance programmes impact on the financial returns from work. The financial returns from work impact on financial incentives for participation in social assistance programmes themselves, in the labour market and in education and training. Financial incentives do not, however, necessarily lead to changes in behaviour. Further, financial incentives not only affect the programmes' participants but also affect a number of people who do not participate in the programmes. The impact of the Family Assistance programmes on the financial rewards from work is discussed below. The discussion begins with the financial return from work from the current Family Assistance abatement regime for one particular family type. The discussion then turns to the interaction of this abatement regime with the abatement of social welfare programmes, personal income taxes and the ACC earners' account levy.[10] This interaction is illustrated with the calculation of Effective Marginal Tax Rates and a Budget Constraint.

6.1 Family Assistance Abatement Regime

Family Support, the Child Tax Credit and the Parental Tax Credit are added together for abatement purposes and it is this total figure that abates. Family Support is the first programme to abate, followed by the Child Tax Credit and then the Parental Tax Credit. The Family Tax Credit is subject to a separate abatement regime. The Family Tax Credit is fully abated before abatement of the Family Support, Child Tax Credit and Parental Tax Credit begins.[11]

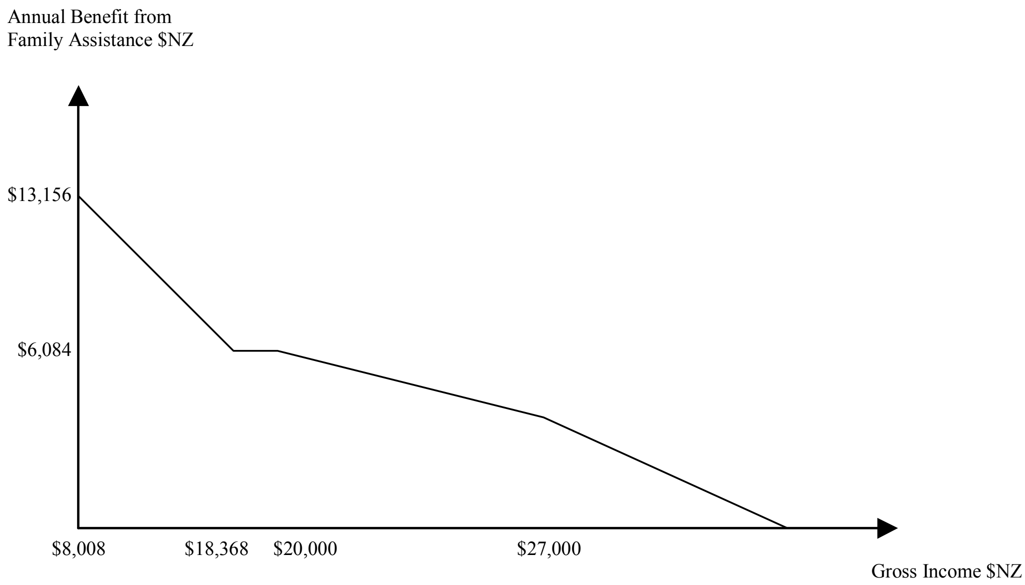
The annual income levels at which the Family Assistance Tax Credits are earned and abated for a working sole parent with two children are shown in Figure 1. A sole parent with two children aged 14 and who is not in receipt of an income-tested benefit qualifies for the Family Tax Credit and the Child Tax Credit in addition to Family Support when he or she works 20 hours per week. Between the qualifying threshold and $15,080 net ($18,368 gross) every dollar increase in net specified income is matched by a dollar reduction in the Family Tax Credit. This phase-out of the tax rebate offsets the benefit from increasing financial earnings in this range.[12] Family Assistance also decreases incentives to increase work hours to those immediately above the qualifying threshold as the income from these payments allows the family to reach a desired level of consumption with less work.

[10] The ACC earners' account levy is the only part of the New Zealand Social Security System that is contributory. These levies are not paid into individualised accounts however.

[11] The 1989 increase in the gross value of the Family Tax Credit (from $14,901 to $16,816) increased the gross level of this rebate above the gross threshold for Family Support abatement ($15,000). This meant that a number of recipients of the Family Tax Credit faced combined abatement of the Family Tax Credit and Family Support. The problem of combined abatement was resolved when the Family Support threshold was increased to $20,000 in the 1994-95 income tax year. Any future increase in the gross level (or reduction in the rate of abatement) of the Family Tax Credit could also require an increase in the gross threshold at which Family Support begins to abate.

[12] The net family income may decrease in this range due to the 1.2 percent ACC earner account levy.

Figure 1: Annual Benefit from Family Assistance for a Sole Parent with Two Children (Aged 14) and Earning $7.70 Gross per Hour



Note: not drawn to scale.

If the family increases its net specified income to between $15,080 and $16,370 ($20,000 gross), the level of the benefit they receive from Family Assistance does not vary with earnings. There may still, however, be a reduced incentive to increase the family's work hours as the income from these payments allows the family to reach a desired level of consumption with less work.

A two-tier abatement regime applies if the family's net specified income increases to above $16,370. The tax rebates abate at eighteen cents in the dollar between $16,370 and $21,900 net ($27,000 gross). The tax rebates abate at thirty cents in the dollar above $21,900 net. In these phase-out ranges additional earnings reduce the benefit from the tax rebates, thus making work relatively less rewarding. Further, these payments may also decrease incentives to increase the family's work hours as the income from these payments allows the family to reach a desired level of consumption with less work.

6.2 Calculating Effective Marginal Tax Rates

This section describes the financial returns from work that result from the interaction of Family Assistance with other policies and programmes, such as personal income tax rates, the ACC earners' account levy and social welfare benefits. Effective Marginal Tax Rates (EMTRs) show the percent by which a dollar increase in gross income is reduced by taxes and the abatement of social security assistance [Prebble, 1992, p. 7]. A profile of EMTRs at different income levels can be drawn. The EMTR profile is unique to a particular type of person, depending on factors such as marital status, number of children, whether or not they receive a social welfare benefit, the hours that they work and the wage rate that they receive. People with different characteristics will have different profiles. Calculations of EMTR profiles can be complex due to the complexity of the tax and abatement schedules. This section summarises and updates an internal Treasury document [1999] on the calculation of EMTR profiles. Segments of two EMTR profiles are shown. Figure 2 shows the interaction of the personal income tax scale and the abatement of Family Assistance. Figure 3 shows the complexity that arises when the family is also eligible to take-up a social welfare benefit.

Figure 2: EMTR Profile of a Person with One Child and a Working Partner

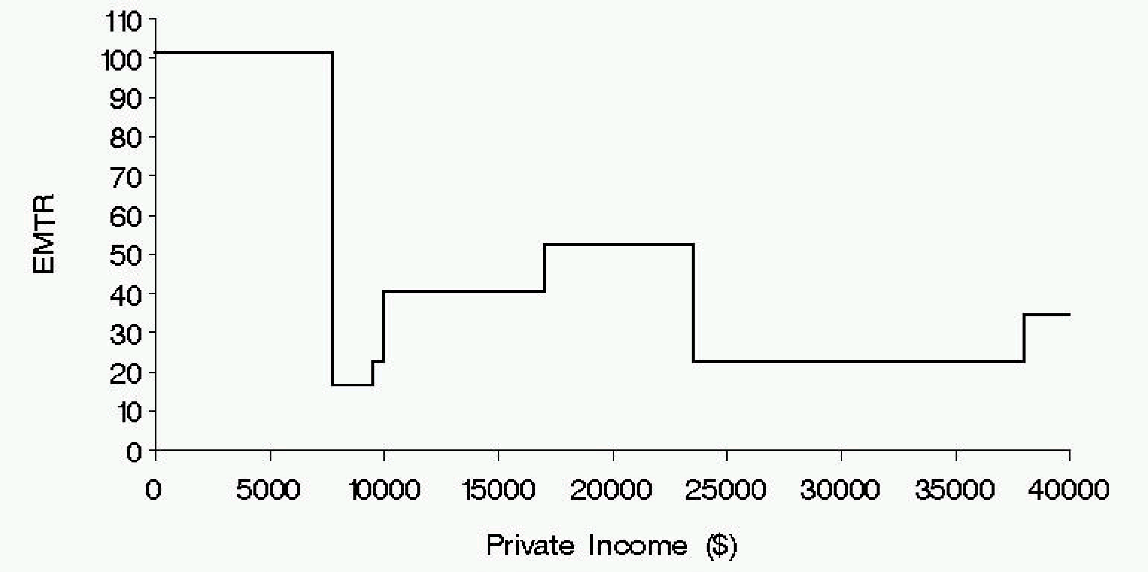


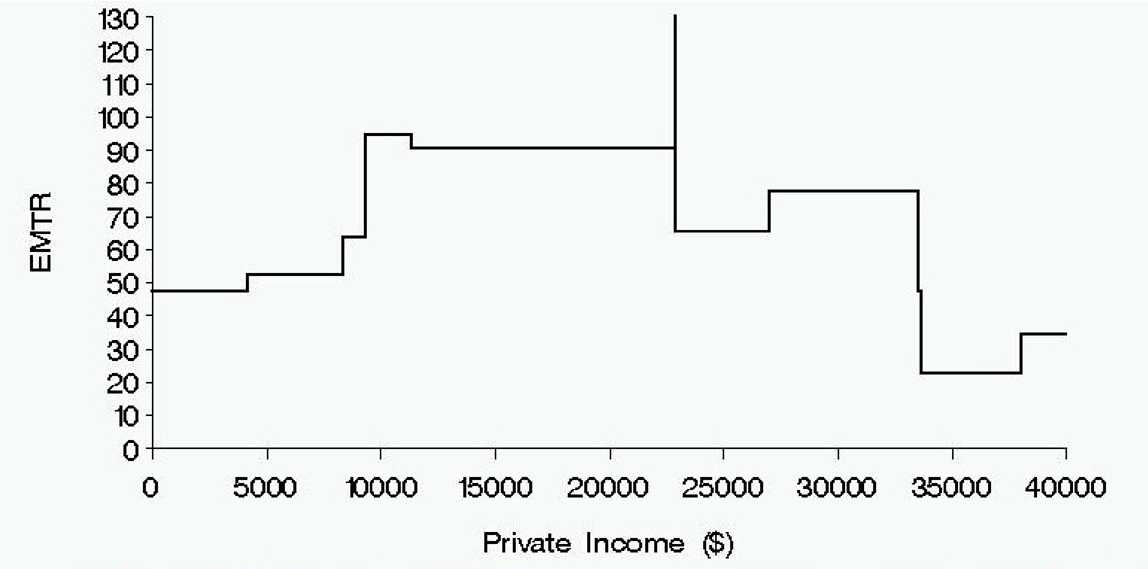
Figure 2 shows the EMTR profile of a person (the primary earner) with one child and a working partner (the secondary earner). It is assumed that the working partner has an unchanging gross income of $10,000. At a combined total of thirty hours of work per week, the family qualifies for the Family Tax Credit. This rebate abates at 100 percent, thus for every dollar that net specified family income increases the Family Tax Credit decreases by a dollar. The 1.2 percent ACC earners' account levy is also charged on additional earnings. Thus if the primary earner increases his or her earnings by a dollar he or she faces an EMTR of 101.2 percent. The Family Tax Credit is fully abated when the primary earner earns around $8,000 in addition to the secondary earner's income.

Once the Family Tax Credit is fully abated the EMTR falls to 16.2 percent. This EMTR is comprised of the 15 percent personal income tax rate and the 1.2 percent ACC levy. When the primary earner increases his or her earnings to $9,500 the personal tax rate increases to 21 percent and the EMTR increases to 22.2 percent.

When the primary earner's earnings increase to $10,000, the combination of this income and the partner's income means that the family reaches the $20,000 threshold at which Family Support and the Child Tax Credit start to abate. These programmes initially abate at 18 percent. Thus the EMTR increases to 40.2 percent. When the primary earner increases his or her earnings by a further $7,000, the combined family income reaches $27,000 and Family Support and Child Tax Credit abatement increases to 30 percent. The EMTR therefore increases to 52.2 percent. When the primary earner earns around $23,500, Family Support and the Child Tax Credit are fully abated against combined family income. The EMTR falls to 22.2 percent.

At $38,000 of earnings, the primary earner moves to the 33 percent personal income tax rate and faces an EMTR of 34.2 percent. At $60,000 the primary earner moves to the 39 percent personal tax rate and faces an EMTR of 40.2 percent. The EMTR remains at this level until the primary earner earns $77,185 (giving a family income of $87,185), where the ACC levy is no longer charged against extra earnings. The EMTR then falls to 39 percent.

Figure 3: EMTR Profile of a Sole Parent with One Child and Receiving the Domestic Purposes Benefit and Accommodation Supplement



For beneficiaries, the Accommodation Supplement abates at 25 percent for the first $80 per week ($4,160 per annum) of gross non-benefit earnings. As the gross level of the Domestic Purposes Benefit is greater than $9,500, the appropriate tax on additional income is 21 percent. The 1.2 percent ACC levy also applies. The EMTR is therefore 47.2 percent.

When the sole parent's gross non-benefit earnings reach $4,160, the Accommodation Supplement abatement stops and the net Domestic Purposes Benefit begins abating at 30 percent. The net benefit is abated against gross non-benefit earnings. Thus when the sole parent earns an extra dollar in gross non-benefit earnings the total gross income (which includes the gross benefit) does not rise by the full dollar because of the benefit abatement.

Effective Marginal Tax Rates (EMTRs) for a dollar increase in gross non-benefit earnings can be calculated using the following algebraic approach [Treasury, 1999]. The gross benefit abatement (r_b) equals the net benefit abatement (r_B) divided by one minus the marginal tax rate on benefit income (t_B).

$$r_b = r_B / (1 - t_B) \tag{10}$$

The change in gross income (y_G) is one minus the gross benefit abatement.

$$\Delta\, y_G = 1 - r_b \tag{11}$$

The change in the tax on gross non-benefit earnings is the marginal personal income tax rate on earnings (t) multiplied by the change in gross income. The marginal tax rate on non-benefit earnings may differ from the marginal tax rate on benefit income (if the beneficiary's non-benefit earnings raise total gross income (benefit and non-benefit income) into a higher tax bracket).

$$\Delta t = t\,(\Delta\, y_G) \tag{12}$$

The abatement of Family Support and Child Tax Credit on gross non-benefit earnings is the marginal Family Support and Child Tax Credit abatement rate (r_P) multiplied by the change in gross income.

$$\Delta FA = r_P\,(\Delta\, y_G) \tag{13}$$

The change in disposable income (y_D) is the change in gross income minus the change in tax liability and the change in the Family Support and Family Plus Tax Credit abatement (where appropriate) minus the ACC earners' account levy (where appropriate).

$$\Delta\, y_D = \Delta\, y_G - (\Delta\, y_G\,(t)) - (\Delta\, y_G\,(FA)) - ACC \qquad (14)$$

$$\Delta\, y_D = \Delta\, y_G\,(1 - t - FA) - ACC$$

The EMTR is one minus the change in the disposable income.

$$\text{EMTR} = 1 - \Delta\, y_D \qquad (15)$$

When the sole parent earns $4,160 of gross non-benefit earnings, the EMTR is 52.2 percent. This EMTR is comprised of the marginal personal tax rate (21 percent) plus the net benefit abatement (30 percent) plus the ACC levy (1.2 percent). When gross non-benefit earnings increase to around $8,400, this income in combination with the abated benefit equals the threshold at which Family Support abatement begins. Family Support abatement is the Family Support abatement rate multiplied by the change in gross income. FS abatement is thus 11.16 percent.[13] Hence the EMTR rises from 52.2 percent to 63.36 percent. At $9,360 of non-benefit earnings ($180 per week) the abatement rate on the net benefit increases to 70 percent. This increase in net benefit abatement also impacts on Family Support abatement as income for Family Support abatement purposes falls as gross benefit abatement increases. Family Support abatement falls to 2.05 percent. The EMTR therefore becomes 94.25 percent (given by 21 + 70 + 2.05 + 1.2).

At around $11,300 of non-benefit earnings, the gross benefit has abated to the point where it is under $9,500 and hence the marginal tax rate on benefit income falls to 15 percent. However, the marginal personal income tax rate on non-benefit earnings remains 21 percent. As the marginal tax rate on the benefit falls, the total gross income increases. This change in gross income means the EMTR falls to 90.5 percent.[14]

There is a large jump in the EMTR at the point where the sole parent exhausts the benefit. The benefit is fully abated at around $22,900 of non-benefit earnings. Once the benefit is fully abated the person becomes eligible for the Child Tax Credit. The Child Tax Credit abates with Family Support. Since abatement of the benefit no longer affects gross income, the total entitlement to Family Support and the Child Tax Credit now abate at 18 percent against gross specified income. However, abatement of the Accommodation Supplement begins again. For non-beneficiaries the Accommodation Supplement abates at 25 percent once market income exceeds the gross amount they would get if they were on the Invalid's Benefit plus an add-on[15] by $4,160 ($80 per week). For this person at this income level the Accommodation Supplement abatement exceeds the Child Tax Credit. The dollar increase in non-benefit earnings that ended the benefit entitlement therefore causes a drop in net income (after Family Assistance) of around $130. This equates to an EMTR of around 13,000 percent. This change in net income only applies to this dollar transition period. For the next dollar of earnings the EMTR equals 65.2 percent (given by the personal tax rate plus Family Support and the Child Tax Credit abatement plus Accommodation Supplement abatement plus the ACC levy).

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[13] This is shown algebraically below:

$$\Delta FA = r_P\,(\Delta\, y_G) = 0.18\,[1 - 0.30/(1\text{-}0.21)] = 0.1116$$

[14] This is shown algebraically below:

$$\Delta y_D = \Delta y_G\,(1 - t\; - FA) - ACC = 0.176\,(1 - 0.21 - 0.18) - 0.012 = 0.095$$

$$\text{EMTR} = 1 - \Delta y_D = 0.905$$

[15] Before 1996 the threshold at which the Accommodation Supplement began to abate was the level of the Gross Invalid's Benefit. As the Invalid's Benefit is set in net amounts and then grossed up, personal tax reductions in 1996 and 1998 reduced the level of the gross benefit while the level of the net benefit remained constant. Thus, to ensure that the threshold for Accommodation Supplement abatement did not change the threshold was increased by an add-on. This add-on is currently $17.92.

When the sole parent's earnings increase to $27,000, the abatement of Family Support and the Child Tax Credit increases to 30 percent and the EMTR increases to 77.2 percent. At approximately $33,500 the Family Support and the Child Tax Credit entitlements are exhausted, and the EMTR falls to 47.2 percent. With approximately a further $100 of earnings, the Accommodation Supplement entitlement is extinguished and the EMTR drops by another 25 percent to 22.2 percent. At $38,000 this person moves to the 33 percent personal tax rate and faces an EMTR of 34.2 percent. At $60,000 this person moves to the 39 percent personal tax rate and faces an EMTR of 40.2 percent. The EMTR remains at this level until $87,185, the income at which the ACC levy is no longer charged, when it drops to 39 percent.

6.3 Calculating a Budget Constraint

Figure 4 shows a section of a budget constraint. This budget constraint shows the impact of the personal income tax scale and the Family Assistance Tax Credits on the difference between gross and net (after Family Assistance) family income when hours of leisure (and thus hours of work) change. A budget constraint is unique to a particular type of person, depending on factors such as their marital status, number of children, whether or not they receive a social welfare benefit and the wage rate that they receive. People with different characteristics will have different budget constraints.

Figure 4: Budget Constraint of a Sole Parent with Two Children (Aged 14) and Earning $7.70 Gross per Hour

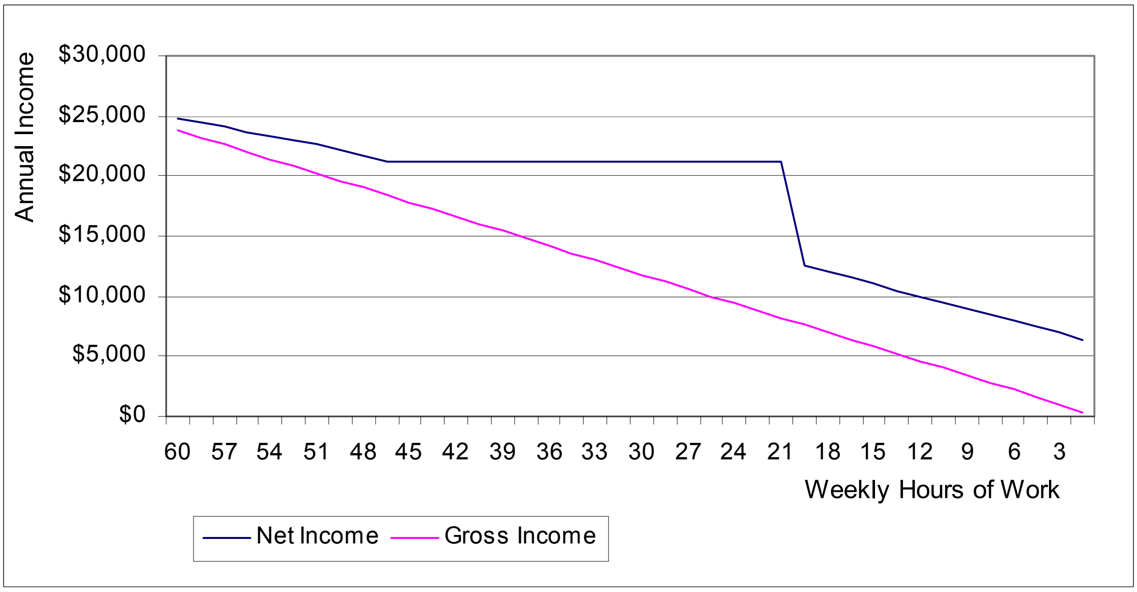


Figure 4 assumes that all income is from wages and salaries.[16] Therefore, the relevant personal income tax scale applying to gross annual income (y) is:

$t = 0.15\ (y_G)$	$y_G \leq \$9{,}500$	(16)
$t = 0.21\ (y_G - \$9{,}500)$	$\$9{,}500 < y_G \geq \$38{,}000$	
$t = 0.33\ (y_G - \$38{,}000)$	$\$38{,}000 < y_G \geq \$60{,}000$	
$t = 0.39\ (y_G - \$60{,}000)$	$\$60{,}000 < y_G$	

Further, it is assumed that the family is composed of a sole-parent and two 14-year-old children. Thus the relevant Family Tax Credit work test is 20 hours of work per week. It is

[16] This means that all income below $38,000 is eligible for the Low Income Earner Rebate.

also assumed that the principal caregiver works constant hours per week during the year, that the family does not receive any income-tested transfer payments during the year (and so may be eligible for the Family Tax Credit and the Child Tax Credit) and that no Family Assistance income adjustments apply. The Family Assistance Tax Credits are earned and abated in the following way:

FA = ($4,524 + $1,560)	$y_G < w\,(20 \times 52)$	(17)
FA = ($18,368 – y_G) + ($4,524 + $1,560)	$w\,(20 \times 52) \leq y_G >$ $18,368	
FA = ($4,524 + $1,560)	$18,368 ≤ $y_G \geq$ $20,000	
FA = (y_G (0.82))($4,524 + $1,560)	$20,000 < $y_G \geq$ $27,000	
FA = (y_G (0.7))($4,524 + $1,560)	$27,000 < $y_G \geq$ (FA = 0)	

If the principal caregiver faces a wage rate *w* of the adult minimum wage ($7.70 gross per hour), then the budget constraint with this wage rate, personal income tax scale and Family Assistance system is:

C = (y_G (0.85)) + ($4,524 + $1,560)	$0 ≤ $y_G >$ $8,008	(18)
C = (y_G (0.85)) + ($18,368 – y_G) + ($4,524 + $1,560)	$8,008 ≤ $y_G \geq$ $9500	
C = (y_G (0.79)) + ($18,368 – y_G) + ($4,524 + $1,560)	$9,500 < $y_G >$ $18,368	
C = (y_G (0.79)) + ($4,524 + $1,560)	$18,368 ≤ $y_G \geq$ $20,000	
C = (y_G (0.79)) + (0.82 x ($4,524 + $1,560))	$20,000 < $y_G \geq$ $27,000	
C = (y_G (0.79)) + (0.7 x ($4,524 + $1,560))	$27,000 < $y_G >$ (FA = 0)	

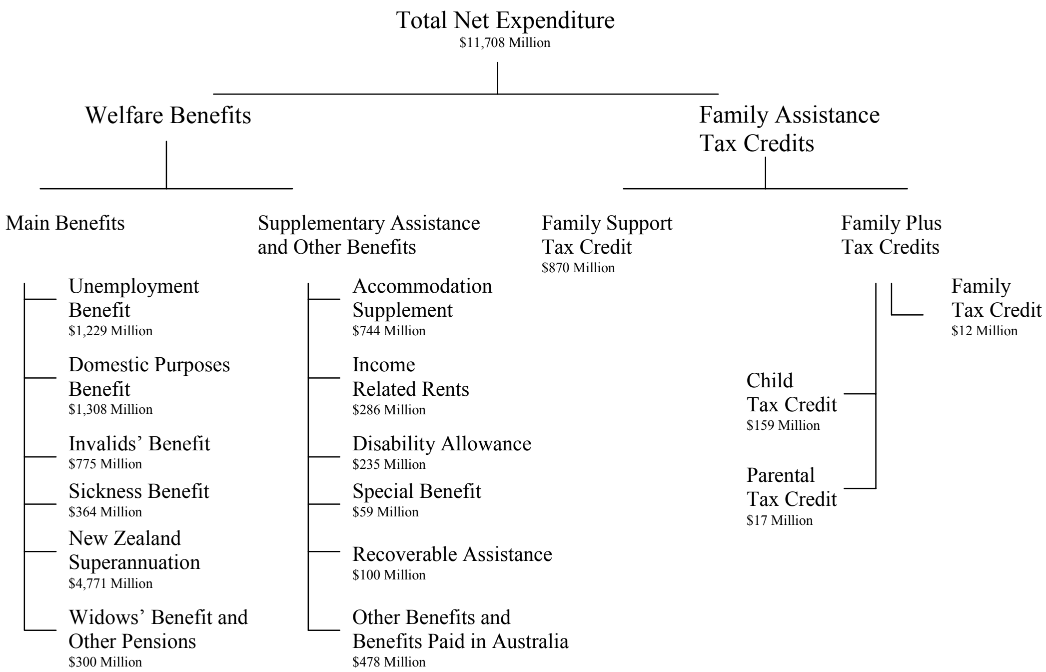
7 Fiscal Cost of the Family Assistance Programmes

Issues regarding the fiscal cost to the government of social assistance programmes can be seen on a number of levels. The first level is the total public expenditure on social security [Barr, 1999, p. 8]. The second level is the proportion of social security expenditure allocated to social assistance programmes and the proportion allocated to other programmes (such as in-kind provision of education) [Barr, 1999, p. 8]. The third level is the proportion of social assistance expenditure allocated to different social assistance programmes (such as out-of-work and in-work-programmes, main and supplementary assistance and expenditure through the social welfare and tax systems) [Barr, 1999, p. 8]. The proportion of total public spending and social assistance expenditure for which the Family Assistance programmes account are discussed below. The discussion then turns to the total expenditure on Family Assistance, the distribution of this expenditure among household deciles and comparisons between expenditure through the tax system in New Zealand, the United States and the United Kingdom.

7.1 Expenditure on the Family Assistance Programmes as a Proportion of Total Public and Social Assistance Expenditure

The New Zealand Government is forecast to have total expenses of approximately $41.2 billion in 2002-03.[17] Forecast expenditure on social security and welfare of approximately $13.9 billion accounts for approximately 33.8 percent of this total [Cullen, 2002, p. Table B.1].[18] As well as expenditure on New Zealand Superannuation and welfare benefits, the forecast expenditure of social security and welfare includes expenditure on departmental expenses, social rehabilitation and compensation and other non-departmental expenses. Expenditure on New Zealand Superannuation and welfare benefits alone is forecast at approximately $13.0 billion for 2002-03 [Cullen, 2002, p. Table B.2]. This figure includes the personal income taxes levied on these programmes.

Figure 5: Forecast Net Expenditure in the New Zealand Social Assistance System (2002-03)



Sources: Ministry of Social Development estimates of expenditure; Cullen, 2002, *Budget Economic and Fiscal Update*, Table B.3; Government of New Zealand, 2002, *Estimates of Annual Appropriations and Departmental Budgets of the Government of New Zealand: Vote Revenue*, B.5, Vol. II, p. 10

[17] The New Zealand Government is forecast to collect approximately $40.1 billion dollars in tax revenue in 2002-03. This revenue represents approximately 32.1 percent of GDP [Cullen, 2002, p. Table A.1].

[18] Other areas of key expenditure include Health (20.3 percent of total expenditure) and Education (18.2 percent of total expenditure) [Cullen, 2002, p. Table B.1].

Figure 5 shows the major areas of forecast expenditure in the New Zealand social assistance system for 2002-03. The figures are net of tax and for the year ended 30 June. Total net social assistance expenditure has been forecast at $11,708 million for this year. This forecast expenditure includes $4,771 million on New Zealand Superannuation and $300 million on the Widows' Benefit and other pensions. By excluding expenditure on New Zealand Superannuation and the Widows' Benefit and other pensions, expenditure on the working aged can be estimated at $6,637 million. This expenditure on the working aged includes forecast expenditure of $1,229 million on the Unemployment Benefit, $1,308 million on the Domestic Purposes Benefit, $1,030 million on the Accommodation Supplement and Income Related Rents and $775 million on the Invalid's Benefit.

Forecast expenditure on the Family Assistance programmes of $1,058 million is approximately 15.9 percent of total welfare spending on the working aged. Family Support payments are forecast to have a total annual fiscal cost in 2002-03 of $870 million. Family Support payments are available to low-income families irrespective of their work status. These payments account for approximately 82.2 percent of tax assistance.[19] The Family Plus Tax Credits are forecast to have a total annual fiscal cost in 2002-03 of $188 million. The largest Family Plus Tax Credit is the Child Tax Credit. The Family Plus payments are only available to families in work. Expenditure on Family Plus programmes accounts for 17.8 percent of tax assistance. Thus, little more than 2.8 percent of total welfare spending on the working aged is assistance provided through the tax system that is only available for families in work.

7.2 Expenditure on the Family Assistance Programmes

The Family Assistance programmes are treated as expenditure (not a reduction in tax revenue) in the national accounts. The entire Family Assistance Vote (annual budgeted appropriation) goes to the Inland Revenue Department. The Ministry of Social Development makes a weekly request to Inland Revenue Department for a cash transfer to fund Family Assistance payments to beneficiaries. Table 7 presents data on the fiscal cost for previous financial years.

[19] Two further forms of tax assistance in New Zealand (the Housekeeper Rebate and the Transitional Tax Allowance) are not discussed in this paper.

Table 7: Family Benefit and Family Assistance Fiscal Cost ($ Million)

Year π	Family Benefit	Family Support	Family Tax Credit*	Child Tax Credit	Parental Tax Credit
1986-87	$273.2	$186.9	N/A	N/A	N/A
1987-88	$290.6	$403.4	N/A	N/A	N/A
1988-89	$258.4	$439.3	N/A	N/A	N/A
1989-90	$284.4	$465.0	N/A	N/A	N/A
1990-91	$223.0	$472.0	N/A	N/A	N/A
1991-92	N/A	$618.0	N/A	N/A	N/A
1992-93	N/A	$577.3	N/A	N/A	N/A
1993-94	N/A	$609.4	N/A	N/A	N/A
1994-95	N/A	$700.1**	N/A	N/A	N/A
1995-96	N/A	$748.3	N/A	N/A	N/A
1996-97	N/A	$777.0	$8.2	$40.5	N/A
1997-98	N/A	$874.4	$6.6	$121.4	N/A
1998-99	N/A	$906.5	$8.2	$161.9	N/A
1999-2000	N/A	$899.0	$10.6	$167.0	$6.8
2000-01	N/A	$860.7	$17.3	$161.3	$17.2
2001-02***	N/A	$888.0	$11.0	$185.0	$22.0

π Prior to 1989-90 the year ended 31 March; from 1989-90 onwards the year ended 30 June

* The Family Tax Credit was recorded together with Family Support until 1996-97

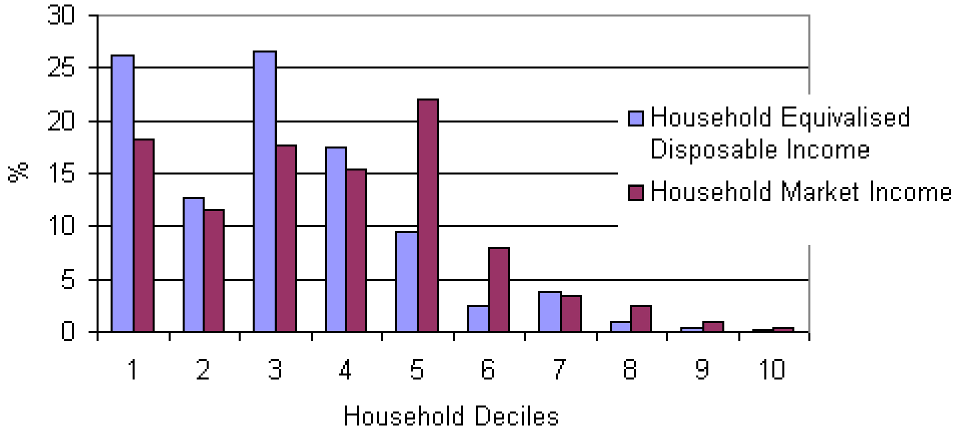
** The increase from 1993-94 to 1994-95 partly reflected the shift from cash to accrual accounting after 30 June 1994

*** Contained in the 2001-02 *Estimates of Annual Appropriations*. Actual out-turns may differ from the figures listed

Sources: Government of New Zealand, various years, *Estimates of Annual Appropriations and Departmental Budgets of the Government of New Zealand*; Inland Revenue Department, various years, *Inland Revenue Annual Report*; Ministry of Social Development, 2001, *Social Services Statistical Report*, Table 14

The distribution of the Family Assistance Tax Credits by household deciles is shown in Figure 6. On the basis of household market income, the bottom three deciles receive approximately 45% of the Family Assistance payments, approximately 65% of these payments go to the bottom four deciles and approximately 85% of these payments go to the bottom five deciles. If household income is equivalised to reflect the numbers and ages of people in households, approximately 65% of the Family Assistance payments go to the bottom three deciles, approximately 85% go to the bottom four deciles and approximately 95% go to the bottom five deciles.

Figure 6: Percentage of Family Assistance Tax Credits by Household Deciles



(1999-2000)

Source: Treasury, 2000, p. 3

In comparison with the United States and United Kingdom, New Zealand has relatively low expenditure (as a percentage of GDP) on in-work tax assistance. Table 8 presents a comparison of in-work tax assistance in these countries. Treasury [2001] calculated that expenditure on in-work tax assistance in New Zealand would have to increase by 80 percent (or $40 million per annum) over current levels to match expenditure in the United States as a proportion of GDP or by 261 percent (or $460 million per annum) to match expenditure in the United Kingdom as a proportion of GDP.

Table 8: A Comparison of Expenditure on In-Work Tax Credits in New Zealand, the United States and the United Kingdom

	Cost Per Annum	Percent of GDP	Claimants ('000)
Earned Income Tax Credit (US$ billion) 1999	32	0.3	19,542
Working Family Tax Credit (UK£ billion) 2000 est.	5	0.6	1,500
Child Tax Credit and Family Tax Credit (NZ$ million) 2000	178	0.2	120

Source: Treasury, 2001, p. 3

There are, however, a number of important caveats to this international comparison. A more comprehensive comparison would require consideration of the interaction of in-work tax assistance with other parts of tax and benefit systems in these countries. In a social insurance system (such as that in the United States), a larger emphasis on in-work tax assistance may reflect the lack of non-contributory out-of-work assistance that exists in social assistance systems (such as that in New Zealand). In contrast, New Zealand's Family Assistance programmes are largely seen as supplementary assistance programmes.[20] A comprehensive comparison would also require consideration of differences in the distribution of income, characteristics of workers and availability of other sources of welfare, such as state or local government level funding [Atkinson and Micklewright, pp. 1693-1697]. It may also be valid to make international comparisons of expenditure on in-work tax assistance as a proportion of social security expenditure (as well as a proportion of Gross Domestic Product).

Whether or not there should be a greater proportion of social security expenditure on tax assistance also depends on the relative merits of different policy instruments. For instance, social welfare programmes are generally more effective than tax programmes at targeting assistance to those in need or at responding to fluctuations in need and circumstances. In contrast, tax programmes are generally more effective at dealing with large numbers of wage and salary earners who have no contact with the social welfare system.

8 Conclusions

This paper has described the evolution and operation of the Family Assistance Tax Credits. The operation of the Family Assistance programmes is complex. This complexity increases when the interface between these refundable tax rebates and the personal tax scale and the social welfare benefit system is also considered. This complexity has both advantages and disadvantages. Complex operational rules can, for instance, increase the

[20] The administration of Family Assistance reflects this supplementary role of Family Assistance in the New Zealand welfare system. In particular, there is a large reliance upon voluntary compliance by taxpayers, subject to the general taxpayer audit programmes.

accuracy with which entitlement is based on need and reduce overall fiscal costs to the government. Such complexity may also, however, increase the administration and compliance costs of programmes and reduce their rate of take-up and effectiveness at reducing poverty. Further research on the Family Assistance Tax Credits could therefore consider evaluating these, and other, advantages and disadvantages and the trade-offs that exist between them. Such evaluation could, in turn, address issues such as the extent that entitlement should be tailored to recipients' circumstances (as opposed to being provided on a more universal basis) and whether there is a need for a change in the role that the Family Assistance Tax Credits play in New Zealand's social assistance system.

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Appendix: Policy Changes to the Family Assistance Programmes by Date of Effect

Family Support Legislative Changes by Date of Effect

		Unabated Entitlement		Abatement Regime	
Date of Effect	Age of Child	Annual Entitlement – Eldest Child	Annual Entitlement – Additional Children	Abatement Threshold – Annual Family Income (Gross)	Marginal Abatement Rate
1 October 1986π	0 to 18	$1,872.00	$832.00	$14,000.00	18%
1 April 1987	0 to 18	$1,872.00	$832.00	$15,000.00	18%
1 April 1988	0 to 18	$1,872.00	$832.00	$15,000.00	9%
				$16,000.00	18%
				$27,000.00	30%
1 April 1989	0 to 15	$1,872.00	$832.00	$16,750.00	18%
	16 to 18	$1,872.00	$1,872.00	$27,000.00	30%
1 April 1990	0 to 15	$1,872.00	$832.00	$17,500.00	18%
	16 to 18	$1,872.00	$1,872.00	$27,000.00	30%
1 April 1991	0 to 15	$2,184.00	$1,144.00	$17,500.00	18%
	16 to 18	$2,184.00	$2,184.00	$27,000.00	30%
1 October 1993	0 to 12	$2,184.00	$1,248.00	$17,500.00	18%
	13 to 18	$2,184.00	$1,820.00	$27,000.00	30%
	**	$2,184.00	$2,184.00		
1 October 1994	0 to 12	$2,184.00	$1,404.00	$18,750.00	18%
	13 to 18	$2,184.00	$1,820.00	$27,000.00	30%
	**	$2,184.00	$2,184.00		
1 July 1996	0 to 12	$2,281.00	$1,501.50	$20,000.00	18%
	13 to 18	$2,281.50	$1,917.50	$27,000.00	30%
1 April 1997	0 to 12	$2,411.50	$1,631.50	$20,000.00	18%
	13 to 15	$2,411.50	$2,047.50	$27,000.00	30%
	16 to 18	$2,580.50	$2,307.50		
1 April 1998	0 to 12	$2,444.00	$1,664.00	$20,000.00	18%
	13 to 15	$2,444.00	$2,080.00	$27,000.00	30%
	16 to 18	$3,120.00	$3,120.00		

π Only applied for the six months of the 1986-87 income tax year for which Family Support was in place

** Provision for those born on or before 30 September 1977 (aged sixteen at the time of the change in policy)

Family Tax Credit Legislative Changes by Date of Effect	
Date of Effect	Annual Guaranteed Net Minimum Family Income
1 October 1986	$10,816.00
1 April 1987	$11,856.00
1 April 1988	$13,416.00
1 April 1989	$13,936.00
1 April 1990	$14,456.00
1 July 1996	$14,768.00
1 July 1998	$15,080.00

Child and Parental Tax Credit Legislative Changes by Date of Effect	
Date of Effect	Annual Credit Per Child
Child Tax Credit	
1 July 1996	$390.00
1 July 1997	$780.00
Parental Tax Credit	
1 October 1999	$1,200.00