Inland Revenue
Te Tari Taake

25OIA1147

18 September 2024

[redacted]

Dear [redacted]

Thank you for your request made under the Official Information Act 1982 (OIA), received on 1 August 2024. You requested the following (numbered for ease of response):

…Is there a detailed breakdown of the stats on the MFTC – past two financial years:

1. *Who gets it – age gender, maritial status number of children and for how long*
2. *How much is the top up00 ranges*
3. *How many children are supported by it?*
4. *Reasons for going off the MFTC*
   - *Full time work*
   - *Failure to sustain required number of hours per week*
   - *Change in relationship status*
   - *Earning too much*
5. *What is the wait time for someone who needs to return to a benefit*
6. *Total debt to IRD due to the MFTC*
7. *Reasons for alleged debt owed because of the MFTC*
   - *Overpayment when not working the required number of hours a week*
   - *Change in relationship status*
   - *Earning more than expected*
   - *Other*
8. *Is the MFTC gross topup payment treated as additions to taxable income for ACC/ and student debt repayment.*
9. *What evaluations have been done to substantiate the use of the MFTC as a work incentive*
10. *If untaxed child support payments are made are there grossed up to reduce the gross MFTC topup required?*
11. *Any additional unredacted policy discussions on the MFTC that can be supplied would be very welcome.*

On 20 August 2024, you were notified of a partial extension of time to make a decision on question 11, as consultations necessary to make a decision on your request were such that a proper response could not be reasonably made within the original time.

On 27 August, I provided a response to questions one to 10 of your request.

Information being released

Item 11

I have identified 19 documents in scope of this part of your request. I am releasing nine of these documents, attached as **Appendix A**, with some information being withheld under the following sections of the OIA:

- 9(2)(a) – to protect the privacy of natural persons,
- 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions by or between or to Ministers of the Crown or members of an organisation or officers and employees of any public service agency or organisation in the course of their duty, and
- 9(2)(h) – to maintain legal professional privilege.

As required by section 9(1) of the OIA, I have considered whether the grounds for withholding the information requested is outweighed by the public interest. In this instance, I do not consider that to be the case.

Please note that Inland Revenue's security classification labels have been removed from the documents in order to allow me to release these documents to you.

Information refused

The remaining 10 documents, listed below, are publicly available. Consequently, I am refusing the release of these documents under section 18(d) of the OIA, as the information requested is publicly available.

Date	Document Name	Link
17 February 2023	DPMC-2022/23-856: Working for Families: Supplementary Briefing to the Incoming Minister for Child Poverty Reduction	Working for Families: Briefing to the Incoming Minister for Child Poverty Reduction (DPMC)
21 July 2023	IR2022/274: Working for Families Review - Public Engagement	Working for Families Review – Public Engagement (IR)
28 November 2023	REP-23-11-891 - Indexing main benefits to inflation	Indexing main benefits to inflation (MSD)
18 January 2024	Supplementary Analysis Report: Indexing Main Benefits to Inflation	Supplementary Analysis Report: Indexing Main Benefits to Inflation (TSY)
8 February 2024	Social Security (Benefits Adjustment) and Income Tax (Minimum Family Tax Credit) Amendment Bill	Social Security (Benefits Adjustment) and Income Tax (Minimum Family Tax Credit) Amendment Bill (MSD)

4 April 2024	Consequential amendments to the Minimum Family Tax Credit following Budget decisions	Budget 2024 Information Release (Page 78)
10 April 2024	Relationship between the Minimum Family Tax Credit threshold and Working for Families abatement threshold	Budget 2024 Information Release (Page 87)
10 April 2024	Cover note for MFTC report [IR2024-119 refers]	Budget 2024 Information Release (Page 93)
12 April 2024	Further information – changes to the Minimum Family Tax Credit threshold in line with Budget 2024 package	Budget 2024 Information Release (Page 96)
19 April 2024	Increase to the Minimum Family Tax Credit threshold	Budget 2024 Information Release (Page 98)

Right of review

If you disagree with my decision on your OIA request, you can ask an Inland Revenue review officer to review my decision. To ask for an internal review, please email the Commissioner of Inland Revenue at: commissionerscorrespondence@ird.govt.nz.

Alternatively, under section 28(3) of the OIA, you have the right to ask the Ombudsman to investigate and review my decision. You can contact the office of the Ombudsman by email at: info@ombudsman.parliament.nz.

If you choose to have an internal review, you can still ask the Ombudsman for a review.

Publishing of OIA response

We intend to publish our response to your request on Inland Revenue's website (ird.govt.nz) as this information may be of interest to other members of the public. This letter, with your personal details removed, may be published in its entirety. Publishing responses increases the availability of information to the public and is consistent with the OIA's purpose of enabling more effective participation in the making and administration of laws and policies and promoting the accountability of officials.

Thank you again for your request.

Yours sincerely

Sue Gillies
Customer Segment Leader, Families

Appendix A
Document 1

Report

Date: 21 July 2022 **Security Level:**

To: Rt Hon Jacinda Ardern, Prime Minister / Minister for Child Poverty Reduction

Hon Grant Robertson, Minister of Finance

Hon Kelvin Davis, Minister for Children

Hon Carmel Sepuloni, Minister for Social Development and Employment

Hon David Parker, Minister of Revenue

Working for Families Review: Evidence and Options

Purpose of the report

1 As part of the Working for Families (WFF) review, this report provides you with:

- A summary of available evidence on tax credits in New Zealand and overseas, and an assessment of the issues with WFF (Part A, beginning at page 10).
- High-level options to address some of the key issues identified, and advice on some of the key considerations and trade-offs that should be taken into account when considering the options (Part B, beginning at page 17).

Executive summary

2 As part of the Review, officials have brought together a range of evidence and analysis on issues relevant to WFF (see Appendix One). Overall, we have concluded that New Zealand's model of tax credits is not an outlier, and we face similar issues to other countries that use tax credits, in terms of balancing objectives such as income adequacy and making work pay. Within current fiscal constraints, the broad structure and targeting of WFF is largely fit-for-purpose, and generally effectively balances different objectives. However, improvements are needed to address identified issues with the design of the system.

3 In addition to an ongoing need to improve the adequacy of incomes for families both on benefit and in work, there are issues with the design of our tax credits that mean that some groups see little return from working more. Our

abatement settings mean that multiple payments across the tax and benefit system withdraw at the same time, and the Minimum Family Tax Credit (MFTC) in particular has serious design issues. Receipt of the various payments also occurs across a complex 'benefit-work interface' that impacts not just on people's experience of the system but also on outcomes.

4 Officials have identified several options under each 'theme' for the review:

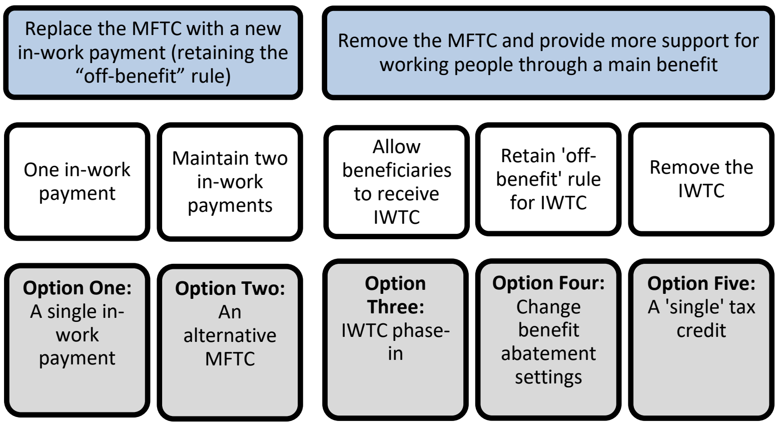
- Theme One: Improvements to the structure and design of in-work tax credits to help make work pay *(beginning at page 17).*
- Theme Two: Improvements in the early years to assist with the costs of children and support preferences around work and caring for children *(beginning at page 29).*
- Theme Three: Administrative and operational improvements to improve client experience and reduce debt *(beginning at page 34).*

Theme One: Improvements to the structure and design of in-work tax credits to help make work pay

5 Officials have provided advice on five options that improve the design of the in-work payments, which all involve removing or replacing the MFTC.

- **Option one** ('a single in-work payment') proposes a significant structural change by introducing a single and more targeted in-work payment that combines the MFTC and In-Work Tax Credit (IWTC).
- **Option two** ('an alternative MFTC') proposes a smaller-scale change that largely keeps existing settings but replaces the MFTC with a similar, more flexible, payment for sole parents that abates gradually.
- **Option three** ('IWTC phase-in') phases in the IWTC more gradually and allows beneficiaries to receive the payment while on benefit.
- **Option four** ('change benefit abatement settings') retains the off-benefit rule for the IWTC and increases benefit abatement thresholds to better support families in part-time work.
- **Option five** ('a single family tax credit') removes the IWTC and creates a single tax credit that improves incomes and helps make work pay.

6 One of the key decisions is whether to retain a 'hard' boundary between benefit and work, or whether to instead allow families in work to receive an abated benefit for longer. The diagram on the right shows the different choices for Ministers on the role of the in-work payments.



- Options one and two retain the off-benefit requirement to qualify for the in-work payment, which provides a clearer pathway for people to move off a benefit and receive the more 'light touch' in-work payments paid by Inland Revenue (IR).
- For options three to five, more working families will receive an abated benefit as their hours of work increase, and the boundary between benefit and work is more gradual. These options therefore mean more working families would interact with the higher-compliance benefit system.

7 The single in-work payment (option one) and single tax credit (option five) options involve significant system reform, and present quite different choices for Ministers on the design of WFF.

- Option one increases incomes for working families and has a strong focus on making work pay through a single, more generous in-work payment.
- Option five removes the in-work payments, relies solely on the Family Tax Credit (FTC) to financially support low to middle-income families, and provides income increases to both non-working and working families. The option modelled modestly reduces the gap between benefit and in-work incomes, but still aims to make work pay through more generous FTC abatement settings rather than through a specific in-work payment.

8 Options two to four are relatively cheaper as they are more tightly targeted and provide relatively small system modifications. They do not inherently include an adequacy-focused component, but they could be progressed alongside adequacy-focused changes and options from Theme Two below.

9 Officials recommend you consider the following important issues as part of subsequent advice on the in-work options:

- Increasing the WFF abatement threshold to reduce overlapping abatement with the benefit system. For some options, changes to abatement settings are a necessary part of the design and therefore do not require separate consideration (options one and five).
- How payments rates and thresholds will be adjusted over time (indexation) to ensure changes are future proof.

10 Table 1 on the next page provides a summary of some of the key trade-offs. We have modelled the options with initial parameters, and can model more variations of options, if for example, Ministers like the design of a particular option but would prefer to see the modelling of an option with a lower fiscal cost or greater focus on reducing child poverty. The fiscal costs are generally scalable, indicative and do not yet include operational costs or any behavioural impacts. For example, some options will see more people better off receiving a benefit and this has not yet been modelled. The key features and impacts of these options are outlined in more detail in the A3s in Appendix Two.

Table 1: Indicative impacts and trade-offs of in-work options for 2024/25

Simplification	Make work pay / financial incentives	Reduce child poverty	Annual fiscal costs	Benefit/work interface
Option One: A single in-work payment *Could be implemented on 1 April 2024 at the earliest*				
Simplifies and rationalises the two in-work payments into one.	Increases gap between benefit and 40hrs min wage work by $131pw for sole parents, and marginally reduces gap at 20hrs. Modestly increases EMTRs for those already in work.	9,000 (BHC50) 28,000 (AHC50) 170,000 HHs gain by $81pw, 24,000 HHs lose by $34pw due to reintroducing an hours test for main in-work payment.	$675m *Option could easily be scaled*	Maintains in-work payment (IWTC and MFTC combined). Maintains 'off-benefit' and 'hours worked' tests to qualify (like MFTC currently).
Option Two: New MFTC payment for sole parents *Could be implemented on 1 April 2025 at the earliest*				
Limited simplification benefits.	Increases gap between benefit and 40hrs min wage work by $6pw for sole parents and maintains gap at 20hrs work. Modestly reduces EMTRs for existing MFTC recipients but means more sole parents eligible for MFTC and high EMTRs.	2,000 (BHC50) 2,000 (AHC50) 134,000 HHs gain by $5pw. No HHs lose	$35m *Limited ability to scale if progressed on its own*	Maintains both in-work payments (IWTC and improved MFTC). Maintains 'off-benefit' and 'hours worked' for MFTC, and 'off-benefit' rule for IWTC.
Option Three: Phase-in the IWTC *Could be implemented on 1 April 2025 at the earliest*				
Reduces number of in-work payments but the phase-in nature of IWTC increases complexity.	Maintains gap between benefit and 40hrs min wage work for sole parents, but increases gap at 20hrs work by $54pw. Reduces EMTRs but less clear about how much work is 'worthwhile'.	1,000 (BHC50) 1,000 (AHC50) 41,000 HHs gain by $33pw, 20,000 HHs lose by $30pw primarily due to losing eligibility to the IWTC as there is currently no phase-in.	$38m *Limited ability to scale if progressed on its own*	Maintains an in-work payment (IWTC). Removes 'off-benefit' rule for IWTC.
Option Four: Changes to benefit abatement settings *Could be implemented as early as 1 April 2024 depending on design*				
Reduces number of in-work payments and doesn't require large structural change to WFF.	Increases gap between benefit and 40hrs min wage work by $8pw for sole parents and increases gap at 20hrs work by $3pw. Reduces EMTRs but less clear about how much work is 'worthwhile'.	1,000 (BHC50) 2,000 (AHC50) 225,000 HHs gain by $8pw. No HHs lose	$83m *Some ability to scale option*	Maintains in-work payment (IWTC). Choice around whether to keep off-benefit rule for IWTC.
Option Five: A single family tax credit *Could be implemented as early as 1 April 2024 depending on design*				
Results in simplest system of all the options as only retains a 'single' family tax credit	Reduces gap between benefit and 40hrs min wage work by $35pw for sole parents and reduces gap at 20hrs work by $19pw. There are options to broadly maintain the gap between benefit and work.	24,000 (BHC50) 27,000 (AHC50) 235,000 HHs gain by $46pw. 24,000 HHs lose by $23pw due to AS and shared care rules.	$540m *Option could easily be scaled*	Removes the in-work payments.

11 As noted earlier, each of the in-work options above could be complemented by additional income adequacy measures. FTC increases could be progressed to further reduce child poverty in both beneficiary and working households, and/or Ministers may like to increase the size of any in-work payment.

Option	Annual cost	Poverty impacts	Winners / losers
Option Six: Increase FTC by $25pw per child	$680m	32,000 (BHC50) 35,000 (AHC50)	267,000 HHs gain by $49pw. 5,000 HHs lose by $3pw.
Option Seven: Increase IWTC by $25pw	$192m	6,000 (BHC50) 8,000 (AHC50)	161,000 HHs gain by $23pw. No HHs lose.

12 There is also an option to improve financial assistance for second earners by allowing the second earner to also receive the IWTC amount. This recognises that single-earner households have higher rates of in-work poverty than dual-earner households; and that the current family-based structure of WFF can reduce labour market participation incentives for second earners. This option has not been modelled, but further advice can be provided.

Theme Two: assisting with the costs of children in the early years

13 You have asked for advice on extending Best Start to three and four-year olds, and whether the IWTC should be repurposed as a Childcare Tax Credit (CTC). Enhancing Best Start would support both working and beneficiary families. It could contribute to childcare costs, either formal or informal, and would importantly provide greater choice around caring for children.

14 We have also modelled an option to increase the existing targeted Best Start payment for low-income families with children up to the age of three. Increasing financial support in the early years would align with the Government's first 1000 days wellbeing objectives by supporting parent-child attachment and reducing stressors. It would also improve flexibility by allowing families to choose care options most suited to their family circumstances.

Option	Annual cost	Poverty impacts	Winners / losers
Option Eight: Extending targeted Best Start payment to eligible families with children up to age five ($40pw)	$104m *Option could easily be scaled*	5,000 (BHC50) 5,000 (AHC50)	49,000 HHs gain average of $41pw.
Option Nine: Increasing Best Start by $40pw for eligible families up to age three	$156m *Option could easily be scaled*	5,000 (BHC50) 8,000 (AHC50)	68,000 HHs gain by $44pw.

15 Officials would not recommend replacing the IWTC with a CTC, as evidence shows many families in in-work poverty do not have childcare costs and would therefore be worse off. A CTC would likely need to replace the Ministry of Social Development's (MSD) Childcare Assistance (CCA), given they have similar objectives. If Ministers are interested, further work could determine the merits of a CTC relative to the improvements currently proposed in the CCA review.

16 Some of the changes currently being considered as part of the CCA review would provide a more meaningful contribution to childcare costs for low-income families. A revised CCA payment, alongside an enhanced in-work payment and

Best Start, could offer a combination of flexible and targeted childcare payments for both working and beneficiary families.

Theme Three: administrative and operational improvements

17 Officials have identified five options to improve the accuracy of WFF payments, reduce WFF debt and improve client experience. Our view is that all options merit further analysis and development.

18 The options for improving accuracy are introducing grace periods, extending protected entitlements, and improving information exchange between MSD and IR. For managing debt once it is incurred, the options are introducing a buffer tax credit and increasing the automatic debt write-off threshold.

19 Officials have previously noted that there are fundamental delivery issues related to the joint administration of the tax credits that could be considered, but advice on these is largely dependent on what decisions are made regarding the different design options for tax credits in this paper.

Implementation advice

20 When options are more fully developed, we will be able to provide more detailed advice on their potential implementation impacts on IR and MSD. The implementation timeframes provided are indicative only and are dependent on the specifics of the final design and what other work Ministers may require IR and MSD to undertake over the same period.

21 Options that only require changes in rates could be made relatively quickly (before 1 April 2024) if early decisions are taken ahead of Budget 2023. Options that require larger structural changes, such as some of the in-work options, could not be implemented until 1 April 2025, with other options likely to be able to be implemented on 1 April 2024.

Child Poverty targets

22 The Review is a primary vehicle for achieving substantial reductions in measured child poverty and for making significant 'headway' towards achieving the ten-year targets, which are due to be achieved in 2027/28.

23 Current projections show child poverty rates on the income measures are estimated to be above the target rate for the current three-year targets, which are due to be achieved in the 2023/24 financial year. While any options that are implemented in mid-2023 would still have some impact on progress towards these targets, reporting methods mean that only around half of the impacts of an initiative would be reflected in the measured rates in the 2023/24 target year.

Next steps

24 Officials will provide refined modelling and more detailed advice on the options identified for further work by Income Support Ministers on 9 August 2022.

Recommended actions

It is recommended that you:

1 **note** that there are trade-offs between progressing options in this paper, as well as wider income support options (such as Childcare Assistance) and other Government priorities

2 **note**, for the in-work options, officials recommend you focus on narrowing down the options to two or three preferred options for further development and advice

3 **note** that options that assist with the costs of children in the early years (theme two) and improve administration (theme three) could complement the in-work options

4 **note** that officials propose that these options are discussed at the Income Support Ministers meeting on 9 August 2022

Theme One: improvements to the structure & design of in-work tax credits

5 **agree** to further advice on two or three of the following options:

5.1 introducing a single and more targeted in-work payment that replaces both the Minimum Family Tax Credit and In Work Tax Credit (option one)

AGREE / DISAGREE

5.2 replacing the Minimum Family Tax Credit with a similar, more flexible payment for sole parents that abates gradually (option two)

AGREE / DISAGREE

5.3 phasing-in the In Work Tax Credit more gradually and allowing beneficiaries to receive the payment (option three)

AGREE / DISAGREE

5.4 retaining the In Work Tax Credit and change benefit abatement settings to better support low-income working families (option four)

AGREE / DISAGREE

5.5 removing the In Work Tax Credit and creating a single tax credit that improves income adequacy and helps make work pay (option five)

AGREE / DISAGREE

6 **indicate** if, as part of further advice on your preferred in-work option(s) in recommendation 5 above, you wish to include variations that increase incomes and child poverty impacts, at a greater fiscal cost (options six and seven)

AGREE / DISAGREE

7 **indicate** if you would like to receive further advice on options to better support second earners through changes to Working for Families settings

AGREE / DISAGREE

Theme Two: improvements in the early years to assist with the care of children and support choices around work

8 **agree** to further advice on the following:

8.1 extending a targeted Best Start payment for low- to middle-income families with children aged three and four years (option eight)

AGREE / DISAGREE

8.2 increasing the Best Start rate for low- to middle-income families with children up to age three (option nine)

AGREE / DISAGREE

8.3 the merits of a Childcare Tax Credit payment relative to the improvements currently proposed in the Childcare Assistance Review

AGREE / DISAGREE

Theme Three: administrative and operational improvements to improve client experience and reduce debt

9 **agree** to further advice on the following:

9.1 giving Working for Families recipients a longer period of time in which to inform Inland Revenue of a change in circumstances ('grace periods')

AGREE / DISAGREE

9.2 introducing or extending the periods in which payments are unaffected by subsequent earnings ('protected entitlements')

AGREE / DISAGREE

9.3 improving information exchange between Inland Revenue and the Ministry of Social Development for people moving on and off benefit

AGREE / DISAGREE

9.4 introducing an end of year supplement ('Buffer Tax Credit')

AGREE / DISAGREE

9.5 increasing the threshold at which debts are automatically written off

AGREE / DISAGREE

9.6 other miscellaneous administrative changes to improve customer experience as set out in theme three in this report

AGREE / DISAGREE

10 **agree** that subsequent advice include:

10.1 refined modelling and advice on your preferred options in this paper
10.2 advice on Working for Families abatement rates and thresholds
10.3 advice on indexation arrangements to future-proof settings

AGREE / DISAGREE

s 9(2)(a)	s 9(2)(a)	s 9(2)(a)	s 9(2)(a)
Clare Ward	Fiona Carter-Giddings	Keiran Kennedy	Eina Wong
Department of the Prime Minister and Cabinet	Ministry of Social Development	The Treasury	Inland Revenue
21/07/22	21/07/22	21/07/22	21/07/22
Date	Date	Date	Date

Rt Hon Jacinda Ardern	Hon Grant Robertson	Hon Kelvin Davis	Hon Carmel Sepuloni	Hon David Parker
Prime Minister, Minister for Child Poverty Reduction	Minister of Finance	Minister for Children	Minister for Social Development and Employment	Minister of Revenue
Date	Date	Date	Date	Date

PART A: CONTEXT, EVIDENCE, ENGAGEMENT, AND ASSESSMENT

Background

25 In May 2021, Income Support Ministers agreed that the original WFF objectives of supporting income adequacy and reducing child poverty, and improving financial incentives for low-income earners to enter the labour market, remain important. They also noted that the third delivery objective, to achieve a system that supports people into, and to remain in, work by making sure they get the assistance they are entitled to in a timely manner, continues to be important regardless of the scale and direction of reform.

26 Income Support Ministers agreed that the Review focus on:

- Low-income working families, while maintaining support for beneficiary families.
- Options that target support to lower-income families rather than more universal support.
- The principle of making work pay and assisting with the costs for people in work.

27 In April 2022, Ministers agreed to two themes for further advice on 'making work pay':

- Improving the settings for in-work assistance and the work-benefit interface.
- Assisting with the costs of children in the early years, particularly additional in-work and childcare costs.

28 Ministers requested advice on how best to remove or reform the MFTC, options for the reform of the IWTC (phasing it in, repurposing the funding for other options), and targeted options to extend Best Start. Across option development, Ministers requested a focus on simplicity and ease of use, and that specific consideration be given to how to improve the accessibility of WFF.

29 Ministers have requested officials' high-level assessment of WFF, with a particular focus on whether the structure of WFF is 'fit-for-purpose' for low-and middle-income NZ families, and whether there are particular families that have not benefited from the payment system who should.

Summary of evidence

30 As part of the Review, officials have brought together a range of evidence and analysis on issues relevant to WFF. This evidence helps us assess the effectiveness of the current WFF payments and/or better understand the context the payments operate in.

31 A summary of the key findings is attached to this report as Appendix One. Across this evidence, there are some issues which can be grouped around similar themes:

- **New Zealand's model of tax credits is not a significant outlier, and faces similar issues to many other countries.** Officials have reviewed the design of different models of tax credits overseas, including Australia, the United Kingdom, the United States and Canada, and concluded that the design of WFF in New Zealand fits broadly within the spectrum of tax credit design in these countries. Other countries are similarly grappling with issues of balancing adequacy for working and non-working low-income families, while also maintaining incentives to work and making work pay.
- **In-work poverty is an increasing issue, as in many other countries.** Sole earners, both sole parents and couples with only one parent working, have higher rates of income poverty and material hardship compared to households with two parents in paid work. Rates of poverty have also been increasing for this group, indicating a single income is becoming a less viable option for providing economic security and meeting basic needs.
- **WFF tax credits are an effective poverty alleviation tool for families with children, but choices about targeting involve trade-offs.** Children in poverty are broadly evenly split between beneficiary families and the working poor, and can also be found across a range of low-to middle-income families. This means there are a range of different choices about how to target child poverty reduction, with different trade-offs around 'coverage' and cost-effectiveness, as well as different impacts on the relative levels of benefit and work.
- **While the gap between benefit and work has increased over the past two decades, issues with the design of WFF tax credits (and other income support payments) mean some groups see little return from working more.** Between 2003 and 2022, the gap between benefit and work increased for all family types, primarily because of the implementation of WFF between 2004 – 2007 and subsequent increases both to the minimum wage and to wages more generally. However, some groups of families currently face very high Effective Marginal Tax Rates (EMTRs), particularly low-income sole parents and second earners. This often means work does not 'pay' and sometimes even means they are worse off the more they work – particularly if they have childcare costs. The extent to which 'work pays' is just one factor that influences employment decisions, but the evidence suggests that changes to financial incentives do have modest impacts on employment decisions, with sole parents and second earners responding more than primary earners.
- **There is a case for investment in the early years of a child's life.** The evidence has demonstrated that this is when children are the most vulnerable to the consequences of poverty, and when caregivers are least able to support themselves through employment in the labour market. There are also affordability issues associated with childcare for low-income

families in New Zealand, and that the costs of childcare make a considerable difference on the extent to which 'work pays'.

- **Administrative issues impact not just on client experience, but also on adequacy and incentives**. The policy objectives of improving income adequacy and making work pay is more difficult if clients are not receiving their entitlements, and there is room for improvement in 'take-up' of in-work payments. The administration of WFF is also a contributor to overall debt to government, which can be a considerable cost burden on low-income families and can also discourage work.

Our high-level assessment of Working for Families

32 Ministers have requested officials' high-level assessment of WFF, with a particular focus on whether the structure of WFF is 'fit-for-purpose' for low and middle-income families, and whether particular families have not benefited from the payment system who should. Our high-level view is that:

- The introduction of WFF between 2004 and 2007 benefited low-income working families more than beneficiary families, and the significant reductions in child poverty it achieved were primarily for low income working households with children. However more recent changes as part of the Families Package in 2018 also provided gains for beneficiary families, and successive benefit increases in 2020, 2021 and 2022 have increased beneficiary incomes further. Both beneficiary and working families have benefited from WFF, though issues of income adequacy and poverty persist for both groups.
- Since the late 2000s, WFF has become progressively more targeted to those on lower incomes, as incomes have increased faster than the abatement thresholds and abatement rates have been increased. While this ensures money is generally well directed to those who need it more, it has now reached the point where payments are beginning to abate for those on very low incomes - even for some families supported by benefits. Abatement now overlaps with other income support payments, creating pockets of very high marginal tax rates.
- The 2004-07 WFF changes increased the margin between benefit and work and helped to 'make work pay', but the immediate impact on employment was relatively modest. Sole parents' paid employment increased, but second earners decreased, which suggests an incentive payment has modest impacts on decisions to work in aggregate.
- Officials believe there are significant issues with the design of in-work assistance, particularly the MFTC but also to a lesser extent the IWTC. There is also significant complexity in the system, not just in the number of payments and the design of their policy settings, but also in the delivery of some payments across two different agencies.

33 Overall, the broad structure and targeting of WFF currently achieves an effective balance between key objectives of income adequacy, fiscal cost, and maintaining financial incentives to work. However, further refinements are recommended to address identified issues.

Insights from engagement

34 The engagement process as part of the review has now concluded. A separate report summarising key findings has been prepared for Ministers, but the following provides a summary from the process. The majority of feedback was from advocacy groups concerned with child poverty and broader social policy issues.

- The majority of survey respondents were of the view that WFF does not currently pay enough to support families. Through targeted engagement, many stakeholders, including a number of academics and those representing groups that advocate for children, emphasized the importance of broader social policy concerns. From these groups, we heard that:
  - The objective of income adequacy and reducing child poverty is important and that the payments need to keep up with the cost of living to provide adequate support.
  - The IWTC should be paid to all families and not just those who are off a benefit and in paid work. These stakeholders argued that the payment was discriminatory or unfair, particularly given children were unable to choose whether their parents were working. They also emphasised the need to value other contributions people make, such as caring for children or voluntary work.
- We heard mixed views on the importance of WFF as a work incentive and its role in supporting employment:
  - Through the survey most people thought WFF influenced work decisions.
  - Through targeted engagement many argued the IWTC was not effective as a work incentive, and that it was more important to remove barriers to employment (such as the costs of travel and childcare).
  - Several stakeholders thought reducing in-work poverty and making work pay was important – although they thought a ‘work incentive’ payment was not necessary to achieve this.
  - Other stakeholders, by contrast, emphasised the importance of financial incentives to work, and argued that, if anything, they should be strengthened. Some stakeholders cautioned against providing the IWTC to beneficiaries on these grounds.

- Across the engagement, stakeholders from a range of different perspectives noted that the current abatement of WFF payments means people often see little or no return from working more.
- Another common theme was that the system is complex and can be difficult for families to access and navigate, particularly for families including disabled people or people for whom English is a second language. Concern around the creation of debt, particularly for families with changing circumstances, has also been a particularly strong theme.

Context for assessing options

Child poverty targets

35 The WFF Review is likely to present the best opportunity in the coming years to achieve substantial reductions in measured child poverty and to make significant 'headway' towards achieving the ten-year targets, which are due to be achieved in 2027/28. The 2022 Child Poverty Budget Report indicates significant further policy interventions are required to reach these targets, particularly on the BHC50 measure. Rates on the BHC50 measure are projected to rise from 2023/24 onwards, particularly due to growth in middle incomes.

36 Current projections also show child poverty rates on the income measures are estimated to be above the target rate for the current three-year targets, which are due to be achieved in the 2023/24 financial year. While any options implemented by mid-2023 would still have some impact on progress towards these targets, reporting methods mean that any impact would be only partial for the reporting on this period.

- If Ministers want to increase the impact on measured child poverty, the options for improving the design of in-work payments could have their parameters altered to improve adequacy, be paired with other increases to payment levels (e.g. an FTC or IWTC increase), or be combined with some of the options from Theme Two. Guidance on the fiscal envelope would help subsequent options development here.
- If Ministers want to make faster progress on child poverty, officials could consider sequencing and phasing. For example, by progressing simpler changes such as rate increases more quickly ahead of more fundamental design changes. We note, however, that in some cases this may constrain design options, by limiting your ability to use any increases to offset any losses created by changes in tax credit design.

37 This paper includes modelled estimates of the *immediate* impact of different options on measured child poverty, but it is important to note that reducing child poverty is not solely about increasing income transfers. Investments to help make work pay (either through WFF and/or childcare) also supports poverty reduction in the longer-term, though the impact is more incremental and difficult to discern on the measures.

Impact on financial incentives and employment

38 When assessing different options, an important consideration is their impact on financial incentives and employment. Financial incentives to work can be thought about both in terms of their impacts on decisions on whether `to work at all (the 'extensive margin') and also decisions about whether to work more or less hours (the 'intensive margin'). The options in this paper have different impacts on these aspects of financial incentives, depending on both their impact on the gap between benefit and employment, and their impact on EMTRs.

39 Changes in financial incentives are likely to have flow-on impacts on employment. As noted in Appendix One, the available evidence both in New Zealand and overseas suggests the impact of financial incentives on employment decisions is relatively modest, but it does have an impact. The impacts are greater on encouraging caregivers to enter work rather than on increasing hours of work. Irrespective of the extent of its impact on decision-making and behaviour, the extent to which work 'pays' and people see a financial return from working more is also important from the perspective of equity and fairness.

40 Throughout this paper, we have attempted to include a high-level assessment of the impact of the different options on financial incentives, but it is important to note that the impacts may vary for different groups, and they are also partially dependent on the parameters used to design the option (which could be adjusted). Subsequent advice on a specific option can consider the fuller range of impacts on financial incentives in more detail, and differentiate more by client group. This may be able to include modelling of impacts on labour supply.

Implementation

41 When options are fully developed, we will be able to provide more detailed advice on the potential impact on IR and MSD of implementing these changes. The implementation timeframes provided for the options in this report should be treated as indicative only. They are current best estimates and are dependent on:

- The specifics of the final design.
- What other work Ministers may require IR and MSD to undertake.

42 It is preferable from an implementation perspective that changes to WFF be aligned with the beginning of the income year (1 April) rather than occurring part way through the year. Indicative timeframes have been framed on this basis.

43 While it is possible for changes to be implemented in the middle of an income year, such changes are complex to implement, and negatively impact on the accuracy of WFF payments resulting in both over- and under-payments for that

year. In addition, changes implemented during the year cannot be incorporated into the usual roll-over process and require new entitlement notices to be prepared and sent to customers. This can increase confusion for customers, which has a consequential administrative impact on IR.

44 Options that only require changes in rates could be made relatively quickly. For example, if Ministers wished to introduce an FTC rate increase applying from 1 April 2023, policy decisions would be required by early October 2022, with legislation being passed by early December 2022. These timeframes are necessary to allow IR and MSD sufficient time to make the required system changes by February 2023, and 2023/2024 entitlement notices to be provided to customers.

45 Options that require more structural changes, such as some of the in-work options, will take longer to implement. It is anticipated that most of the in-work options could not be able to be implemented until 1 April 2025, although some options could be implemented from 1 April 2024.

46 For MSD, options that allow a greater number of working families to receive a main benefit would require significant further work on fundamental parts of the benefit system, such as the definition of full-time employment and the approach to working beneficiaries. This may mean a longer implementation timeframe (beyond 1 April 2024).

47 Further advice on implementation dates is provided throughout the report, alongside options analysis.

PART B: OPTIONS FOR REFORM

Theme One: Improvements to the structure & design of in-work tax credits (making work pay)

48 These options relate to the design of in-work tax credits to help improve incomes and support movement into work for low-to middle-income families. The options would be relatively targeted to households in in-work poverty, with a focus on providing more support for low-income primary earners. At the end of this section, we have an option that gives more financial assistance to encourage second earners to move into work.

Issues with in-work payments and the benefit / work interface

WFF is part of a complex system of payments across the 'benefit-work interface'

49 WFF includes two work-focused payments (the MFTC and IWTC), and two income adequacy-focused payments (the FTC and Best Start). They interact with tax settings and a wider suite of payments provided by MSD, the primary ones being main benefits and Accommodation Supplement.

50 Each payment has its own set of eligibility rules and abatement settings, and when delivered across two agencies it can make it challenging for people to navigate the system, keep their circumstances updated, and understand what they are entitled to and when they are better off. It can also result in very high EMTRs when payments abate at the same time (e.g. the FTC and main benefits, as outlined on the first page of Appendix Two).

The MFTC is complex and not well integrated into the income support system

51 The MFTC is complex and not well understood by customers, which means it has lower take-up and awareness compared to other WFF tax credits. The MFTC's 'hours worked' and 'off-benefit' tests can also make entitlement sensitive to any changes in work circumstances. These issues limit its effectiveness as a work incentive and income adequacy payment.

52 The rigidity to MFTC's eligibility criteria can also result in under and over-payments of entitlements during the year. IR data shows that almost half of the 3,500 MFTC recipients are overpaid their annual entitlement during the year due to subsequent income increases, while most of the remaining MFTC recipients receive a lump-sum payment at the end of the year due to underpayments during the year.

53 The small number of stakeholders who commented on the MFTC suggested removing it, due to its complexity and the debt it often creates for families.

Some elements of the MFTC and IWTC do not support making work pay

54 Due to recent policy decisions on how the MFTC threshold should be calculated, the MFTC no longer ensures that couples are financially better off moving off-

benefit.[1] The MFTC also now only ensures sole parents are financially better off moving off-benefit in the months when they are not receiving the Winter Energy Payment.

55 Additionally, the MFTC's 100 percent abatement rate means recipients do not receive any additional income from an extra hour of work (even before any in-work costs are considered). For example, a sole parent in receipt of the MFTC and earning the minimum wage is financially no better off working 35 hours a week compared to 20 hours.

56 While the MFTC was designed to strongly incentivise part-time work, evidence from MSD shows that most sole parents who exit benefit into employment go into full-time work. This suggests the incentives provided via the MFTC do not align with the lived experiences of sole parents moving off benefit, or the availability of suitable part-time work, nor does it affect their work decisions.

57 There are also some issues with the IWTC, but to a lesser degree. While the payment reduces in-work poverty, some elements of the payment do not support making work pay, and there is mixed evidence of its effectiveness as a work incentive payment.

Options to better support low to middle-income families through changes to the benefit / work interface

58 There are a range of options available to redesign and/or replace the MFTC, and some options propose redesigning the IWTC as well. Each option, to varying degrees, will:

- **Reduce child poverty.** Including increasing financial assistance for low-to middle-income families.
- **Better support making work pay.** Including reducing EMTRs of greater than 100 percent to ensure people are financially rewarded for increasing their hours of work.
- **Improve take-up, administration, and customer experience.** Including simplification and greater integration of the MFTC (or any replacement tax credit) into the wider suite of tax credits.

59 We have provided five options that make improvements to the status quo, but all have significant trade-offs. One of the main high-level decisions that differentiate these options is whether to retain a 'hard' boundary between benefit and work. These trade-offs are summarised below and then expanded on further for each option.

[1] Due to recent decisions not to increase the MFTC by the full amount suggested by increases in the benefit system. A partial increase avoided overlapping abatement with the FTC and reduced the fiscal cost of structural changes to in-work assistance as part of this review.

Options that replace, but maintain an in-work payment and the 'off-benefit' rule

- **Option One: A single in-work payment** that combines the MFTC and IWTC into a single more targeted, flexible and integrated in-work payment.
- **Option Two: An alternative MFTC payment for sole parents** that is more flexible and abates more gradually.

60 Maintaining an in-work payment and the 'off-benefit' rule will provide greater incentives to move off benefit and into a desired level of hours worked. These options provide a clear pathway for people to move off a main benefit and receive the more 'light touch' in-work payments provided by IR.

61 However, these options mean people are more likely to need to switch between MSD and IR systems if their hours worked change regularly, which can result in more under and over-payments across MSD and IR. There are some changes that could 'soften' this boundary, such as introducing grace periods and greater flexibility to assess hours worked.

Options that remove the MFTC and provide more support for working people through a main benefit

- **Option Three: Phase-in the IWTC** and allow beneficiaries to receive the payment.
- **Option Four: Changes to benefit abatement settings** to better support low-income working families.
- **Option Five: A single family tax credit** that still ensures work pays by removing the IWTC and redirecting it into the FTC.

62 Options three to five all involve a significant change in the role of main benefits to include supporting some families in close to full-time work, but they will result in more steady income changes if hours worked increase or fluctuate regularly. It could also support greater take-up of in-work assistance from MSD such as Accommodation Supplement and Childcare Assistance.

63 However, these options then require working families to interact with the higher-compliance benefit system which can include weekly income declarations and assessments, and meeting certain obligations. Currently take-up of FTC/IWTC is relatively high for those not receiving a benefit (at over 80 percent) and overseas research suggests there is a risk that the lowest-paid working families will not take-up benefit assistance from MSD. Low take-up is due to a wide range of factors including lack of awareness, compliance costs and stigma associated with the benefit system, which could undermine the intent behind these options.

Option 1: Single in-work payment

64 This option combines the IWTC and MFTC into a new in-work payment to provide more support to low-to middle-income working families. It would:

- Replace the MFTC and IWTC with a new in-work payment that is a set amount (up to $310pw) that is broadly equal to the current IWTC and MFTC amount.
- The new in-work payment abates gradually (e.g. at 30%), at the same abatement rate as but ahead of the FTC, as incomes increase.[2]
- Annually adjust the income abatement thresholds to ensure incomes in work remain higher than on benefit (like current MFTC adjustments do).
- Maintain the 'hours worked' and 'off-benefit' tests that are currently applied to the MFTC (i.e., beneficiaries don't qualify, and sole parents need to work 20 hours a week and couples 30 hours a week).
- Allow for some ups and downs of work hours from week to week (e.g., by using average hours worked across a month) and/or through grace periods to better support those with fluctuating hours.

65 The earliest this option could be implemented is 1 April 2024. The estimated annual cost of the option modelled is $675m, increasing in outyears due to indexation.

Advantages

66 This option simplifies WFF as it merges two in-work tax credits into one, and better targets in-work assistance to low-to middle-income working families. It maintains the current incentives to move off benefit and work a particular level of hours and reduces EMTRs for families currently receiving the MFTC.

67 It has the potential to significantly improve income adequacy for working families, with around 170,000 households estimated to gain by $81pw. It is estimated to reduce child poverty by around 9,000 on the BHC50 primary measure, and 28,000 on the AHC50 primary measure.

68 The reductions in poverty are lower on the BHC50 primary measure partly because it increases the median income at the same time which can move additional families below the relative poverty line (whereas the AHC50 primary measure fixes the median income), and some low-income working families are made worse off.

69 This option may also result in modest increases in employment from having a more generous in-work payment (similar to the initial WFF changes in 2005/06), which could lead to modest reductions in poverty amongst the unemployed. As noted earlier, officials can provide further advice on possible labour supply effects of options in subsequent modelling.

[2] The payment would begin to abate from where families in minimum wage work qualify for the MFTC ($25,000 for sole parents, and $37,400 for couples) and FTC would begin to abate immediately afterwards ($78,700 for smaller families) The order of abatement is switched to mirror the current MFTC, which abates ahead of the FTC (and IWTC currently abates last).

70 Some stakeholders noted that work incentives should be strengthened, and many stakeholders were supportive of a simplified system.

Disadvantages

71 This option is likely to be relatively more costly than most other options ($675m p.a. and increasing in outyears due to indexation) because it provides larger income increases for working families. It can also result in higher EMTRs for relatively higher income families, which for them could reduce the financial incentives to work more hours.

72 Around 24,000 households will be financially disadvantaged because this option effectively reintroduces an hours-test to qualify for the in-work payment[3]. Most families who benefited from the removal of the IWTC hours test in 2020 are those who regularly work less than 20 hours and many have persistently low incomes below the BHC50 poverty line (rather than having variable working hours). It is likely that many of these families qualify for a main benefit on income grounds and would be financially better off doing so.

73 For customers who currently receive the IWTC, the re-introduction of an hours test could result in the same issues customers experienced when moving on and off benefit. In addition, re-introducing an hours test may be confusing for some customers, at least during the transitional period after implementing the change, which may result in increased customer contacts.

74 Officials can provide further advice on options that phase-in some of the new in-work payment sooner to help reduce the number of people worse off and provide more support for those with low and/or variable working hours. For example, officials could explore options to gradually phase-in the new payment and/or allow people to receive a portion of the payment earlier.

Option 2: Alternative MFTC payment for sole parents

75 This option replaces the MFTC with an alternative payment for sole parents that is more flexible and abates gradually as incomes increase. This option:

- largely maintains existing settings, except it abates the MFTC more gradually to modestly reduce EMTRs for sole parents (from 100% to 80%-90%).
- increases flexibility of the MFTC to improve coherency, customer experience, and reduce debt for families who have changes in family and work circumstances (e.g. through grace periods and/or measuring the work hours requirement over a longer time period).
- annually adjusts the alternative MFTC and FTC abatement thresholds so that abatement occurs sequentially to ensure no overlapping abatement across MFTC and FTC for sole parents.

[3] The hours test for the IWTC was removed in 2020 during the initial COVID-19 outbreak to allow people who faced reduced, or more variable, working hours to continue to qualify for the IWTC.

76 The earliest this option could be implemented is 1 April 2025. The estimated cost is $35m pa.

Advantages

77 This option would better support the existing 3,500 sole parent MFTC recipients by modestly reducing EMTRs. It would also improve customer experience by adding flexibility through grace periods and measuring the work hours requirement over a longer time period.

Disadvantages

78 This option does not address wider design issues associated with the benefit-work interface, simplify WFF, nor does it significantly reduce EMTRs for those receiving the MFTC. This option therefore has fewer design and simplification advantages relative to option 1, but does have a lower fiscal cost ($30m p.a., but increasing in outyears).

79 It would be challenging to keep an MFTC type payment for couples without significantly increasing fiscal costs to avoid very high EMTRs from overlapping abatement with FTC and the 30% income tax rate. There is also not a particularly strong rationale for incentivising low-income couples to work 30 hours and providing minimal financial returns for any additional hours of work. Evidence shows that primary earners in couples overwhelmingly work full-time and that they are least responsive to changes in financial incentives to work.

80 Officials recommend that if Ministers are interested in keeping an MFTC like payment, that it be only made available for sole parents. Improving incomes for couples would be better explored through other options in this paper. This would also avoid exacerbating financial disincentives for sole parents to enter a relationship. This option therefore means a relatively small number of couples with children will no longer be eligible to receive the MFTC.

Option 3: IWTC phase-in

81 This option phases-in the IWTC to better help smooth incomes of low to middle-income working families. This option would:

- gradually phase-in the IWTC.
- allow working beneficiaries to receive the IWTC (remove the 'off-benefit' rule).
- remove the MFTC.

82 The earliest this option could be implemented is 1 April 2025, with an estimated cost of $38m pa. There are also options to extend the payment to students.

Advantages

83 This option is preferable if Ministers would like working beneficiaries to receive the in-work payment. It would provide more consistent returns from increasing

hours of work by 'smoothing' incomes for people in low-paid and part-time work, particularly if their income or hours worked change regularly.

84 This option would improve the incomes of around 41,000 low-income working households by an average $33pw and reduce child poverty by around 1,000 on both the BHC50 and AHC50 primary measures.

Disadvantages

85 As noted earlier, this option would lead to more working people needing to interact with the benefit system for financial assistance.

86 Of the in-work options, it would be the most difficult to implement and administer on an on-going basis, and would likely lead to a higher incidence of overpayments and WFF debt. It would require timely sharing of information across MSD and IR and significantly more training for MSD staff on WFF to ensure full and correct entitlement. Officials can provide further advice on options to mitigate these impacts, including additional funding required to train and/or greater information sharing across agencies.

87 There would also be less clear messaging about how much work is 'worthwhile' to move off benefit. It would also mean a small reduction in income when people move off benefit when they no longer entitled to WEP during the winter period.

Option 4: Changes to benefit abatement settings

88 This option removes the MFTC and reduces EMTRs for low-income working people by changing abatement settings for main benefits. This option would:

- increase the benefit abatement thresholds from $160pw to $192pw to ensure people can continue to work 8 hours on the minimum wage before their benefit begins to abate (alternatively, this option could also reduce the benefit abatement rate).
- remove the MFTC.
- maintain, but there are options to adjust, the IWTC 'off-benefit' and 'hours-worked' rules.

89 Depending on detailed design, the earliest this option could be implemented is 1 April 2024. The estimated cost is $83m pa.

Advantages

90 Changes to benefit abatement settings would increase the incomes of working beneficiaries by enabling those working part-time to keep more of their earnings. It would also provide income increases to AS recipients due to complex flow-on impacts and allow more low-income working families to receive a main benefit (such as those currently receiving the MFTC).

91 Increasing the benefit abatement thresholds to maintain the level of minimum wage work before benefits abate would benefit around 225,000 working households by an average of $8pw.

92 While this option is not strictly WFF, it does provide another way of removing the MFTC and achieves similar outcomes to phasing-in the IWTC without undertaking structural changes to WFF. Relative to phasing in the IWTC, it would be easier to explain and less complex.

Disadvantages

93 This option carries a greater fiscal cost compared to options 2 and 3 ($83m p.a) with no additional reductions in child poverty (1,000 – 2,000 reductions across both BHC50 and AHC50 measures). The greater fiscal cost is because it also benefits families without children and has flow-on effects to AS. Officials can explore different variations to mitigate these impacts, such as options to only increase abatement thresholds for families with children and/or making consequential adjustments to AS settings.

94 The IWTC would still need to have either an hours-worked or off-benefit test, which means it can result in relatively large increases (or decreases) in financial assistance if hours worked change. Like the IWTC phase-in option, there would be more people receiving a main benefit and how much work is 'worthwhile' would become less clear.

Option 5: Redirect IWTC into FTC to have a single tax credit that still ensures work pays

95 This option removes all in-work payments in WFF by redirecting the IWTC into the FTC and having one main WFF tax credit. This option:

- removes the MFTC and IWTC, but increases the eldest child rate of FTC by $50pw, and subsequent child rate by $15pw.
- increases the FTC abatement threshold to $50,000 and reduces the abatement rate to 25% to help make work pay.
- introduces a two-tiered abatement regime to target increases more to lower-income working families and to reduce fiscal costs.

96 Depending on detailed design, the earliest this option could be implemented is 1 April 2024. The estimated cost is $540m pa.

Advantages

97 A simple 'rebalance' of the $72.50pw IWTC into FTC without changes to FTC abatement settings would be a relatively cost-effective way of reducing child poverty but would significantly reduce the margin between benefit and in-work incomes. Many stakeholders, particularly social sector NGOs, recommended incorporating the IWTC into the FTC as their view was a work incentive payment was not needed and/or was discriminatory.

98 Making changes to FTC abatement settings, alongside rebalancing the IWTC into FTC, attempts to spread the income increases more equally across both benefit and working families to reduce the negative impacts on financial incentives to work. Stakeholders also saw making work pay as important and many of them recommended changes to FTC abatement settings as well.

99 This option would result in 235,000 households gaining by $46pw on average and reduces child poverty by around 24,000 on the BHC50 primary measure and 27,000 on the AHC50 primary measure. 65,000 non-working households gain by on average $66pw, while 170,000 working households gain by on average $39pw. The lowest income working households gain by relatively more, with an average gain of $46pw.

100 This option would significantly simplify WFF by having one main tax credit and remove the overlapping abatement currently occurring across benefits and FTC. However, it would require substantial changes to the way MSD and IR jointly administer WFF which may delay implementation until April 2025.

Disadvantages

101 The option modelled increases the FTC by less than $72.50pw so relies on some of the lowest-paid working families, particularly smaller families, moving onto a main benefit to ensure they are not financially disadvantaged from the removal of the IWTC. In addition, households in shared care situations[4] or receiving AS would be financially disadvantaged due to complex interactions. It is estimated that this option will mean 24,000 households lose by $23pw on average due to the removal of IWTC and flow-ons to AS, and an additional 12,000 households in shared-care situations may also be worse off.

102 This option is one of the costliest ($540m p.a.) because it benefits the largest number of households as it provides income increases to both non-working and working families. The option modelled modestly reduces the gap between benefit and in-work incomes and therefore modestly reduces the financial incentives to work. It may also make any future changes to the FTC more expensive. Further advice could develop variations of this option that would provide relatively larger increases to working families and/or to reduce the number of people worse off due to flow-on impacts.

Summary advice on the in-work options

103 All of the options provide improvements relative to the status quo and take some of the 'rough edges' out of the system related to the MFTC, either through a more gradual phase-in or phase-out of assistance, or through structural changes.

104 The single in-work payment (**option one**) and single tax credit (**option five**) options are relatively more expensive ($540m-$675m), have greater child

[4] For people in shared care situations each parent can receive the full IWTC whereas the FTC is apportioned based on the share of care of the child.

poverty impacts (27,000 to 28,000 on the AHC50 measure), and between them they present quite different choices for Ministers on the design of WFF.

- **Option one** better supports working families to meet in-work costs by simplifying, and increasing, the in-work payment to improve incomes and customer experience for working families. It recognises the importance of making work pay by maintaining an in-work payment to achieve this.
- **Option five** removes the in-work payments, relies solely on the FTC to financially support low to middle-income families, and provides income increases to both non-working and working families. The option modelled modestly reduces the gap between benefit and in-work incomes. This option recognises the importance of making work pay through more generous FTC abatement settings rather than having a payment specifically for working people not receiving a main benefit. Officials' view is that it is important to maintain a reasonable gap between benefit and work.

105 The MFTC replacement (**option two**) and IWTC phase-in (**option three**) options are relatively cheaper ($30-$40m) and would be more tightly targeted. However, these options provide relatively small system modifications compared to the status quo and have their own set of complexities. Changes to benefit abatement thresholds (**option four**) can achieve similar outcomes to both options above (at a slightly higher fiscal cost of around $80m) while leaving a system that is less complex system for customers to navigate. **Options two, three and four** are unlikely to result in significant improvements to income adequacy and child poverty reduction on their own so would be best complemented with increases to FTC payment rates or abatement thresholds, IWTC and/or BSTC.

Complementary changes could further reduce child poverty alongside changes to in-work payments

106 As noted earlier, significant further progress on reducing child poverty is required to meet the Government's targets, particularly the ten-year targets. Each of the in-work options could be complemented by additional income adequacy measures.

107 For example, FTC increases could be combined with any of the in-work options to further reduce child poverty in both beneficiary and working households. FTC increases provide good coverage of families likely to be in poverty by going to (broadly) the bottom half of the income distribution (**option six**).

108 For options that retain an in-work payment, Ministers may like to increase the size of this payment. This would reduce child poverty by more, but the relative reductions in poverty are likely to be less than FTC increases as the in-work payments are less targeted to the lowest-income families and there are likely to be increases to median incomes at the same time. Option one provides a more targeted in-work payment, which means greater reductions in child poverty can be achieved by increasing this payment rate compared to increasing the IWTC under existing settings (**option seven**).

109 Illustrative examples of increasing the FTC and increasing the IWTC within the current system are shown below. Further advice could combine these with some of the options in this paper to show the combined impacts.

Option	Annual cost	Poverty impacts	Winners / losers
Option Six: Increase FTC by $25pw per child	$680m	32,000 (BHC50) 35,000 (AHC50)	267,000 HHs gain by $49pw. 5,000 HHs lose by $3pw.
Option Seven: Increase IWTC by $25pw	$192m	6,000 (BHC50) 8,000 (AHC50)	161,000 HHs gain by $23pw. No HHs lose.

110 Whether increases to the FTC should be progressed depends on fiscal constraints and the desired reductions in child poverty. Officials do not recommend increasing the IWTC if it is retained in its current form because of its mixed effectiveness as a work incentive payment. Other options in this paper to 'make work pay' and reduce childcare costs are likely to be more targeted to the families who face the most significant financial disincentives to work and are likely to be more effective in making work pay for these families.

111 By convention, increases to FTC have been passed on to caregivers receiving the Orphan's Benefit (OB) or Unsupported Child's Benefit (UCB) or Foster Care Allowance (FCA), as these caregivers cannot receive the FTC. This would contribute towards supporting caregivers to care for and meet the needs of children, enabling them to thrive under the protection of whānau, hapū and iwi. Further consideration will need to be given to how the FTC would be passed on to caregivers receiving OB/UCB and FCA.

Options for second earners to help meet the costs of working

112 So far, the options have been more focused on improving the benefit and work interface for primary earners (sole parents and single earner couples). However, there are also benefits to improving financial assistance for second earners at the same time to increase their labour market participation.

113 Firstly, households with one earner in the couple have higher rates of in-work poverty than dual-earner households. Secondly, the current family-based structure of WFF can reduce labour market participation incentives for second earners. Income support is targeted on a 'per family' basis which can mean that there are relatively high abatement rates and EMTRs for second earners looking to enter paid work.

114 Individual in-work assistance is found in some studies to have strong positive effects on employment rates for women in couples, such as in Italy and Ireland, following tax credit reform. A recent study in Australia has also highlighted the importance of employment for second earners as a mitigation against poverty in the event of a relationship breakdown.[5] Further information on this is provided in Appendix One.

115 Further work could be undertaken to explore options that would improve incomes and financial incentives to enter paid work for second earners. For example, one option is to base entitlement to the IWTC on the work circumstances of the individual. This could be achieved by allowing the second earner in the family to also receive the $72.50pw IWTC amount if they meet certain work requirements (e.g., are working 20 hours a week).

116 There are more trade-offs associated with options to increase support for second earners in couples because the options are likely to have greater fiscal costs and, if not designed effectively, they could also result in a reduction in hours worked for some second earners.

117 If Ministers are interested in providing better support for second earners through WFF then officials can provide further advice on different options, including exploring whether a specific tax credit for second earners would be more appropriate than an individualised IWTC (i.e. a Second Earner Tax Credit). A Second Earner Tax Credit would allow for more design choices and allow more/less targeting of the payment to increase/decrease the poverty reductions and fiscal costs.

[5] https://melbourneinstitute.unimelb.edu.au/research/reports/breaking-down-barriers/research-report-pages/report-5

Theme two: assisting with the costs of children in the early years

118 In New Zealand, the key income support payments for the early years are Best Start, Paid Parental Leave (PPL), universal subsidies for early childhood education (ECE) providers (zero to five-year olds), 20 Hours ECE, and the smaller CCA targeted to low-income working families. The FTC and IWTC are also available for eligible families with dependents aged from zero to 18 years.

119 In comparison with other OECD countries, New Zealand's spending on formal 'childcare' for the zero-to-two age group is amongst the lowest per child in the OECD, but amongst the highest per child for 'pre-primary education' for ages three to five, (below only Belgium, Norway and Iceland).[6] This is driven largely by the universal 20 Hours ECE provision.

Young children are most vulnerable to the consequences of poverty, and financial support in the early years can help counter this

120 A vast literature indicates that poverty in early childhood, aside from being detrimental to the health and wellbeing of children and their families in the 'here and now', is a risk factor for a number of negative outcomes, including lower school achievement, reduced earnings, poorer health, and differences in brain structure and function. A number of public policy academics specialising in family tax credits recommend that tax credits should be expanded for families with young children, not only because young children appear to be most vulnerable to the consequences of poverty, but also because mothers are least able to support themselves through employment in the labour market when their children are very young.[7]

121 Evidence provides support for a greater emphasis on policies that support parental care and attachment in infancy; and childcare and early learning are more likely to have positive impacts for children once they are older (from three). There is also evidence on the importance of supporting disadvantaged families in particular, who may benefit from earlier ECE where the quality is high. This suggests income support to help enable choice around parental care is particularly helpful when children are very young, followed by more support for high quality childcare potentially from ages two or three, depending on factors such as the home environment and the quality of the childcare.

122 Access to childcare has a strong socioeconomic gradient. Research suggests that mothers from low-income households, the lowest paid occupation groups, and more disadvantaged mothers generally have higher rates of issues with affordability and access to childcare; whereas mothers in the higher skilled and higher paid groups have low rates of issues. Māori and Pasifika mothers are

[6] OECD Family Database (2021), 'Public spending on childcare and early education' (based on purchasing power parity rates).
[7] Duncan, G, Magnuson, K (2011), Collyer, et al., (2020), Troller-Renfree et al., (2022).

three-to-four times as likely to experience long-term childcare access issues than European mothers, which includes issues of suitability of childcare.[8]

Best Start options to boost income adequacy for low-income families with young children

123 Increasing financial support in the early years would provide additional support at a crucial time for child development and improve flexibility for families to choose care options best suited to their individual circumstances. Enhancing the Best Start payment would provide more income to both working and beneficiary families with children, and would not be connected to childcare or work. Consideration could be given to increasing the payment for low-income families through one of the following two options, which could easily be scaled.

Option Eight: Extending Best Start to eligible families with children up to age 5

124 You have asked for advice on options to extend a targeted Best Start payment for an additional two years up to the age of five. The current Best Start payment of $65 a week is a universal payment for families with a baby up to age one, followed by a targeted payment for the subsequent two years, up to age three (abated at 25 percent after family earnings exceed $79,000 pa).

125 We have modelled a payment rate of $40pw to eligible families with three- and four-year olds. This would cost an estimated $104m pa, reduce child poverty by around 5,000 on both the BHC50 and AHC50 primary measures, and an estimated 49,000 households would gain by an average of $41pw.

126 This option would help support low-income families who incur costs over and above the 20 Hours ECE provision and the Childcare Subsidy, as well as those families for whom formal childcare models may not be suitable (e.g. if working non-standard or variable hours, or for cultural reasons). It would help to recognise that many parents in New Zealand use a mix of formal and informal childcare and help to acknowledge the value of unpaid work and the costs of caring for children. The option does, however, focus on the age group where New Zealand's spend is already high, relative to OECD standards, rather than the zero-to-two-year age group where it is comparatively low.

Option Nine: Increasing payment rate to families eligible for Best Start up to age 3

127 This option would increase the rate of the Best Start payment to lower income families by an additional $40 a week, while keeping the current age settings for the payment. The universal payment of $65 a week for the first year would remain, and the targeted increase would apply to eligible families with infants under three years of age (provided their earnings are under $79,000 pa, with the payment abated at higher earnings). Families with an income of less than

[8] Motu (2021) 'Access to childcare: who has difficulty accessing affordable childcare?', Isabelle Sin.

$79,000 pa would therefore receive a maximum Best Start payment of $109 a week in tax year 2024/25 for each child under the age of three.

128 Increasing the payment rate by $40pw to eligible families with a child up to age 3 would cost an estimated $156m pa, and reduce child poverty by around 5,000 on the BHC50 primary measure and 8,000 on the AHC50 primary measure. An estimated 68,000 households would gain by an average of $44pw.

129 Given the evidence for support targeted to the early years, and the fact that NZ spends less in the first three years of a child's life on childcare, there could be merit in considering this option, which would allow for a longer period of personal care in infancy and/or additional support for either formal or informal childcare. This option would align well with the Government's First 1000 days wellbeing objectives by supporting strong parent-child attachment and reducing stressors. It would then lead into the age that the 20 Hours ECE entitlement begins, as well as part-time work requirements for those on Sole Parent Support.

Support for childcare

Low-income families face the greatest barriers to childcare in relation to access and cost

130 Supporting parents with parental preferences for personal care also needs to be balanced with better enabling parental choices to work, particularly given the importance of employment in improving income adequacy, and child and family wellbeing outcomes over the longer term. The inability to access childcare that meets parents' needs can have a significant impact on the long-term labour market outcomes of mothers in particular, and childcare costs can substantially weaken employment incentives.

131 In European OECD countries, and in New Zealand, low-income families face the greatest barriers to childcare in relation to both access and cost. The OECD recommends that countries should provide carefully targeted support measures that ensure public support reaches the parents who need it most, in order to preserve equity and boost work incentives – as opposed to the current situation of public childcare support often being effectively redistributed toward higher-income families who are more likely to use childcare, thus raising equity and efficiency concerns.[9]

132 There are various options and levers to provide additional childcare support to low-income families outside of (or as part of) direct provision to providers. Some countries with child and family tax credits provide an unconditional child payment to families, irrespective of work, such as Canada's Child Benefit,

[9] OECD (2020) 'Is Childcare Affordable?' *Policy Brief on Employment, Labour and Social Affairs*.

whereas the Child Tax Credit in the US is conditional on work.[10] Other countries differentiate their tax credit rates according to the age of children to ensure families with younger children receive higher payments, such as Canada, which has an add-on for children under six, and Australia whose Family Tax Benefit Part B has a higher rate for children under five (and a Newborn Supplement payment)[11].

Repurposing the IWTC to support childcare costs

133 You have asked for advice on repurposing the IWTC to support childcare costs, such as a Childcare Tax Credit (CTC) in place of the IWTC, given the primary costs of working for parents with young children are childcare costs. While this would help many families, the evidence suggests it would also take payments away from working families in poverty who have no childcare costs.

134 Recent research on aggregated poverty rates show that rates are broadly similar across the age ranges.[12] Prior to the introduction of the Families Package in mid-2018 and Best Start, poverty rates were slightly higher for the early years, but the distribution is now relatively even by age of youngest child. Rates of in-work poverty are still prevalent for families with older children no longer requiring childcare, and single earner couple families have high income poverty rates, despite being less likely to require childcare with one parent at home.

135 Both employment and unemployment rates notably improve for sole mothers and partnered mothers as the age of the youngest dependent child increases. This might suggest that poverty rates would decline as children age and childcare costs are no longer a factor. Given that the evidence suggests otherwise, other factors are likely to play a role, such as separation rates increasing as children get older, and becoming a sole parent can be a trigger for poverty or material hardship.

136 In summary, the evidence on the distribution of in-work poverty amongst families suggests that a CTC that reimburses parents for childcare costs should not be in lieu of an in-work payment. Officials would not recommend repurposing the IWTC in this way, given many families in poverty would be worse off as a result. A more effective lever to address childcare costs is an age-related one, such as the Best Start options (or alternatively a higher rate of FTC for younger children).

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[10] It was made unconditional for a year as part of the COVID-19 response, which had a significant impact on child poverty reduction.
[11] NZ formerly had higher FTC payments for older children, but the 2018 Families Package aligned the FTC rates and introduced Best Start for 0 – 2 year-olds. There is still a higher eldest child rate to reflect higher set up costs.]

Establishing a standalone Childcare Tax Credit payment

137 Choices for a childcare tax credit largely fall between a formal CTC that is conditional on working (though could also include study and training), or an unconditional tax credit, which would essentially be similar to a transfer such as the FTC payment. A conditional Childcare Tax Credit tied to work and reimbursing parents for childcare costs would require some degree of verification of formal care used throughout the year.

138 Given there is already a requirement to do this as part of the Childcare Subsidy, we would advise that consideration of a CTC be on the basis of a payment in lieu of the current Childcare Subsidy. Further work could assess the potential benefits in replacing the Childcare Subsidy with a CTC, and whether there could be improvements in the administration for clients and delivery via one agency (IR), and improved take-up. Work to explore the relative merits of this approach would best be dealt with through the CCA review.

139 MSD have also provided advice on options to increase the generosity of MSD's CCA, currently provided to low-income families. This advice includes options to increase subsidy rates, significantly increase the coverage of the subsidy for middle-income families (by increasing income thresholds) and substantially simplify the eligibility requirements and administration for parents. It will also explore the possibility of moving subsidies closer to meeting actual costs for parents, similar to a childcare tax credit. Some of these changes would provide a more meaningful contribution to childcare costs for low-income families and, combined with an enhanced in-work payment and Best Start payment, could offer a combination of flexible and targeted childcare payments for both working and beneficiary families.

Theme Three: administrative and operational improvements

140 This theme focuses on changes that would improve accuracy of payments, reduce WFF debt and improve client experience. Options address the third objective of the original WFF reform – supporting people into work (and to remain in work) by making sure they get the assistance they are entitled to in a timely manner.

141 While the options earlier in this report are anticipated to improve income adequacy, make work pay, and simplify the system, they do not address some of the underlying customer experience issues that are present within WFF, namely:

- Annual income assessments and the requirement for families to estimate their annual income. Families therefore often face the choice between deliberately over-estimating income (reducing the risk of WFF debt but also the level of support they receive during the year) or risk under-estimating income (ensuring the receive full support during the year but with the risk that they will be overpaid and incur a debt). These issues are exacerbated for individuals who switch between being on and off benefit.
- The difficulty families face when trying to understand how a particular change in circumstances (e.g. working more hours, taking a higher paying job, or entering into a relationship) might affect their WFF entitlements and relatedly, the practicalities of notifying of a change in the required timeframes.
- The difficulty in understanding the more technical aspects of WFF, such as how BSTC interacts with paid parental leave resulting in overpayments and debt, or what amounts must be included in income estimates (for example gifts and loans).

142 These issues arise from the complexity of WFF policy design, which must then be made to work at an administrative level, and ultimately influence financial support and outcomes for families.

143 The options below attempt to address some of these issues. Although they could help with some issues after the fact to some degree, the issues around estimating annual income and the difficulty customers have understanding their entitlements are more fundamental to the design of WFF and not easy to fix in the shorter term.

144 The options are high-level, and do not detail the trade-offs that they would present. We would expect that each of these options will be supplemented with detailed modelling once further analysis is undertaken.

145 Work under this theme is closely linked to the wider Debt to Government workstream which has the dual focuses of ensuring debt recovery is fair,

effective, and avoids exacerbating hardship and of preventing debt from occurring so that it does not create future problems for those in hardship.

Reducing overpayments

146 A key issue with administering WFF is the incidence of overpayments. As at April 2022, approximately 57,000 WFF customers had accumulated WFF debt of almost $250 million (being $178 million of overpayments and $71 million of penalties and interest).

147 Customers who receive the payments weekly or fortnightly during the tax year receive them in advance of the end of year calculation, based on an estimate of their family's income. If the information held by IR is not accurate or is out-of-date, a customer might receive more WFF than they are entitled to, giving rise to WFF debt that must be repaid.

148 Customers are required to inform IR if they have a change in circumstances during the year that affects their WFF entitlements, including: changes in income, care arrangements, or relationships. Depending on when someone notifies IR of a change and when that change is updated in the system, payments received in the interim might have been too high, which would ultimately lead to a WFF debt at an end of year square up.

149 Through engagement we consistently heard concern that the current structure and administration of WFF is driving the creation of debt for families, and the negative impacts this has on families. We heard that families are fearful of incurring debt, and this acts as a barrier to receiving the financial support they need.

150 To help mitigate the incidence of WFF overpayments, there are several options that could be progressed as part of the WFF Review, outlined below.

151 **Grace periods** - Customers could be given an extended period of time after a change in circumstances in which to inform IR of that change without being liable to repay any overpayment made in the intervening period. For example, currently, if customers have a change of relationship status they would need to inform IR or MSD before the next WFF payment to avoid being overpaid. Instead, the customer could be given a grace period (e.g. two weeks) from the date of the change of circumstance to inform IR before being charged an overpayment. The indicative implementation date for introducing grace periods is 1 April 2024 at the earliest.

152 **Extending protected entitlements** - Customers who have periods during the year in which they receive MFTC, can end up with overpayments and debt if they have a higher paid job at other times in the year. To address this, the entitlements received in the low-income periods could be ring-fenced (deemed correct) even if later earnings would mean those entitlements would otherwise have been overpaid. This would be a similar approach to that taken for FTC,

when customers who receive the payment for a period in which they receive a main benefit are deemed to have received the correct entitlement for that period. The indicative implementation date for extending protected entitlements is 1 April 2024 at the earliest.

153 **Improvements in information exchange** - Improving the exchange of information between IR and MSD would improve the accuracy of WFF payments by ensuring IR and MSD have access to more timely, complete and accurate information about customers' circumstances and would reduce the reliance on customers to advise of changes in circumstances. Options to improve the flow of information between IR and MSD could range from improvements to the existing data exchanges (e.g., including additional information or increased frequency) through to more fundamental changes to how information is shared (e.g., more real time information sharing or the development of a portal for MSD staff to access IR-held information). Any changes to the exchanges of information between agencies would require system changes for both agencies, the extent of which would depend on the nature and scale of the change.

Managing WFF debt once incurred

154 Debt resulting from the overpayment of WFF can be particularly problematic for recipients on lower incomes and rely on WFF assistance to meet their living costs. The burden of debt repayments for these families is more likely to give rise to, or exacerbate, financial hardship and psychological stress.

155 The following two options are both aimed at reducing lower-level debt amounts and should be treated as alternatives to each other. Both options require consideration of current causes of debt when setting eligibility requirements and the amounts covered. These are not easy issues to solve. Officials would also need to know what other tax credit options are to be progressed under the WFF before being able to advise on appropriate levels for setting a buffer tax credit or automatic write-off amount. For example, if Ministers decide to progress other options that will reduce the incidences (and amounts) of WFF overpayments, then a lower setting for a buffer tax credit or automatic write-off amount may be appropriate.

156 **Buffer tax credit** – A buffer tax credit is essentially a refundable tax credit made available at the end of the income year. It would be first applied against any WFF debt a customer may have accrued due to over-payments. Where a customer has not accrued any WFF debt, the balance of the buffer tax credit could be paid as a one-off lump sum. A type of buffer tax credit is currently used in Australia. The method chosen for calculating the buffer credit amount would reflect the purpose Ministers wish the credit to serve. There are a range of methods for calculating the buffer amount, for example, using:

- a percentage of each family's entitlement

- a specified number of weeks of each family’s entitlement, and/or
- a specified number of weeks of the FTC.

157 IR has indicated a buffer tax credit could be available from 1 April 2023. However, because the buffer tax credit would be processed at the end of the tax year, it would not be processed and paid until after March 2024. In any case, early decisions on other options would be required to allow sufficient time for officials to consider the appropriate buffer amount.

158 **Increased automatic debt write-off threshold** - Increasing the threshold for automatic write-offs for WFF debt (currently $50) could be considered as a means of clearing low-value WFF debt. During the early part of the COVID-19 pandemic, the automatic write-off threshold was temporarily increased to $200. An increased automatic write-off threshold could either apply to all customers or could be targeted to smaller groups with greater need (e.g. customers with income under a certain amount). Like the buffer tax credit, this option could apply from 1 April 2023. However, because automatic write-offs are processed at the end of the income year, it would not need to be processed until after March 2024. In any case, early decisions on other options would be required to allow sufficient time for officials to consider the increased automatic write-off threshold option.

Miscellaneous amendments

159 Officials have identified a number of possible administrative changes that could be made to either simplify existing WFF Scheme or improve customer experience for certain groups of customers, including:

- Amending the calculation of Family Scheme Income to exclude the income of a partner derived outside the relationship period. Although the issue itself is relatively simple to articulate, the solution is not straight forward. Further analysis on this option is still required to determine its feasibility.
- Allowing IR to grant families the Independent Earner Tax Credit where their entitlement to it would be greater than their WFF entitlement. IR would determine the greater entitlement at the end of year square up, rather than during the year, to avoid complications. This option has an indicative implementation date of 1 April 2023.
- Amending the MFTC’s work requirements to allow a two-week grace period (matching the IWTC grace period). This would allow workers, such as teacher aides, to continue receiving the MFTC over periods, such as school holidays, when work is not available. This option is contingent on whether Ministers decide to remove the MFTC and has an indicative implementation date of 1 April 2024.
- Repealing the Child Tax Credit for the purpose of simplifying the WFF Scheme. The Child Tax Credit is a grand-parented entitlement that is only

available to approximately ten WFF customers. This could be implemented by 1 April 2023.

160 With regards to some of the above options with indicative implementation dates of 1 April 2023, legislation would need to be passed by early December 2022 to allow Inland Revenue sufficient time to make the required system changes by February 2023, in time to inform customers of their entitlements beginning from 1 April 2023. This would in turn require Ministers' decisions by early October 2022 at the latest.

Fundamental administrative options

161 Previously, officials had indicated that Theme Three could also consider longer-term, more fundamental administrative issues relating to how WFF payments are jointly delivered by IR and MSD [refer IR2021/321].

162 Officials now consider that these more fundamental joint administration issues are largely dependent on the decisions on the different design options for tax credits covered earlier in this paper, particularly those that change payments across the benefit-work interface. Changes to delivery settings based on the options in this paper could be considered as part of subsequent advice.

163 MSD's Transformation Programme, Te Pae Tawhiti, will provide opportunities over the coming years to explore improvements to clients' experience of WFF, for example through enhanced information sharing ability with partner agencies. Longer-term changes could provide further opportunities to explore other changes to administrative arrangements but at this stage this is likely to be beyond the timeframe of this review.

Appendix two: Current policy settings for the benefit/work interface | As at 21 July 2022

Payments for people on benefit

JS SPS

Main Benefit settings

Eligibility

Sole Parent Support (SPS) is available for sole parents with children 13 and under. Jobseeker Support (JS) is available for sole parents with children 14 and over and couples with children.

Abatement

Abatement settings are different for different family types, based on different expectations about the level of work encouraged.

- Couples on JS can earn up to $160 before their benefit begins to abate (~8 hours min wage). For every dollar earned above this threshold, the net rate reduces by 70 cents.
- For sole parents (SPS or JS) their benefit reduces by 30 cents for every dollar earned over $160 a week, and by 70c above $250.

Sole parents generally move off-benefit at 20 hours worked when they are better off receiving the IWTC and MFTC instead.

For couples, historically they were better off moving off benefit at 30 hours worked but in recent years couples may be financially better off remaining on benefit if one member of the couple is in full-time work (provided the primary recipient of benefit is the one that does not work 30 hours or more).

WEP

Winter Energy Payment

Eligibility

Generally all main benefit recipients qualify for WEP. For families with children, they can receive $31.82pw during the payment period.

Abatement

There is no gradual abatement of WEP. As people move off benefit they lose entitlement to WEP.

Payments for people both on or off benefit

FTC

Family Tax Credit

Eligibility

The FTC is available to beneficiaries and working families. It is $127.73 for the eldest child, and $104.08 for subsequent children.

Abatement

The FTC abates at 27c in the dollar if a family earns over $42,700. Increases to the minimum wage (and non-adjustment to the threshold) has meant that the FTC now begins abating at 39 hours on the minimum wage, or for some couples while they are receiving a main benefit.

AS

Accommodation Supplement

Eligibility

The AS is available to both low-income beneficiaries and working families if they have high housing costs.

Abatement

AS is abated at 25 cents from each dollar of income above the benefit cut-out point. This is $842 a week for a sole parent, and $969 a week for a JS couple with children.

BSTC

Best Start Tax Credit

Eligibility

BSTC is a payment of $65.15 per child a week for families with children under 3. It is universal in the first year of a child's life, and in the second and third years it is income tested.

Abatement

The payment abates at 21% in the second and third year once the family earns above $79,000 a year. It abates outside of other WFF payments.

Payments for people not receiving a benefit

MFTC

Minimum Family Tax Credit

Eligibility

The MFTC is a 'top up' for low-income working families to ensure they are better off in-work than when on a benefit. The MFTC threshold ensures a weekly income of $632 per week and is paid to around 3,500 of the lowest income working families. To be eligible, parents must meet an hours test, of 20 hours of work for sole parents and 30 hours of work for couples.

Abatement

For every dollar a family earns over the MFTC amount, their entitlement reduces by more than one dollar (due to ACC levies) which can mean no additional income from an extra hour of work.

IWTC

In-Work Tax Credit

Eligibility

The IWTC is a payment for low- and middle-income working parents and provides $72.50 per week for the first three children and $15 for each child after that.

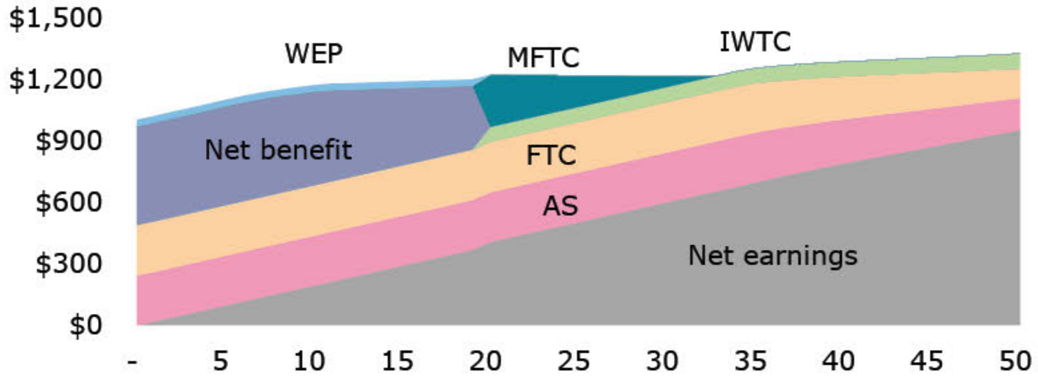
IWTC recipients are no longer required to meet an hours worked test, but IWTC is only available to families in work and not receiving a main benefit.

Abatement

The IWTC starts to abate at 27c in the dollar after FTC is fully abated (around $65,000 for a one child family, and $84,500 for two child family).

Income by hours worked, by payment type

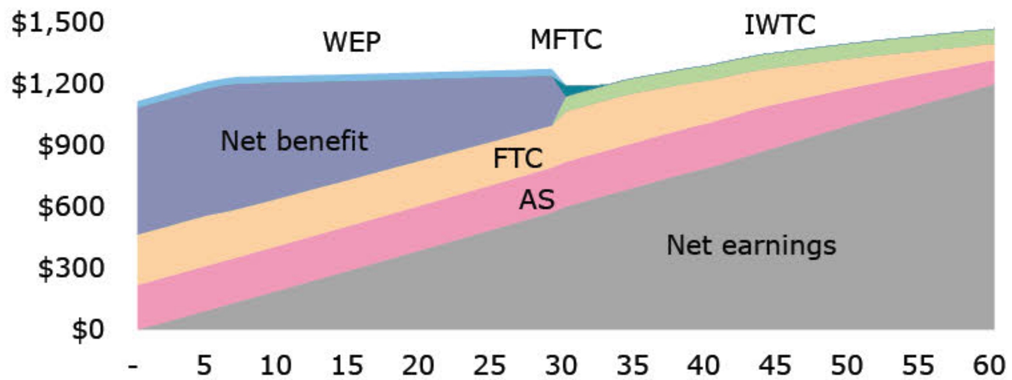
Sole parent with two children (aged over 3)



When working no hours, this family's income is made up of their main benefit, AS, FTC, and WEP. At around 8 hours of work, their benefit starts to reduce at 30c for every $1 earned. At around 12 hours, their benefit abates at a much higher rate (70c for every $1 earned), which means they see little return for working more.

At 20 hours of work, they become eligible for the IWTC and the MFTC. The MFTC reduces dollar for dollar so means no financial gain for increasing hours of work until they pass the MFTC threshold at around 35 hours.

Couple with two children (aged over 3)



When working no hours, this family's income is made up of their JS benefit, AS, FTC and WEP. At 8 hours their benefit starts to abate at 70%.

When the primary benefit recipient works 30 hours a week they no longer qualify for a main benefit and instead become eligible for the IWTC and MFTC. This means a drop in income because the MFTC no longer ensures couples are better off moving off benefit. However, most couples continue to qualify for a benefit at this point provided the partner of the primary recipient is not working more than 30 hours, which means they don't face a drop in income.

Options that replace the MFTC with a new in-work payment (retaining the “off-benefit” rule)

Option 1 – Single integrated in-work payment

Description

A single in-work payment that combines the MFTC and IWTC into a more targeted, flexible and integrated in-work payment.

Key aspects of design

- New in-work payment that abates gradually as incomes increase.
- Fully integrated into WFF, with abatement occurring ahead of FTC, at the same rate.
- Include an ‘hours worked’ and ‘off-benefit’ test to incentivise movement off benefit (similar to current MFTC).
- Introduce grace periods and make hours test more flexible.

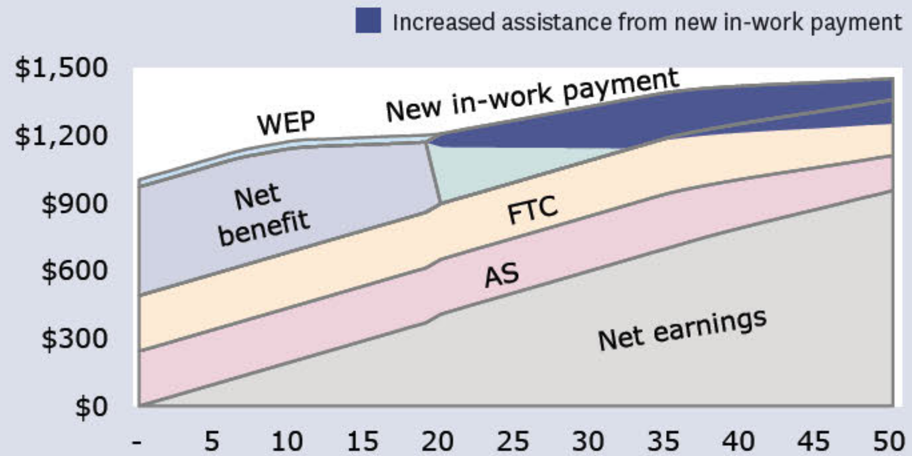
Pros

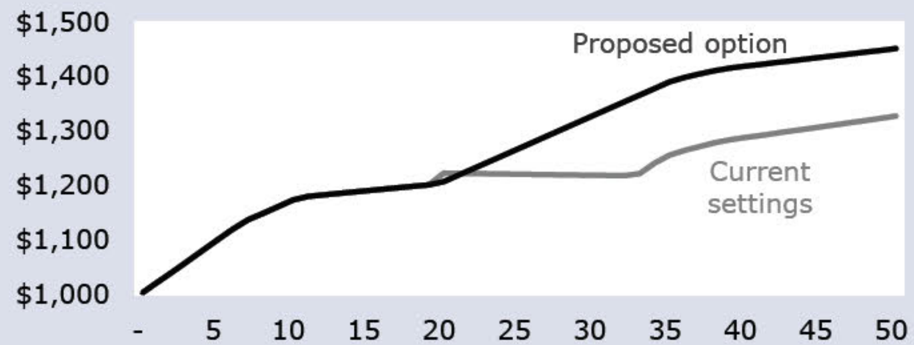
- Simpler in-work payment.
- Greater returns from working full-time.
- Significantly reduces child poverty in working families.
- Retains incentive to move off benefit.
- Better targets the in-work payments and better recognises in-work costs.

Cons

- Increases EMTRs for higher-income families.
- People currently receiving IWTC and working less than 20 hours will be worse off (with some already in poverty).

Sole parent income by hours worked – proposed Vs current settings





Option 2 – Alternative MFTC payment

Description

Replace the MFTC ‘top-up’ with a new payment for sole parents that is more flexible and abates gradually as incomes increase.

Key aspects of design

- Largely maintains the existing design of the MFTC and IWTC, but introduces abatement for the MFTC.
- Make changes to MFTC to improve coherency, customer experience and reduce debt through adding grace periods and making hours test more flexible.

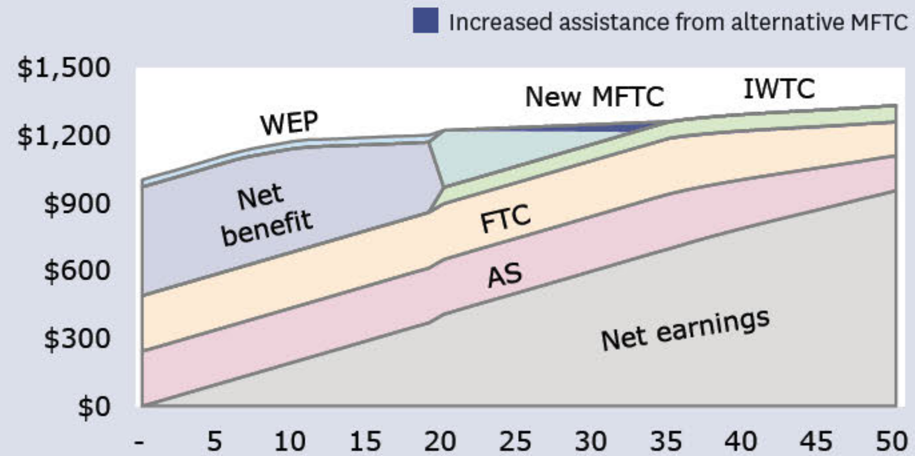
Pros

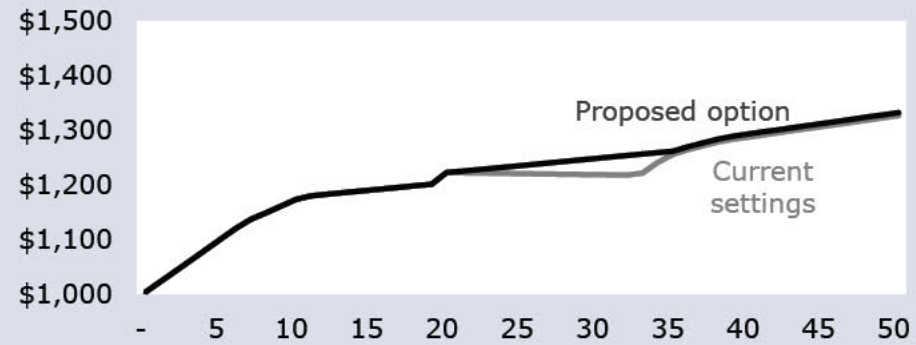
- Slightly greater returns from moving from 20 hours of work to 40 hours for low wage sole parents.
- Provides a greater incentive for sole parents to move into full-time work.

Cons

- Does not address wider design issues associated with the MFTC and IWTC.
- Does not simplify WFF as two in-work payments are maintained.
- Does not significantly reduce EMTRs for those in receipt of MFTC.
- Limited rationale to extend payment to couples.

Sole parent income by hours worked – proposed Vs current settings





Options that remove the 'off-benefit' rule or work incentive payment entirely

Option 3 – IWTC phase-in

Description

Remove the MFTC and phase-in the IWTC as incomes increase and allow beneficiaries to receive the payment while on benefit.

Key aspects of design

- Gradually phase-in the IWTC and allow working beneficiaries to receive IWTC (remove the 'off-benefit' rule).
- Remove the MFTC.
- Main benefits will gradually abate to $0 as incomes increase.

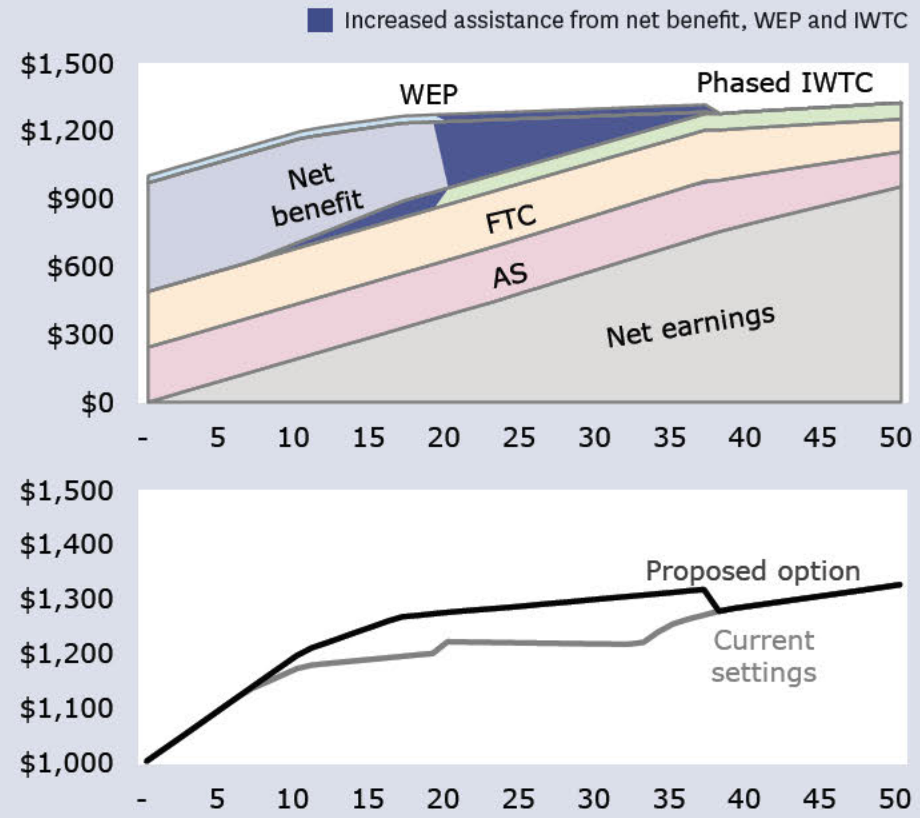
Pros

- Greater returns from moving from part-time (more than 8 hours) to full-time work for low wage sole parents.
- Reduces need to switch between MSD and IR systems.
- Smoother income for people in precarious/irregular work.

Cons

- More working families in higher-compliance benefit system.
- Less incentive to move off benefit complex/harder to understand eligibility for IWTC.
- More administratively complex.

Sole parent income by hours worked – proposed Vs current settings



Option 4 – Change benefit abatement settings

Description

Remove the MFTC and change benefit abatement settings to increase the incomes for low-income working families.

Key aspects of design

- Increase the benefit abatement thresholds.
- Remove the MFTC.
- Maintain, but potentially adjust, IWTC settings.
- Similar outcomes to IWTC phase-in option but less complex.

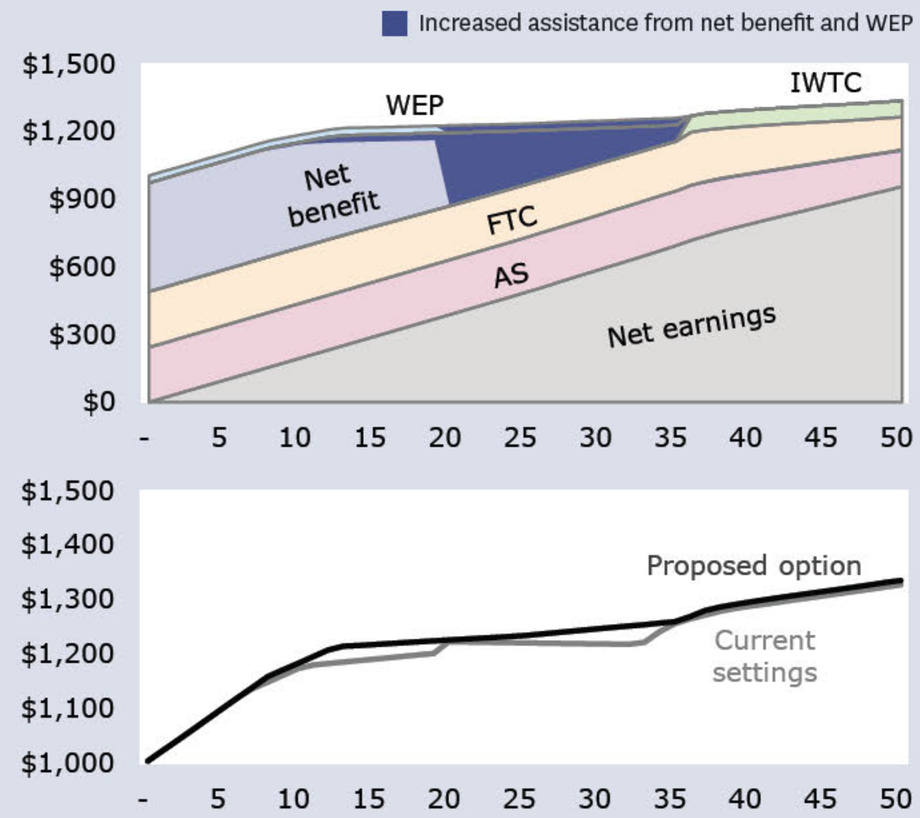
Pros

- Slightly greater returns when moving from part-time (more than 8 hours) to full-time work for sole parents.
- Reduces need to switch between MSD and IR systems as frequently.
- Smoother income for people in precarious/irregular work.

Cons

- Has flow-ons to AS and those without children that make it more expensive.
- More working families in higher-compliance benefit system.
- Less incentive to move off benefit.

Sole parent income by hours worked – proposed Vs current settings



Option 5 – IWTC into FTC for 'single' tax credit

Description

Removes all in-work payments in WFF, creating one tax credit by redirecting the IWTC into FTC.

Key aspects of design

- Removes the MFTC and IWTC, but increases the rate of FTC.
- Increases the FTC abatement threshold and reduces abatement rate to help make work pay.
- Introduce a two-tiered abatement rate to target increases more to lower-income working families and reduce fiscal cost.

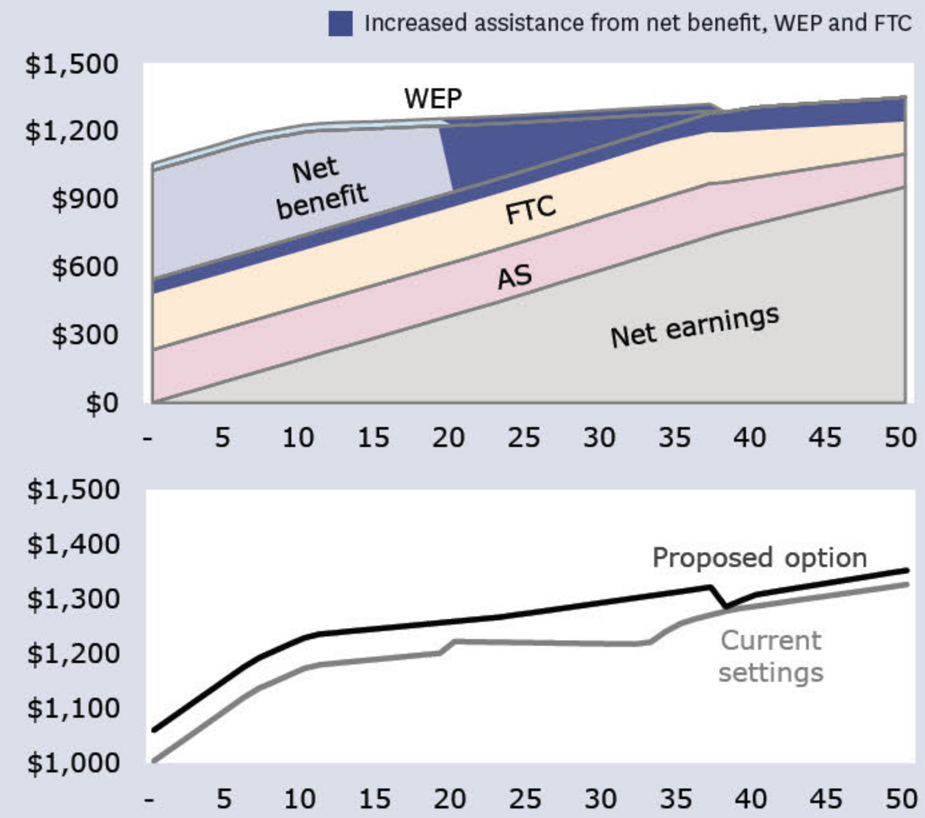
Pros

- Significant simplification of WFF by having one main tax credit.
- Addresses concerns about in-work payments raised by some key stakeholders.
- Significant child poverty reductions.

Cons

- More working families in higher-compliance benefit system.
- Some households in shared care situations or receiving AS would be worse off.
- Modestly reduces financial incentives.

Sole parent income by hours worked – proposed Vs current settings



Summary of options: Costs, impacts and trade-offs | Tax year 2024/2025

Theme one: improvements to the structure and design of in-work tax credits in order to make work pay

Option	Child poverty reduction and distributional impacts	Annual fiscal costs	Benefit/work interface	Simplification	Make work pay / financial incentives
1. Single integrated in-work payment	9,000 (BHC50), 28,000 (AHC50). 170,000 HHs gain by $81pw, 24,000 HHs lose by $34pw primarily due to IWTC not currently having an hours test.	$675m. Option could easily be scaled.	Maintains in-work payment (IWTC and MFTC combined into one). Maintains 'off-benefit' and 'hours worked' tests to qualify for in-work payment (like MFTC currently).	Simplifies and rationalises the two in-work payments into one.	Increases gap between benefit and 40hrs min wage work by $131pw for sole parents, and marginally reduces gap at 20hrs. Modestly increases EMTRs for those already in work.
2. Alternative MFTC payment	2,000 (BHC50), 2,000 (AHC50). 134,000 HHs gain by $5pw, no HHs lose.	$35m. Limited ability to scale if progressed on its own.	Maintains both in-work payments (IWTC and improved MFTC). Maintains 'off-benefit' and 'hours worked' for MFTC, and 'off-benefit' rule for IWTC.	Limited simplification benefits.	Increases gap between benefit and 40hrs min wage work by $5pw for sole parents, and maintains gap at 20hrs work. Modestly reduces EMTRs for existing MFTC recipients, but means more sole parents eligible for MFTC and high EMTRs.
3. IWTC phase-in	1,000 (BHC50), 1,000 (AHC50). 41,000 HHs gain by $33pw, 20,000 HHs lose by $30pw primarily due to IWTC not currently having an hours test.	$38m. Limited ability to scale if progressed on its own.	Maintains in-work payment (IWTC). Removes 'off-benefit' rule for IWTC.	Reduces number of in-work payments but the phase-in nature of IWTC increases complexity.	Maintains gap between benefit and 40hrs min wage work for sole parents, but increases gap at 20hrs work by $54pw. Reduces EMTRs but less clear about how much work is 'worthwhile'.
4. Change benefit abatement settings	1,000 (BHC50), 2,000 (AHC50). 225,000 HHs gain by $8pw, no HHs lose.	$83m. Some ability to scale option.	Maintains in-work payment (IWTC). Choice around whether to keep off-benefit rule for IWTC.	Reduces number of in-work payments and doesn't require large structural change to WFF.	Increases gap between benefit and 40hrs min wage work by $8pw for sole parents and increases gap at 20hrs work by $3pw. Reduces EMTRs but less clear about how much work is 'worthwhile'.
5. IWTC into FTC for 'single' tax credit	24,000 (BHC50), 27,000 (AHC50). 235,000 HHs gain by $46pw. 24,000 HHs lose by $23pw due to removal of IWTC and flow-ons to AS.	$540m. Option could easily be scaled.	Removes in-work payments.	Results in simplest system of all the options as only retains 'single' tax credit.	Reduces gap between benefit and 40hrs min wage work by $35pw for sole parents, and reduces gap at 20hrs work by $19pw. There are options to broadly maintain the gap between benefit and work.

*Options 1, 4 and 5 could be implemented by 1 April 2024 at the earliest depending on final design. Options 2 and 3 could be implemented by 1 April 2025 at the earliest depending on final design.

Complementary changes that could further reduce child poverty alongside changes to in-work payments

Option	Child poverty reduction and distributional impacts	Annual fiscal costs
Increase FTC (eldest and subsequent child rate) by $25 p/w.	32,000 (BHC50), 35,000 (AHC50). 267,000 HHs gain by $49pw. 5,000 HHs lose by $3pw.	$680m. Option could easily be scaled.
Increase IWTC by $25 p/w.	6,000 (BHC50), 8,000 (AHC50). 161,000 HHs gain by $23pw, no HHs lose.	$192m. Option could easily be scaled.

* These options could be implemented relatively quickly after Budget funding and legislative amendments.

Theme two: improvements in the early years to assist with the costs of children and support choices around work and childcare

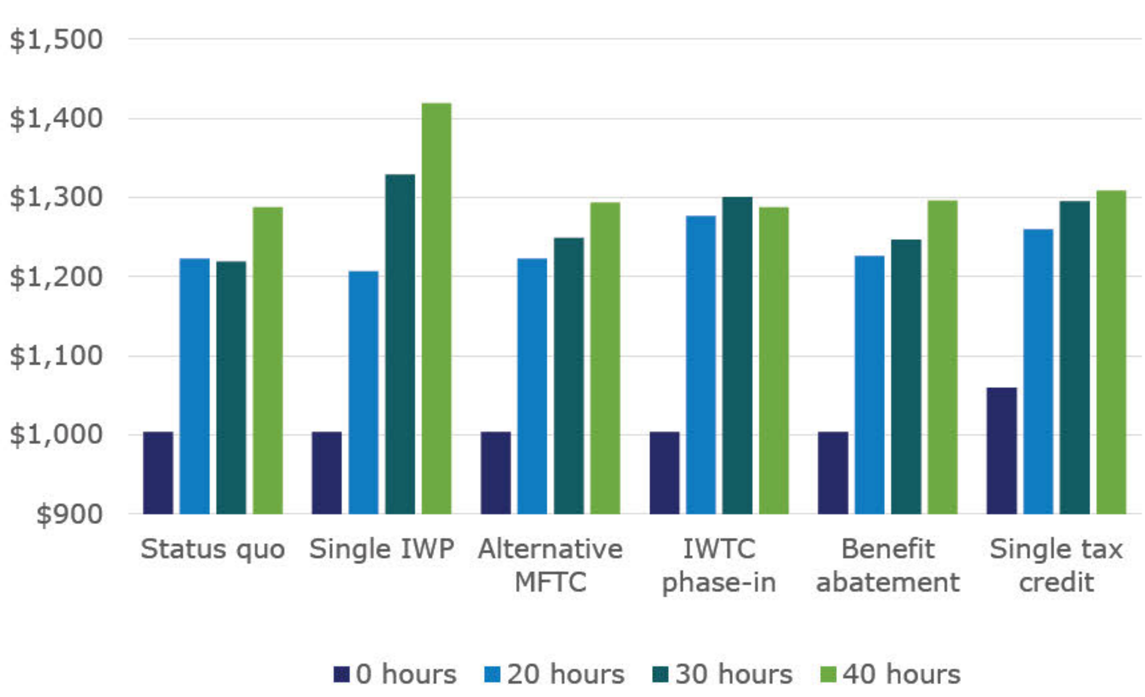
Option	Child poverty reduction and distributional impacts	Annual fiscal costs
Extending Best Start to eligible families with children up to age 5 ($40pw).	5,000 (BHC50). 5,000 (AHC50) 49,000 HHs gain average of $41pw.	$104m. Option could easily be scaled.
Increasing payment rate by $40pw to families eligible for Best Start up to age 3.	5,000 (BHC50). 8,000 (AHC50) 68,000 HHs gain average of $44pw.	$156m. Option could easily be scaled.

Impacts of options on households in different employment situations

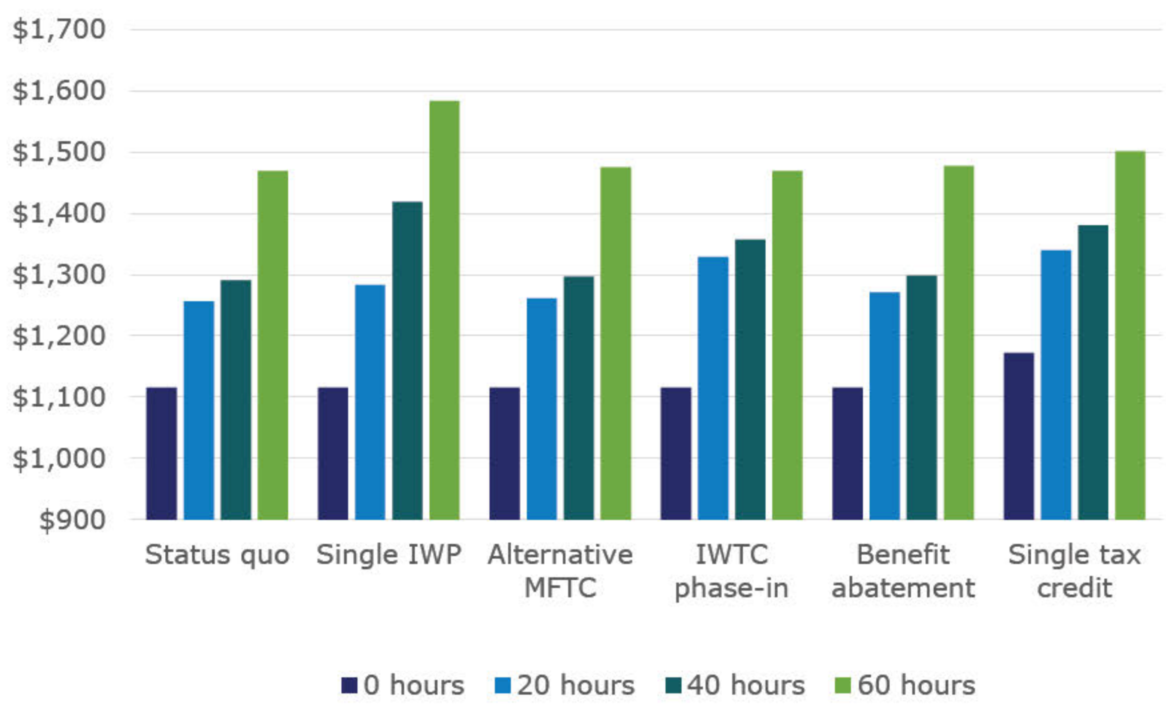
How options affect incomes

The charts show the impact of the options on incomes at different levels of hours worked on the minimum wage. They assume each family type lives in South Auckland and pay $500pw rental costs. It is important to note that the incomes for people will depend on individual circumstances, time of year (WEP), housing costs and take-up of entitlement of those in work. They should therefore be considered 'order of magnitude' estimates for people in certain employment situations. The design of most options can be altered to provide smaller or larger increases for people in certain employment situations.

Income for a sole parent with 2 children



Income for a couple with 2 children



Distributional impacts of each option by household income decile

This table shows the number of households who gain (or lose), and average weekly gain (or loss) by income decile. Similar to the above, the design of most options can be altered to provide smaller or larger increases for people in certain employment situations. Officials can provide further advice on options to mitigate the number of people financially disadvantaged.

			Equivalised household income decile for tax year 2024/25										
Option			$28.4k	$34k	$40.7k	$49.2k	$57.8k	$66.8k	$78.3k	$93.8k	$123k	$123k+	All
1. Single in-work payment	Gain	# of households	9k	30k	56k	45k	14k	8k	4k				170k
		$ gain per week	$75pw	$90pw	$86pw	$70pw	$78pw	$79pw	$89pw				$81pw
	Lose	# of households	11k	4k	4k								24k
		$ loss per week	-$45pw	-$30pw	-$22pw								-$34pw
2. Alternative MFTC	Gain	# of households	10k	31k	46k	26k	10k	5k	4k				134k
		$ gain per week	$5pw	$5pw	$6pw	$5pw	$5pw	$6pw	$5pw				$5pw
	Lose	# of households											
		$ loss per week											
3. IWTC phase-in	Gain	# of households	5k	9k	13k	9k							41k
		$ gain per week	$29pw	$34pw	$35pw	$34pw							$33pw
	Lose	# of households	8k		5k								20k
		$ loss per week	-$32pw		-$28pw								-$30pw
4. Benefit abatement	Gain	# of households	20k	30k	49k	40k	29k	20k	14k	13k	9k		225k
		$ gain per week	$29pw	$34pw	$35pw	$34pw	$7pw	$7pw	$6pw	$5pw	$5pw		$8pw
	Lose	# of households											
		$ loss per week											
5. Single tax credit	Gain	# of households	43k	52k	68k	36k	18k	9k	5k				235k
		$ gain per week	$61pw	$50pw	$42pw	$38pw	$42pw	$41pw	$38pw				$46pw
	Lose	# of households	6k		6k	4k							24k
		$ loss per week	-$23pw		-$26pw	-$24pw							-$23pw

Appendix Three: Detailed modelling assumptions for the in-work options in Theme One

WFF settings: April 2024		Status quo	Option 1: Single IWP	Option 2: Alternative MFTC	Option 3: IWTC phase-in	Option 4: Ben. abate.	Option 5: Single tax credit
FTC	**Eldest child rate**	$136.00	$136.00	$136.00	$136.00	$136.00	$186.00
	Subsequent child rate	$110.81	$110.81	$110.81	$110.81	$110.81	$125.81
	Abatement threshold	$42,700	$78,700 *Indexed to IWTC cut-out*	$43,765.43 *Indexed to MFTC cut-out*	$42,700	$42,700	$50,000
	Abatement rate	27%	30%	27%	27%	27%	25%, 35% after $80,000
IWTC	**Payment rate**	$72.50pw + $15pw for 4+ children	Sole Parents: $310pw, Couples: $235pw +$15pw for 4+ children	$72.50pw + $15pw	$72.50pw + $15pw	$72.50pw + $15pw	
	Minimum work hours	In employment	Sole parents: 20hrs Couples: 30hrs	In employment	N/A	In employment	Removed
	Abatement threshold	After FTC abated	Sole Parents: $24,960 Couples: $37,440 *Indexed to maintain gap*	After FTC abated	After FTC abated	After FTC abated	
	Off-benefit rule	Yes	Yes	Yes	No	Yes	
	Phase-in	N/A	N/A	N/A	30% phase-in after $160pw	N/A	
MFTC	**Retained?**	Yes	Removed	$253.15pw for sole parents	Removed	Removed	Removed
	Abatement rate	100% + ACC levies		70% (+ taxes and levies) from $24,960 *indexed to maintain gap*			
Main Benefit	**Abatement thresholds**	$160, $250				$192, $300	

MINISTRY OF SOCIAL DEVELOPMENT
TE MANATŪ WHAKAHIATO ORA

DEPARTMENT OF THE PRIME MINISTER AND CABINET
TE TARI O TE PIRIMIA ME TE KOMITI MATUA

Inland Revenue
Te Tari Taake

TE TAI ŌHANGA
THE TREASURY

Report

Date: 15 November 2022 **Security Level:**

To: Rt Hon Jacinda Ardern, Prime Minister / Minister for Child Poverty Reduction

Hon Grant Robertson, Minister of Finance

Hon Kelvin Davis, Minister for Children

Hon Carmel Sepuloni, Minister for Social Development and Employment

Hon David Parker, Minister of Revenue

Working for Families Review: Further advice on options to progress for Budget 2023 and beyond

Purpose of the report

1 This report seeks agreement on a preferred Working for Families (WFF) option to progress for Budget 2023 and beyond.

- a new, more generous, in-work payment (option 1),
- a single tax credit with no in-work payment (option 5b),
- retain the IWTC plus complementary changes (option 6).

2 A companion report on overpayments of WFF and administrative options, including a buffer tax credit, has been sent to you separately [IR2022/512, REP/22/11/1111 refers]. Together these two reports will form the basis for discussions on the next steps for the WFF Review.

Executive summary

3 Following advice in July and October, Ministers requested further advice on:

- Option 1 (new, more generous, in-work payment) and option 5b (single tax credit with no in-work payment), with variations, to improve the structure of the in-work tax credits
- options to scale and phase the reforms to fit within a desired fiscal envelope ($200m-$400m p.a.)
- an alternative option (referred to as option 6) that retains the In-Work Tax Credit (IWTC) and makes complementary changes within the existing structure of WFF
- administrative and operational improvements, with a focus on the buffer tax credit.

Significantly reducing fiscal costs of structural reforms requires some trade-offs

4 Reducing the fiscal costs of the options to within the fiscal envelope is challenging, and only feasible at the upper end of the fiscal envelope. If done at low cost, structural changes can lead to very high effective marginal tax rates (EMTRs),or result in more families being financially disadvantaged.

5 The options presented in this paper therefore require finely balancing some important trade-offs. All the options, including their scaled variations, provide improvements relative to the status quo, either through significant structural changes (options 1 and 5b) or through changes within the existing WFF system (option 6).

Summary of each option

Option 1: A new, more generous, in-work payment

6 This option increases the incomes for working families and has a strong focus on making work pay through a single, more generous, in-work payment. The payment ensures families are better off 'off-benefit' when working a certain number of hours (i.e. 20 hours for sole parents and 30 hours for couples). There are two variations of this option:

- Variation 1a: allows families to receive some of the payment before the hours test is met, before being topped up to the full amount
- Variation 1b: allows families to receive all of the payment before the hours test is met.

7 Variation 1a has greater incentives to work more hours and better manages system integrity, by requiring a certain level of hours worked to receive the full amount of the significantly higher new payment. However, it can mean higher compliance for clients with fluctuating hours and is more complex to administer. Variation 1b is simpler, better accommodates variable work and may reduce the incidence of debt. However, having a large payment with minimal work requirements (i.e. as little as an hour a week) undermines aspects of the benefit system, and could risk potential gaming.

8 The best way to reduce the cost of this option (and its variations) to fit within the fiscal envelope is to introduce a two-tiered abatement regime. This would better target income increases to the lowest income working families and still help to make work pay. If Ministers prefer a lower in-work payment instead to reduce the cost, this would be best achieved through option 6.

Option 5b: A single tax credit with no in-work payment

9 This option provides income increases to both working and non-working families. It removes the in-work payments but instead makes work pay through more generous Family Tax Credit (FTC) abatement settings. Officials' view is that it is important to maintain a reasonable gap between benefit and work to ensure families see financial returns from working, but it is not essential to have a specific in-work payment to achieve this.

10 There is limited scope to reduce the cost of this option by changing the payment rates and abatement settings further. We have instead explored a cost saving option that phases in the reforms across multiple years. On balance, this provides a viable alternative that continues to meet the objectives of the reforms.

Option 6: retain the IWTC plus complementary changes

11 This option increases the incomes of working families and better makes work pay within the existing structure of WFF. It increases the WFF abatement threshold, removes the Minimum Family Tax Credit (MFTC), and increases the FTC (variation 6a) or IWTC (variation 6b). Further variations could also be considered in subsequent advice, such as combining a more modest increase to the IWTC alongside changes to Best Start. These changes are all scaleable, could be done if structural reforms are not progressed, or could be done ahead of the structural reform option 1.

Summary advice across the options

12 The trade-offs associated with changes to in-work assistance are summarised below and in the A3s in Appendix One.

Annual fiscal costs 2024/25	Reduce child poverty	Make work pay / financial incentives	Benefit/work interface	Simplification
Option 1a: A new, more generous, in-work payment (hours test) *Ensures families are 'better-off' off-benefit after a certain number of hours worked – with hours test*				
Full cost: $813m	**Full cost:** 14,000 (BHC50), 33,000 (AHC50)	Improves the returns from working full-time, reduces incentives for second earners.	Maintains historic policy intent of IWTC/MFTC – to ensure families better off if hours test is met.	Minor simplification, as features of MFTC 'top-up' maintained.
Scaled: $333m	**Scaled:** 8,000 (BHC50), 12,000 (AHC50)			
Option 1b: A new, more generous, in-work payment (no hours test) *Ensures families are 'better-off' off-benefit after a certain number of hours worked – without an hours test*				
Full cost: $955m	**Full cost:** 19,000 (BHC50), 37,000 (AHC50)	Similar to 1a, but significantly higher payment at few hours of work can disincentivise additional hours of work.	Similar to 1a, but can reduce incidence of debt, however can also disincentivise work.	Moderate simplification through removal of MFTC.
Scaled: $472m	**Scaled:** 15,000 (BHC50), 15,000 (AHC50)			
Option 5b: A single tax credit with no in-work payment *Removes the in-work payments but still ensures each additional hour of work pays through more gradual abatement of the FTC*				
Full cost: $686m	**Full Cost:** 20,000 (BHC50), 29,000 (AHC50)	Generally, improves the returns from working more hours, reduces incentives for second earners.	Main benefits play more of a role in supporting low-income workers.	Significantly simplified tax credit system.
Phased: $365m in the first year	**Phased (1st year):** 15,000 (BHC50), 14,000 (AHC50)			
Alternative Option 6: retain the IWTC plus complementary changes *Maintains the IWTC in its current form, but doesn't ensure families working part-time are 'better-off' off benefit.*				
6a (FTC increase): $359m	**6a (FTC increase):** 11,000 (BHC50), 16,000 (AHC50)	Similar to 5b, generally improves the returns from working more hours, reduces incentives for second earners.	Like option 5b, main benefits play more of a role in supporting low-income workers.	Moderate simplification through removal of MFTC.
6b (IWTC increase): $413m	**6b (IWTC increase):** 10,000 (BHC50), 16,000 (AHC50)			

13 All options provide improvements relative to the status quo and meet the objectives of supporting income adequacy and reducing child poverty, and improving financial incentives to work, as well as the areas of focus for the

review. Which option to progress depends on how Ministers see WFF operating for families and the relative weight put on certain objectives.

Fiscal costs

14 The lower cost variations continue to meet the objectives for reforms, and provide a viable alternative if Ministers are comfortable trading-off smaller reductions in child poverty and a small amount of additional complexity. Option 1b is more expensive relative to the other options, and there's more room to scale option 6 if Ministers prefer a lower cost option.

Supporting income adequacy and reducing child poverty

15 The full cost variations have greater reductions in child poverty than the scaled variations. There are also differences in who gains across options:

- Option 1 lifts the incomes of working families only which can limit the size of the poverty reductions achieved,
- Option 5b benefits both working and non-working families, therefore benefits more families in poverty and has the greatest child poverty reductions. Option 5b benefits 84% of all sole parents compared to around 40% in option 1.

Financial incentives to work / make work pay

16 All the options generally improve the financial incentives to enter work. Option 1 is the most favourable as it provides the largest income increases to working families, whereas option 5b has smaller improvements on average as it provides income increases to both working and non-working families.

Benefit/work interface

17 The biggest choice for Ministers here is whether to encourage movement off benefit after a certain number of hours worked (option 1) or instead let working families receive an abated benefit for longer (option 5b and 6). Under options 5b and 6, main benefits play more of a role in supporting low-income workers instead of the more generous in-work payment in option 1.

Simplifying the system

18 Most of the options are likely to help to reduce overpayments, depending on the detailed implementation design. Options 1b and 5b have the greatest advantages from a client and delivery perspective, whereas Option 1a has less benefits for families working variable hours. The lower cost variations also simplify WFF, but add a small amount of complexity relative to progressing the full cost options due to two tier abatement (option 1a/b) and phasing (option 5b) – which increases complexity in the short term.

Next steps

19 Each option requires significantly more detailed policy design work given the complexities associated with structural reforms. If you wish to progress changes through Budget 2023, officials recommend you choose one preferred

option for further consideration. Officials can provide more advice on your preferred option in early 2023, including advice on:

- the design of specific policy parameters, as changes to these can further alter the costs and impacts of each option (noting that significant further scaling is limited),
- updating the fiscal costs using HYEFU (rather than BEFU 2022) and including operational/IT costings, and
- transitional arrangements for families financially disadvantaged (at an additional cost), flow-ons to other assistance and implementation advice.

Recommended actions

It is recommended that you:

Variation of option

1 **note** that officials recommend that you focus on one option for further development for a Budget 2023 bid

2 **agree** to further advice on one of the following options:

2.1 a new, more generous, in-work payment, that has:

a. a higher payment rate when hours worked test is met (option 1a)

AGREE / DISAGREE

b. no hours worked test (option 1b)

AGREE / DISAGREE

2.2 a single tax credit with no in-work payment (option 5b)

AGREE / DISAGREE

2.3 retain the IWTC plus complementary changes (option 6).

AGREE / DISAGREE

Scaling and phasing

3 **note** that the scaled variations require balancing some key trade-offs across fiscal costs, child poverty reduction, making work pay, and minimising unintended consequences.

4 **indicate** if, as part of further advice on your preferred in-work option in recommendation 2 above, you wish to focus on:

4.1 the variations of options that have relatively higher fiscal costs (i.e. full cost 1a, 1b, or 5b), OR

AGREE / DISAGREE

4.2 the scaled or phased variations that fit within the fiscal envelope (i.e. scaled versions of 1a or 1b, phased version of 5b, or option 6).

AGREE / DISAGREE

5 **note** that officials will provide more detailed advice on setting payment rates and thresholds to ensure the preferred option is consistent with the scale of reforms agreed to in recommendation 4 above.

Next steps

6 **agree** that subsequent advice in early 2023 include detailed policy and implementation decisions required to fully develop the options to inform a Budget 2023 bid.

AGREE / DISAGREE

7 **note** Minister Sepuloni has been invited to submit a Budget Bid for the Working for Families Review by 16 December 2022.

Clare Ward Department of the Prime Minister and Cabinet 15/11/2022	Keiran Kennedy The Treasury 15/11/2022	Polly Vowles Ministry of Social Development 15/11/2022	Eina Wong Inland Revenue 15/11/2022
Date	Date	Date	Date

Rt Hon Jacinda Ardern Prime Minister, Minister for Child Poverty Reduction	Hon Grant Robertson Minister of Finance	Hon Kelvin Davis Minister for Children	Hon Carmel Sepuloni Minister for Social Development and Employment	Hon David Parker Minister of Revenue
Date	Date	Date	Date	Date

There are key trade-offs on fiscal cost, child poverty, work incentives and administration for comparing options

20 In May 2021, Income Support Ministers agreed the original objectives of WFF of supporting income adequacy and reducing child poverty, and improving financial incentives for low-income earners to enter the labour market. Providing timely and accurate entitlements to families also remained important. Ministers also agreed the WFF Review should focus on:

- Low-income working families, while maintaining support for beneficiary families
- Options that target support to lower income families rather than more universal support, and
- The principle of making work pay and assisting with the costs for people in work.

21 These have guided the development of the options one and five presented in this report[1]. Any options will continue to be assessed against these objectives and focus areas, as well as other trade-offs such as fiscal costs.

Child poverty targets

22 The Government's three-year (intermediate) child poverty reduction targets (to be assessed in 2023/24) aim to support the achievement of the ten-year targets. The reforms considered in this paper won't affect the second intermediary targets for 2023/24 due to implementation timing, but the WFF review is a key mechanism to make progress towards the 10-year targets

23 The ten-year targets require the Government to aim to reduce child poverty on the before housing costs primary measure (BHC 50) to 5% (approximately 60,000 children) and the after-housing costs primary measure (AHC 50) to 10% (approximately 120,000 children). Substantial WFF changes will make an important contribution, but further significant investment will likely be required in Budgets 2024 and Budget 2025 to achieve the 10-year targets.

Financial incentives to work

24 Previous advice noted that the available evidence in New Zealand and overseas suggests the impact of financial incentives on employment decisions is relatively modest, but it does have an impact[2]. Increasing in-work incomes and 'making work pay' can increase the financial incentive to work for sole parents but decrease it for some second earners.

25 For example, the original WFF reforms between 2004-07 resulted in an additional 8,100 sole parents in work (a 1.8ppt increase) and 9,300 fewer

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[1] Ministers have discounted options 2, 3 and 4 presented in previous advice REP/22/7/682, DPMC-2021/22-2539, IR2022/145, T2022/1644.

[2] The impacts are broadly greater on encouraging caregivers to enter work rather than on increasing hours of work.

second earners (a 2.3ppt decrease). The labour supply response was relatively modest in the context of the $1.5b p.a package[3].

26 It is difficult to assess the impact of our options on labour supply because:

- different family types respond differently to changes in financial incentives, and any such impacts are dependent on the parameters used to design the option (which are regularly being refined).
- there are non-quantifiable factors, such as changes in the accessibility and flexibility of payments.
- there isn't a labour supply model within government agencies that would be readily available to use, and the recent commissioning for lower cost options has meant reprioritisation of modelling resources.

27 Our initial view is that the scaled variations of the options are more modest than the original WFF reforms in 2004-07 and will likely have relatively smaller impacts on aggregate labour supply. Option 1 is likely to increase labour supply for sole parents and decrease it for second earners. The impacts of option 5b (single tax credit) would be more challenging to quantify, but officials consider its impact on labour supply to be neutral at best (even if it increases the returns from working for many) given it also increases the incomes of both working and non-working families.

28 Investment in labour market programmes, and other forms of in-work assistance can also help support positive labour market outcomes. For example, the recently announced changes to the Childcare Assistance income thresholds will help improve the financial incentives to work.

Administration and family experience

29 Eligible working families can currently receive an abated benefit from MSD, or the IWTC from Inland Revenue (IR) (and MFTC if eligible). Families can qualify for both at the same time but may only receive one or the other.

30 While we generally expect families will choose the payment that provides them with the most financial support, this isn't always the case. MSD data suggests there are around 5,000 benefit recipients who would financially gain from receiving the MFTC/IWTC instead, and there are IWTC recipients who would be better off receiving an abated benefit. There are several reasons why, such as a lack of understanding of what payments make families 'better off', as well as non-financial factors (such as compliance costs and stigma).

31 There are compliance costs for families having to switch between benefit and work, with two different delivery agencies administering either benefit or tax credit payments. This can result in under or overpayments of WFF, and leads to debt to government.

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[3] Changing Families' Financial Support and Incentives for Working: the summary report of the evaluation of the Working for Families package, 2010.

32 Most options are likely to reduce the incidence of debt, to different degrees, depending on which option is progressed. The feasible options considered in the companion report on overpayments of WFF and administrative options are intended to complement the more fundamental redesign options included in this advice.

Option 1: A new, more generous, in-work payment

33 Option 1 introduces a new in-work payment, which combines the MFTC and IWTC into a single, more generous, payment (up to $310pw), and retains FTC. It would continue to be available for low to middle-income working families not receiving a main benefit and ensure they are better off off-benefit at 20 hours worked (or 30 hours for couples).

34 Similar to MFTC currently, payments would begin to abate with earnings of $25,000[4] and would be adjusted each year to ensure incomes in work remain higher than on benefit.

35 Ministers have requested further advice on two variations of this option. One that allows families who do not meet an hours test to receive some of the new in-work payment (option 1a), and another that allows families to receive the entire new in-work payment regardless of hours worked (option 1b).

36 Under both options, eligible families regularly working a small number of hours would remain better off receiving a main benefit rather than the in-work payment. Some families, however, may instead receive the in-work payment, such as those in self-employment, those who do not meet main benefit eligibility (for example because they do not meet their obligations), or those who do not regularly meet the hours test. These families would experience significant income gains under option 1b, and therefore increase the fiscal cost by around $140m p.a relative to option 1a.

Option 1a – a higher payment rate when hours worked test is met	Option 1b – no hours worked test (but must be in employment)
Description: Allow families with children off-benefit to: • receive a portion of the payment ($100) before the hours test is met • receive a higher amount (up to $310pw) if the hours test is met (20hrs for sole parents, 30hrs for couples). This option most closely reflects the current system, with the IWTC ($72.50) not subject to an hours test but the higher amount provided through the MFTC is. We estimate around 5,000 families may choose to receive the in-work payment instead of an abated benefit. **Higher compliance:** Would require clients to inform IR of any changes in work hours (similar to MFTC currently). If	**Description:** Allow families with children off-benefit to receive the full payment (up to $310pw) regardless of hours worked (similar to IWTC currently). This removes the current hours test required by the MFTC under the status quo. We estimate around 12,000 families may choose to receive the in-work payment instead of an abated benefit. **Lower compliance:** With no hours test, families don't have to notify changing hours to IR (similar to IWTC currently). Therefore, this variation is simpler to administer, reduces debt to Government, and better supports families with variable work hours. **Can disincentivise working more hours:** This option means working families can receive the significantly

[4] The payment would begin to abate from $25,000 for sole parents, and $40,000 for couples. The FTC would begin abating immediately after the in-work payment has full abated.

families do not update their hours, or switch between benefit and the payment, debt may be created. **Greater for work incentives:** A top-up once the hours test is met provides stronger incentives to work the desired level of hours. Clients working a small number of hours are significantly better off receiving an abated benefit, which balances the State paying financial support with requiring clients to meet work obligations.	higher new payment at lower hours of work if they choose not to be on benefit. The payment rate of $310pw is comparable to the single rate of Jobseeker Support, currently $315pw, but has no work obligations, which require clients to be looking for work in order to receive financial support at no or low hours of work. However, it would be more amenable for people working variable hours week to week.

Reducing costs for option 1 is best achieved through a two-tier abatement regime, rather than a lower payment rate

37 The most cost-effective way to lower fiscal costs while maintaining the policy intent of this payment is to introduce a two-tier abatement regime. This would reduce the fiscal costs by more tightly targeting income increases to working families on relatively lower incomes, and provide smaller increases to relatively higher income families.

38 The full cost variation has a single abatement rate of 30%. We have modelled a scaled variation that has higher abatement at low incomes (55%), and lower abatement at higher incomes (30%). This would replace the high EMTRs associated with the MFTC and replace it with more moderate EMTRs over a slightly wider income range.[5] It increases complexity relative to the full cost variation, but still offers some simplicity relative to the status quo as it reduces the number of in-work payments.

39 Officials also explored whether a lower payment rate would help reduce fiscal costs and continue to support the wider outcomes sought under this option. On balance, the payment rate would likely need to be reduced significantly to fit within the fiscal envelope provided – to levels that do not ensure families are better off off-benefit at the same level of hours worked (i.e. 20/30 hours of work). If Ministers prefer a lower in-work payment, then progressing option 6 is recommended instead.

Summary of impacts

40 The full cost variations have the potential to significantly improve income adequacy for working families, and reduce child poverty. If option 1 is scaled, it would reduce the fiscal costs by approximately half and result in relatively lower income increases and child poverty reductions.

[5] The higher abatement of 55% can be done at lower incomes before the AS begins abating (at 25%). For AS recipients this means the abatement rate would be 55% in total across both payments.

Option	FY25 cost[6]	Poverty impacts	Gainers	Losers
Option 1a – full	$813m	14,000 (BHC50), 33,000 (AHC50)	190,000 HHs gain by $82pw.	4,000 HHs lose by $19pw.
Option 1b - full	$955m	19,000 (BHC50), 37,000 (AHC50)	194,000 HHs gain by $94pw.	-
Option 1a - scaled	$333m	8,000 (BHC50), 12,000 (AHC50)	159,000 HHs gain by $41pw.	8,000 HHs lose by $20pw.
Option 1b - scaled	$472m	15,000 (BHC50), 15,000 (AHC50)	163,000 HHs gain by $56pw.	4,000 HHs lose by $20pw.

41 Option 1a benefits 134,000 couples (28% of all couples), and 58,000 sole parents (38% of all sole parents). The distributional impacts of option 1b are similar to option 1a, but the average gains are significantly larger for those working relatively fewer hours.

42 As noted in previous advice, the reductions in poverty are lower on the BHC50 primary measure for the full cost variations because it increases the median income which can move additional families below the relative poverty line (whereas the AHC50 primary measure fixes the median income). In addition, this option benefits only working families (around half of families in poverty), and there are fewer working families in poverty under the BHC50 measure (as there are fewer families in poverty overall under this measure). This means there is a limit on how much BHC50 reductions can be achieved through a higher in-work payment alone.

43 The fiscal costs of this option would continue to increase over time as officials recommend that payment settings are linked to changes in benefit rates and minimum wage levels, to maintain policy objectives of families being better-off off benefit (i.e. $0-$60m additional cost in 2025/26 relative to 2024/25, depending on the variation). Under the status quo, WFF settings gradually become more targeted over time as wages grow due to no regular indexation of WFF abatement thresholds.

44 Up to 8,000 families are estimated to be financially disadvantaged (depending on the variation), likely due to the removal of the 4+ rate of IWTC[7]. Further advice can be provided on transitional arrangements or options to minimise the number of families made worse off.

Administrative and client experience

45 The earliest this option could be implemented is 1 April 2024. Administration of WFF would remain largely the same, with IR delivering the new in-work tax credit, and MSD making FTC payments for most beneficiaries. As noted

[6] The cost estimates have been revised from previous modelling due to changes to complex ringfencing rules. These will continue to be refined as we work through the detailed policy design.
[7] Families with 4 or more children can currently receive an extra $15 per week for the fourth and each subsequent child. Officials have proposed removing this rate to help simplify and better rationalise the new in-work payment.

earlier, this can mean compliance costs and debt for families if they switch between benefit and work due to a change in work circumstances. This could potentially be mitigated by applying the existing IWTC grace period.

46 Option 1b doesn't have an hours test which also helps with the client experience at the benefit work interface, like IWTC currently. Inland Revenue prefers not to re-introduce an hours test given the administrative complexity and potential impact on debt, all else equal.

47 To illustrate the potential benefits of no hours test, we analysed administrative data on the impact of the removal of the IWTC hours test from 1 July 2020. We estimate that approximately 7,200 families potentially benefitted from the removal of the IWTC hours test in the 2020-21 tax year. Of these, most families (80%) had family incomes less than $40,000 before tax, and just over half had transitioned on/off benefit during the year.

48 Some other comparable countries also have in-work payments, like the United States and Canada, however their equivalent payments are at much lower levels and function more as an income adequacy back stop for working families (more like option 6 or the status quo).

Option 5: A single tax credit with no in-work payment

49 Option 5b creates a single tax credit by removing all in-work payments and redirecting the funding into the FTC. This option supports income adequacy for families with children and aims to make work pay by making FTC abatement settings more generous, instead of having an in-work payment.

50 It increases the FTC eldest child rate (by $50pw) and subsequent child rate (by $15pw). It also makes abatement settings more generous by increasing the abatement threshold from $42,700 to $60,000 and reduces the abatement rate from 27% to 25%. Earnings above $80,000 are abated at 30% via a two-tiered abatement regime.

51 Ministers requested further advice on the variation of option 5 that includes moving part of the benefit rates into FTC at the same time. This doesn't mean a reduction in beneficiaries' total incomes, but it means a small reduction in benefits to go with the larger FTC increases. Rebalancing benefits saves around $200m, shifts the balance of gains more towards working families, while still providing income increases to non-working families, and makes the option more neutral on work incentives (given the removal of the IWTC).

52 In practice, this means that main benefits rates for couples 'with' and 'without children' will be the same, with additional support for children provided solely through the FTC. This would bring settings back to how they were post WFF reforms in 2004-07 through to early 2016.

Reducing costs for option 5b is best achieved by phasing it in, rather than scaling it down

53 There is limited scope to significantly change payment rates and abatement settings to a level where it reduces costs to within the desired fiscal envelope.

This is because officials have already 'pushed the boundaries' of this option to manage fiscal costs by increasing FTC by slightly less than the IWTC reduction, introducing a two-tiered abatement regime, and incorporating a main benefit rebalance to more cost effectively improve work incentives.

54 Higher abatement rates would further reduce fiscal costs, but this increases EMTRs and shifts the balance of gains away from working families. On the other hand, a lower FTC payment rate would create additional losers among working families. Both these trade-offs would likely undermine some of the objectives and outcomes sought under this option.

55 Officials have instead explored a cost saving option that phases in the reforms across multiple years and uses existing CPI increases that are forecast to occur anyway. This approach involves gradually increasing the FTC payment rate and abatement thresholds across two years, while gradually reducing the IWTC and abatement rate at the same time. This reduces the cost in the first year (due to phasing), and reduces the net cost from the policy in the second and subsequent years (compared to the full cost option) as the FTC policy increases are smaller due to building into the reforms the CPI increases that would occur anyway.

Summary of impacts

56 The full cost option has the potential to significantly improve income adequacy for both non-working and working families, and make significant reductions to both BHC50 and ACH50 poverty. It provides relatively larger income gains to working households ($57pw), compared to non-working households ($41pw).

57 If this option is phased, it could reduce the fiscal costs to around $365m in 2024/25 but result in relatively lower child poverty impacts in the initial year. The total costs increase to $489m in 2025/26 (when fully implemented) and the child poverty reductions are increased.

Option 5b	FY25 cost	Poverty impacts	Gainers	Losers
Option 5b – full	$686m	20,000 (BHC50), 29,000 (AHC50)	262,000 HHs gain by $53pw	34,000 HHs lose by $23pw
Option 5b – Phased (1st year)	$365m	15,000 (BHC50), 14,000 (AHC50)	254,000 HHs gain by $28pw	11,000 HHs lose by $22pw

58 Option 5b benefits 141,000 couples (30% of all couples), and 129,000 sole parents (84% of all sole parents). There are significantly more sole parents that gain from option 5b compared to option 1 because sole parents are more likely to be receiving a main benefit.

Some families would be financially disadvantaged from rebalancing IWTC into FTC

59 Some families would be worse off from rebalancing IWTC into FTC, given the two payments have different apportionment rules, eligibility settings and

flow-on impacts. These issues are summarised below, with more information included in Appendix Two.

- A small number of losers for families in shared care situations, as families with shared care of children have the FTC apportioned, while both parents can receive the full amount of IWTC
- Some working families receiving a small reduction in their AS and IRRS due to an increase in the amount families need to contribute to their housing costs while receiving these payments, and
- Some Orphan's Benefit (OB), Unsupported Child's Benefit (UCB) and Foster Care Allowance (FCA) families as they are eligible to receive the IWTC but not the FTC.

60 Some families may also be financially disadvantaged due to the FTC increases proposed for the eldest child rate being lower than the IWTC reduction (to manage costs). Some of these families may currently be eligible to receive a benefit and would financially benefit from transitioning onto one.

61 There are options to mitigate most of the issues discussed in this section, but they require more detailed policy development and consideration. Further advice and modelling on mitigating these impacts, including fiscal costs, will be provided in subsequent advice (if this option is preferred).

Option 5b also improves the return from working more

62 Option 5b improves the financial return from working more compared to the status quo for many households. This is primarily due to the inclusion in this option of the main benefit rebalance into FTC. In particular, this option provides greater returns from working for primary earners in couples and sole parents earning just above the minimum wage.

63 While it generally improves the financial incentives to enter work, it does so by less than option 1. Due to the removal of the MFTC, it may also reduce the returns from working part-time for some sole parents and how much work 'is worthwhile' may become less clear. However, as noted in previous advice the MFTC is not well understood and has relatively poor take-up.

64 Ministers could also explore extending WEP to working families in receipt of WFF to improve the financial incentives to work at relatively lower cost. This could be through a lumpsum payment at the end of the tax year, due to tax credits having an annual entitlement unlike main benefits. Officials can provide further advice and modelling if Ministers are interested in exploring this further, noting it is likely to be administratively complex and unlikely to be implemented quickly.

65 In the context of the original advice on option 5 (without the main benefit rebalance included), Ministers requested advice on whether changes to tax settings would improve the work incentives of this option. Advice on this is provided in Appendix Three.

Administrative and client experience

66 This option could be implemented from 1 April 2024 at the earliest[8], and would require primary legislative change and changes to the benefit system. Option 5b would mean main benefits and FTC become the primary payments for providing financial assistance to working families on very low incomes and/or working part-time.

67 This means more working families would be incentivised to receive an abated benefit (instead of tax credits currently), which comes with some important trade-offs. Any impact on benefit numbers is highly uncertain, likely to be relatively small within the context of changes to wider economic conditions (estimated at around 3,000 additional families) and would happen gradually over time. Take-up rates for benefit may be lower due to the relatively higher compliance associated with the benefit system compared to tax credits.

68 At the same time this option also has some advantages. It could reduce the incidence of debt, due to a significantly simplified tax credit system. In addition, many low-income working families are likely to also be eligible for AS and childcare assistance, which could lead to higher take-up across a wider suite of in-work supports provided by MSD.

69 If this option is progressed, main benefit settings will need to be amended to allow sole parents with children aged 14+ to receive Sole Parent Support (instead of Jobseeker Support), and to allow couples with one partner working full time to continue to receive an abated benefit for longer. These changes are technical in nature (and described in more detailed in Appendix Two) but allow working families to be better able to receive an abated benefit.

70 This structure of payments would be consistent with how Australia supports families with children, as they don’t have a specific work focused payment. Similarly, with the UK’s implementation of their universal credit they will no longer have an in-work tax credit (the design of the NZ’s IWTC was originally based off the UK’s in-work tax credit). These countries therefore rely on higher abatement thresholds for working families to help make work pay rather than through a specific in-work payment.

Option 6: Retain the IWTC plus complementary changes

71 At the last Income Support Ministers meeting, it was requested that officials explore an additional option that removes MFTC and makes complementary changes within the existing structure of WFF, such as adjusting abatement thresholds, increasing rates, and possible changes to Best Start or WEP.

72 Such an option could be progressed instead of fundamental reforms, particularly if Ministers find the lower cost structural reform options do not

[8] Recommended changes to the benefit system are not possible for 1 April 2024, with earliest implementation in 2025, dependent on other priorities.

meet the objectives for reform, or ahead of more structural reforms through option 1 (discussed at para 83).

73 Options 1 and 5b have trade-offs around whether to significantly increase the in-work payment (option 1) or whether to remove it entirely (option 5b). We have therefore explored an option that involves more minor redesign, by:

- removing the MFTC (saves $16m p.a.),
- maintaining the more modest IWTC in its current form[9]; and
- increasing the WFF abatement threshold to $50,000 ($235m p.a.).

74 In the modelling for this option, we have also included a choice on whether to include a:

- $5pw FTC increase (+$140m p.a.[10]), or a
- $25pw IWTC increase (+$194m p.a.).

75 These additions were included to make the option more comparable in scale to the scaled variations of options 1 and 5b. While the IWTC option maintains an in-work payment, it does not ensure families are better-off going off-benefit at 20/30 hours of work (like option 1 does).

76 There is scope to vary these to fit within different cost envelopes or target different families. For example, increasing the targeted component of Best Start to around $100pw (an increase of $30), at an estimated cost of $116m p.a., could be progressed alongside a more modest increase to the IWTC.

Summary of impacts

77 When combined, option 6 helps to reduce child poverty, and make work pay by avoiding pockets of very high EMTRs and overlapping abatement. The variations of option 6 modelled are estimated to cost around $360m-$410m and reduce child poverty by 10,000-16,000 (depending on the measure and option).

Option 6	FY25 cost	Poverty impacts	Gainers	Losers
6a: Remove MFTC, higher WFF abatement threshold ($50k), **AND a $5 FTC increase**	$359m	11,000 (BHC50), 16,000 (AHC50)	263,000 HHs gain by $27pw	10,000 HHs lose by $24pw
6b: Remove MFTC, higher WFF abatement threshold ($50k), **AND a $25 IWTC increase**	$413m	10,000 (BHC50), 16,000 (AHC50)	174,000 HHs gain by $47pw	6,000 HHs lose by $35pw

[9] Maintaining the no hours test.
[10] The costs of FTC and IWTC progressed on their own are indicative as they have been costed as part of other packages.

Option 6a (with FTC increase)

78 This option has the potential to improve income adequacy for both non-working and working families, with relatively larger income gains to working households ($32pw), compared to non-working households ($11pw). Option 6a benefits 138,000 couples (29% of all couples), and 132,000 sole parents (86% of all sole parents).

Option 6b (with IWTC increase)

79 This option has the potential to significantly improve income adequacy for working families only, with around 169,000 working households estimated to gain by $48pw. It benefits 122,000 couples (26% of all couples), and 55,000 sole parents (36% of all sole parents). The lower impact on sole parents reflects that, like option one, this option does not provide gains to beneficiary families, who are largely sole parent families.

80 A scaled down version of the IWTC increase for working families could allow for an accompanying increase in Best Start, which would go to both working and beneficiary families.

Discussion on the options

81 Which variation of this alternative option to progress largely depends on whether you want an increase that is directed to working and beneficiary families (option 6a) or only working families (option 6b). If option 6 is preferred, officials can provide additional variations for further consideration.

82 If Ministers see these options as an interim step ahead of larger structural reforms (through either options 1 or 5), then any interim changes progressed also need to be consistent with the desired longer-term outcomes (covered further in Appendix Four).

83 **If Ministers would like to progress option 1 in the longer-term,** then the variations of option 6 would be consistent with the outcomes being sought in option 1 and would not preclude implementation of this option at a later stage. The main difference between a higher IWTC (option 6b) and the variations of option 1 is that the IWTC does not ensure families are better off after working a certain number of hours.

84 **If Ministers would like to progress option 5b in the longer-term,** then option 6 would not be recommended because neither variation of option 6 provides a cost-efficient pathway. In particular, increasing the IWTC would not be recommended if Ministers would like to remove the payment at a later stage. Officials would instead recommend phasing in option 5b.

Administrative and client experience impacts

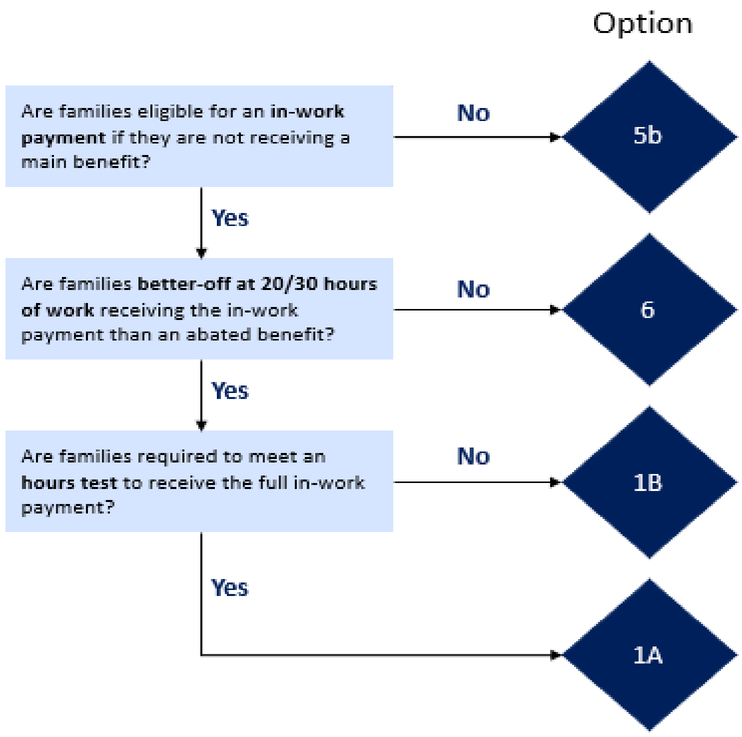
85 Option 6 could be implemented from 1 April 2024 at the earliest, and would require primary legislative change and possible changes to the benefit system. It would involve less fundamental redesign and instead focus on improving income adequacy and smoothing EMTRs for families on very low incomes within the existing structure of WFF.

86 The removal of the MFTC may result in more working sole parents continuing to receive an abated main benefit for longer, but to a lesser degree than option 5b due to the retention of the IWTC. For couples, there would be little impact on administrative and client experience compared to the status quo.

87 All the benefit interface changes recommended under option 5b (Appendix Two) are likely to be recommended under this option as well, to ensure working families are better supported through the benefit system[11].

A framework on the role of in-work payments

88 A framework for the role of in-work payments is provided below. Making work pay remains an important policy objective across all the options, but the role and size of the in-work payment/s differs across each of the options. Which option to progress depends on the relative weight put on the different trade-offs and objectives by Ministers.



Next steps

89 Officials recommend that Income Support Ministers proceed with a preferred option for consideration through Budget 2023. Subsequent advice in early 2023 will reflect any feedback provided on this paper and include more details on the parameters of your preferred option, including:

- Refining the detailed payment rates and thresholds in line with the feedback provided by Ministers
- Updating the fiscal costs using HYEFU (rather than BEFU 22), and including operational/IT costings

[11] Changes to the benefit system are not able to be implemented until 2025 at the earliest.

- Transitional arrangements for any families financially disadvantaged, at an additional cost, and flow-ons to other assistance (such as to Community Services Card and the Best Start abatement threshold)

90 We will include more detailed advice on implementation and administrative settings (including operational costs) for the preferred option. The implementation timeframes provided in this report are the current best estimates and are dependent both on the specifics of the final design, and other work Ministers may require IR and MSD to undertake, such as a potential income insurance scheme.

Appendix One: A3 summary comparing options 1, 5 and 6

(Attached separately)

Appendix Two: More detailed considerations

Impacts of specific family types

Table 1: FTC and IWTC current settings

	FTC	IWTC
Payment structure	Paid per child Higher rate for eldest child	Paid per family, but additional $15 per child for 4+ children
Shared care	Payment apportioned based on care	Payment not apportioned, both parents can receive it if they qualify
OB/UCB/FCA	Not eligible (analogous to FTC).	Eligible.

Shared Care

91 Under the status quo, families with shared care of children have the FTC apportioned, based on the division of care of the child, while both parents can receive the full amount of IWTC. There are approximately 25,000 families in shared care representing around 6-7% of WFF recipients, with around 16,000 of these receiving both the FTC and IWTC[12].

92 Under option 1, both parents in shared care arrangements will be eligible for the new in-work payment, like the IWTC. The new payment is significantly more generous and may create greater integrity risks for partnered families to falsely claim they have separated. This risk will be greater under option 1b, where the full payment is available without an hours test.

93 Under option 5, without any changes, some families in shared care will be worse off from the removal of the IWTC and MFTC. Both families which previously received the full IWTC would instead receive an apportioned FTC. There are options to reduce the number of families financially disadvantaged by these changes, and we can provide further advice if option 5 is a preferred option. These may increase costs.

94 Both variations of option 6 maintain the IWTC, therefore no changes to shared care are required.

Orphan's Benefit, Unsupported Child's Benefit and Foster Care Allowance

95 Under the status quo, families who are receiving OB, UCB or FCA are ineligible to receive the FTC as the payments are considered analogous. These families can receive the IWTC and MFTC. There are approximately 16,000 OB/UCB/FCA caregivers, caring for 25,000 children.

96 Under option 1, these caregivers will be able to receive the new in-work payment, if they meet the eligibility criteria. No changes are required to rates of OB/UCB/FCA as there are no changes to the FTC.

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[12] Around 4,500 only receive the FTC, and 4,000 only receive the IWTC.

97 Under option 5, families who currently receive the IWTC will be worse off if no changes are made[13], as these families will not benefit from the increase to the FTC and will lose entitlement to IWTC. An increase to the rates of OB/UCB/FCA could be made to flow through any increases to the FTC. This would see an increase in rates for all caregivers, not just those who received the IWTC. There are choices around how much to increase the rates by which may increase costs.

98 Under option 6, the IWTC is retained, therefore no significant changes to OB/UCB/FCA are required. If you progress an FTC increase (6a is currently modelled with a $5 FTC increase) you could pass on the equivalent increase to OB/UCB/FCA rates at a small cost, as had been done previously.

Benefit/work interface under options 5 and 6

99 Currently Sole Parent Support recipients (youngest child is aged under 14) can work any number of hours, until their benefit has abated to zero. However, Jobseeker Support (JS) sole parents (youngest child is aged over 14) and couples have some restrictions on work, due to the 30-hour rule[14].

100 This means complementary changes to the benefit system are required for options five and six, to better support more working families to receive an abated benefit (outlined below). Some of these issues already exist under the current system, given the eroded value of the MFTC, but may be exacerbated under options five and six.

- **Move JS sole parents onto Sole Parent Support** (as was the case pre 2013 welfare reform): This change would allow sole parents with older children to receive an abated benefit for longer, like other sole parents, while retaining full time work obligations that currently apply under JS[15].
- **Make changes to settings for couples receiving JS**:
    - changes to JS to allow couples to qualify without meeting the requirement to be available for full time work, if one person in the couple is already working full time and they have children under 14
    - changes to work obligations for couples who qualify through the above exemption to ensure they better reflect the age of dependent children
    - process improvements for switching the primary recipient to support couples to receive an abated benefit for longer while on low incomes.

101 These changes require more policy work if either option 5 or 6 is preferred, and detailed advice can be provided in early 2023, including operational and flow on costs.

[13] Estimates suggest that this may affect around 3,000-3,500 families, but further work is required.
[14] Primary recipients are unable to qualify for Jobseeker Support if they are working 'full time' which is defined in the Social Security Act as 30 hours per week.
[15] There are currently no full-time obligations under Sole Parent Support so this would require introducing them

Appendix Four: Further detail on options can be phased or stepped through

Diagram 1: Pathways for reform

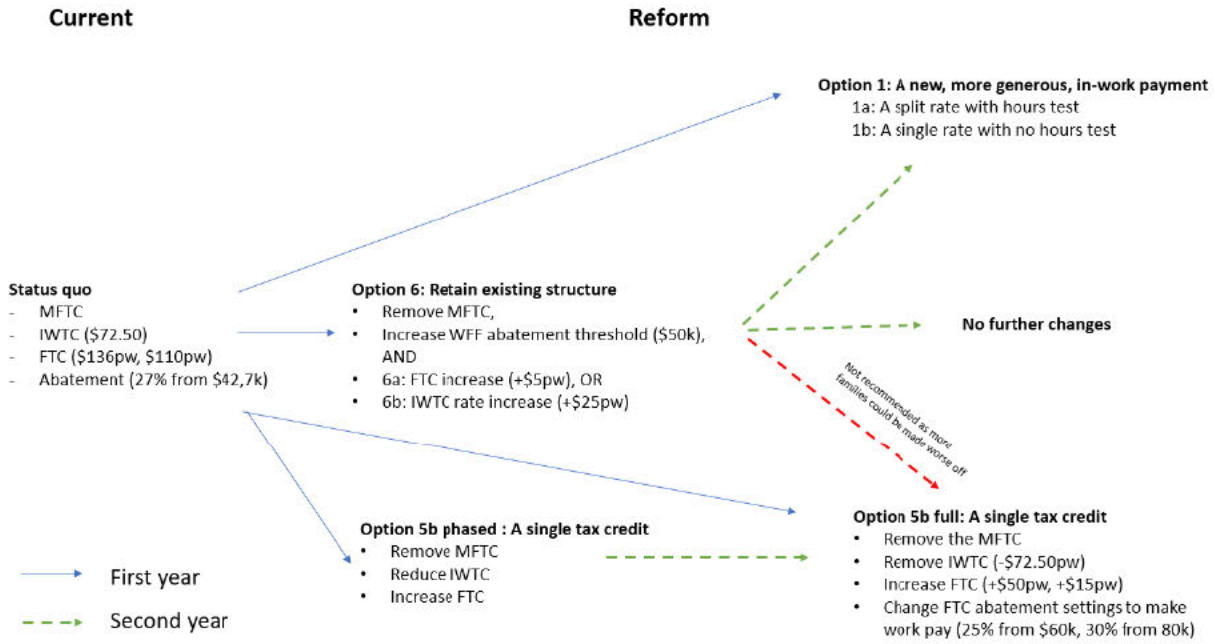


Table 2: Detailed costs and impacts of phasing or stepping through options

		FTC eldest child rate	FTC subs. child rate	In-work payment	Abatement threshold	Abatement rate	Cost
Option 5b phased	1 April 2024	+$20pw	+$7pw	-$20pw	Increase from $42,7k to $47,7k	No change	**$365m** (1st year)
	1 April 2025	+$34pw	+$12pw	-$52.50pw (no more IWTC)	Increase from $47,7k to $60k	Reduce from 27% to 25%. Abate at 30% from $80k	**$489m** (2nd year) Note this includes the costs of the first year
Option 6 to option 1	1 April 2024 (option 6b)	No change	No change	+$25pw	Increase from $42,7k to $50k	No change	**$413m**
	1 April 2025 (option 1)	No change	No change	+$212.50pw	Increase from $50k to $78,7k	Increase from 27% to 30%	Not yet modelled
Option 6 to option 5 *Not recommended as will result in more families worse off*	1 April 2024 (option 6b)	No change	No change	+$25pw	Increase from $42,7k to $50k	No change	**$413m**
	1 April 2025 (option 1)	No change	No change	-$97.50pw (no more IWTC)	Increase from $50k to $60k	Reduce from 27% to 25%. Abate at 30% from $80k	Not yet modelled

Working for Families – November Income Support Ministers meeting

Context

- Income Support Ministers requested further advice on an option that creates a new in-work payment (option 1), an option that removes the in-work payment (option 5), and an alternative variation that largely maintains the existing structure but removes the MFTC (option 6).
- There are significant trade-offs across the options, which are summarised in these A3's and expanded on in the paper. The modelling will continue to be refined as we get feedback from Ministers and work through the detailed policy design.

Option 1: New, more generous, in-work payment

Description:

- A new in-work payment that combines the MFTC and IWTC into a more targeted and generous payment that ensures families are better off off-benefit.

Key aspects of design

- New in-work payment that replaces the MFTC and IWTC
- Available for working families who are off-benefit.
- Ensures families are better off off-benefit, like MFTC currently, but with more gradual abatement.
- Options to pay a higher amount if hours test is met (1a) or regardless of hours worked (1b).
- Could include two-tiered abatement to target increases more to lower-income working families and reduce fiscal cost.

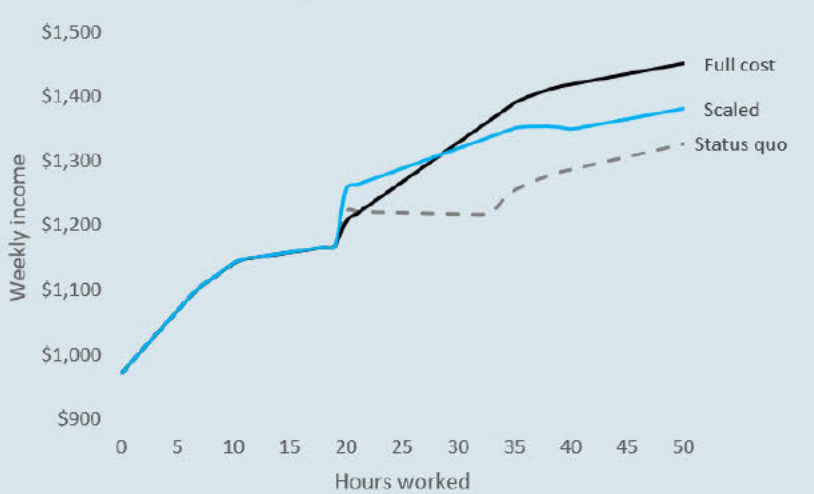
Pros

- Simpler and more targeted in-work payment.
- Greater returns from working full-time.
- Improves income adequacy and significantly reduces child poverty in working families.
- Retains incentive to move off benefit.

Cons

- Increases EMTRs for higher-income families.
- No income increases for beneficiary families.
- Higher longer term costs.

Sole parent income by hours worked (no WEP)



Option 5: A single tax credit with no in-work payment

Description:

- Removes all in-work payments in WFF, and redirects the IWTC into the FTC to create a single tax credit.

Key aspects of design

- Removes the MFTC and IWTC, but increases the FTC.
- Increases the FTC abatement threshold and reduces the abatement rate to help make work pay.
- Introduces two-tiered abatement to target increases to lower-income families and reduce fiscal cost.
- Rebalances some of main benefits into FTC to make child payments more neutral on work status.

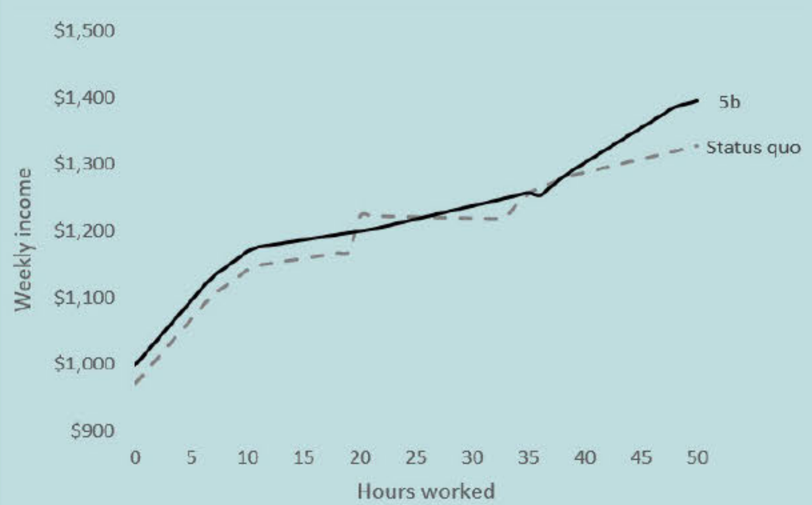
Pros

- Significant simplification of WFF by having one tax credit.
- Addresses concerns about the in-work payments raised by some stakeholders.
- Continues to make full-time work pay through the FTC.
- Significant child poverty reductions.

Cons

- Slightly more working families receiving a benefit.
- Complementary changes required to ensure some shared care HHs or HHs receiving AS are not made worse off.
- Generally increases incentives to work, but can reduce it for the small number of HHs who would otherwise receive the MFTC.

Sole parent income by hours worked (no WEP)



Option 6: Retain the IWTC plus complementary changes

Description:

- Largely maintains the existing structure by maintaining a modest in-work payment (IWTC) alongside the FTC.

Key aspects of design

- Removes the MFTC, but keeps the FTC and IWTC in its current form.
- The IWTC continues to support those in work, but doesn't ensure families are better off off-benefit.
- Increases the WFF abatement threshold to help make work pay and avoid overlapping abatement with benefits.
- Increases the IWTC or FTC to improve income adequacy.

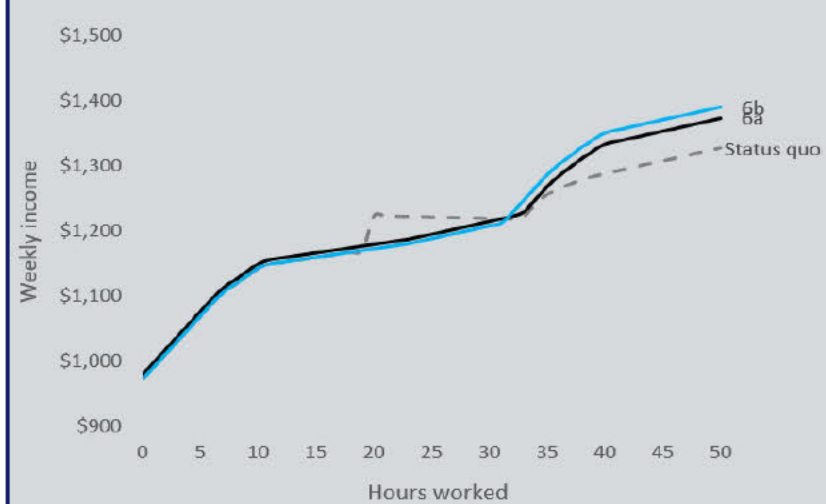
Pros

- Increases income adequacy and helps make work pay.
- Maintains existing WFF structure but with some simplification.
- Moderate child poverty reductions.

Cons

- Slightly more working families receiving a benefit (similar to option 5 but to a lesser extent).
- While it maintains an in-work payment, it does not guarantee low-income families are better off receiving it.
- Generally increases incentives to work, but can reduce it for the small number of HHs who would otherwise receive the MFTC.

Sole parent income by hours worked (no WEP)



Working for Families – November Income Support Ministers meeting

Summary of impacts (2024/25)

Option	Option 1: New, more generous, in-work payment				Option 5: A single tax credit with no in-work payment		Option 6: Retain the IWTC plus complementary changes	
	1a: Partial hours test		1b: No hours test		5b: Full amount	5b: Phased (1st year)	6a: FTC increase	6b: IWTC increase
	Full cost	Scaled	Full cost	Scaled				
Costs*	$813m	$333m	$955m	$472m	$686m	$365m	$359m	$413m
Child poverty	14,000 (BHC50) 33,000 (AHC50)	8,000 (BHC50) 12,000 (AHC50)	19,000 (BHC50) 37,000 (AHC50)	15,000 (BHC50), 15,000 (AHC50)	20,000 (BHC50), 29,000 (AHC50)	15,000 (BHC50), 14,000 (AHC50)	11,000 (BHC50), 16,000 (AHC50)	10,000 (BHC50), 16,000 (AHC50)
Gainers / losers	190,000 HHs gain by $82pw, 4,000 HHs lose by $19pw.	159,000 HHs gain by $41pw, 8,000 HHs lose by $20pw.	194,000 HHs gain by $94pw, No HHs lose under this option.	163,000 HHs gain by $56pw, 4,000 HHs lose by $20pw.	262,000 HHs gain by $53pw, 34,000 HHs lose by $23pw.	254,000 HHs gain by $28pw, 11,000 HHs lose by $22pw.	263,000 HHs gain by $27pw, 10,000 HHs lose by $24pw.	174,000 HHs gain by $47pw, 6,000 HHs lose by $35pw.
Benefit/work interface	Maintains historic policy intent of IWTC/MFTC – to ensure families better off if hours test is met.		Similar to 1a, but without an hours test and much larger in-work payment at lower levels of hours worked.		Main benefits play more of a role in supporting low-income workers. May reduce the incidence of debt due to major simplification of WFF scheme.		Like option 5 but to a lesser degree, main benefits play more of a role in supporting low-income workers.	
Administration	Moderate simplification due to removal of MFTC. People would need to inform IR of any changes in work hours (similar to MFTC currently).		Moderate simplification due to removal of MFTC. No need to notify IR of changes to work hours (similar to IWTC currently).		Significantly simplified tax credit system by having one main tax credit.		Moderate simplification through removal of MFTC.	
Incentives to work / make work pay (more analysis on next page)	Improves the returns from working full-time for sole parents and primary earners in couples, reduces financial incentives for second earners in couples.				Generally improves the returns from working more hours (particularly for couples and those with earnings above the minimum wage), reduces financial incentives for second earners in couples.		Generally improves the returns from working more hours (particularly for couples and those with earnings above the minimum wage), reduces financial incentives for second earners in couples.	

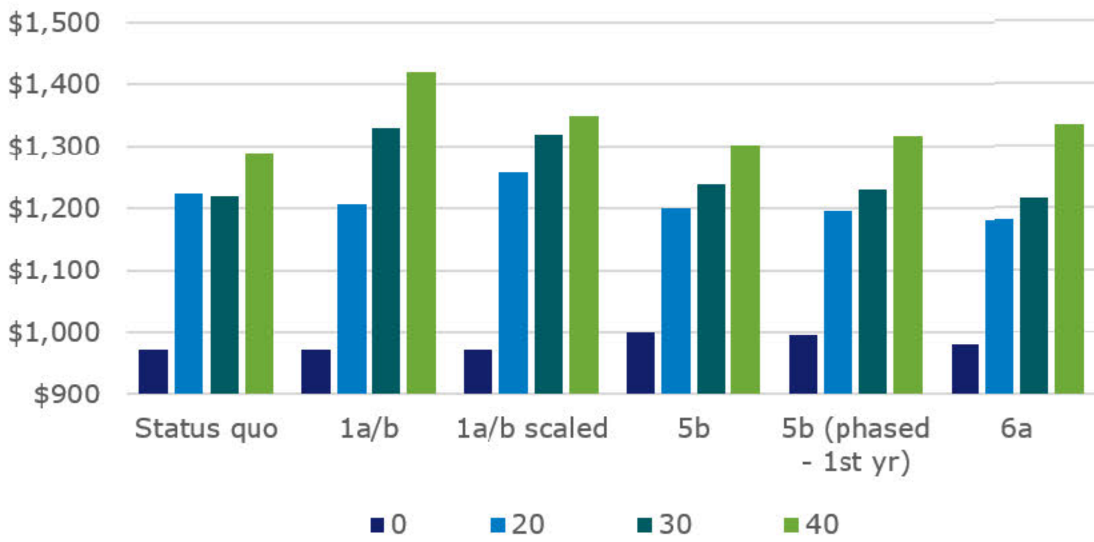
* The fiscal costs will continue to be refined as officials work through the detailed policy parameters, include operational/IT costs, and use more up-to-date forecasts (HYEFU). The cost estimates for option 1a/b have also been revised since the previous modelling due to changes to complex ringfencing rules for families who do not qualify for the IWTC throughout the entire year.

Parameters (2024/25)

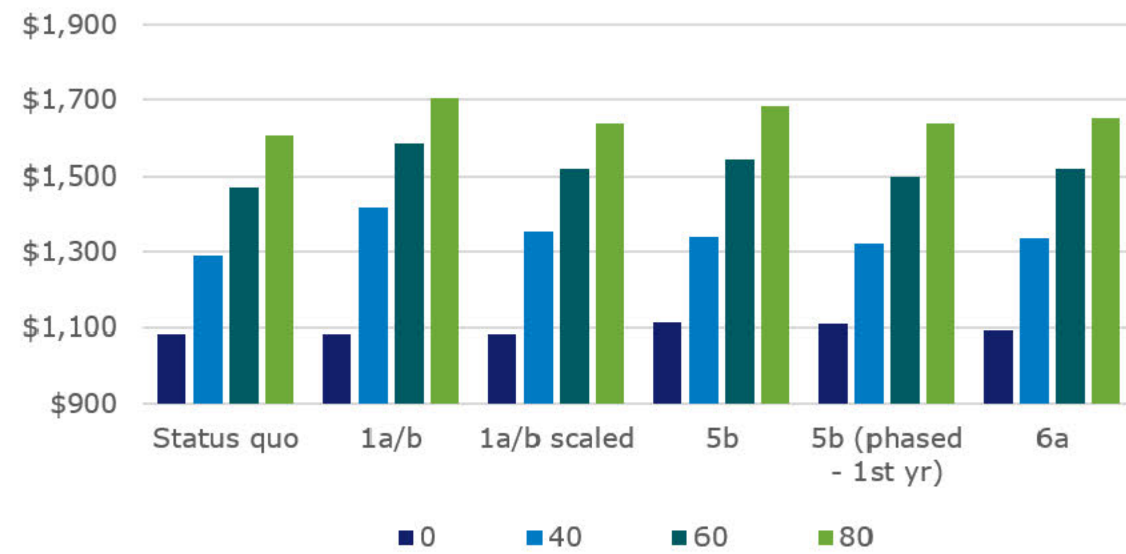
		Status quo	Option 1: New, more generous, in-work payment		Option 5: No in-work payment		Option 6: Retain the IWTC plus complementary changes	
			1a: Partial hours test	1b: No hours test	5b: Full amount	5b: Phased (1st year)	6a: FTC increase	6b: IWTC increase
Family Tax Credit	**Eldest child rate**	$136pw	$136pw	$136pw	$186pw	$156pw	$141pw	$136pw
	Subsequent child rate	$110.81pw	$110.81pw	$110.81pw	$125.81pw	$117.81pw	$115.81pw	$110.81pw
In-work payment	**Amount for being 'off-benefit'**	$72.50pw	$100pw	$310pw	$0	$52.50pw	$72.50pw	$97.50pw
	Amount for being 'off benefit' and meeting hours test	$72.50pw + MFTC (up to $250pw for min wage earner)	**Full cost:** $310pw* **Scaled:** $360pw*	**Full cost:** $310pw **Scaled:** $360pw	$0	$52.50pw	$72.50pw	$97.50pw
Abatement	**Abatement threshold**	$42,700	$24,960*	$24,960	$60,000	$47,700	$50,000	$50,000
	Abatement rate	27%	**Full cost:** 30% **Scaled:** 55%, then 30% from $50,000	**Full cost:** 30% **Scaled:** 55%, then 30% from $50,000	25%, then 30% from $80,000	27%	27%	27%

* Note that this is the maximum payment available for a sole parent working 20 hours on the minimum wage. A couple can only qualify for the payment at 30 hours worked under option 1a, at which point they will only be eligible to receive $230pw and their payments will therefore begin abating from $37,440 gross annual income.

Income by hours worked for a **sole parent** with 2 children

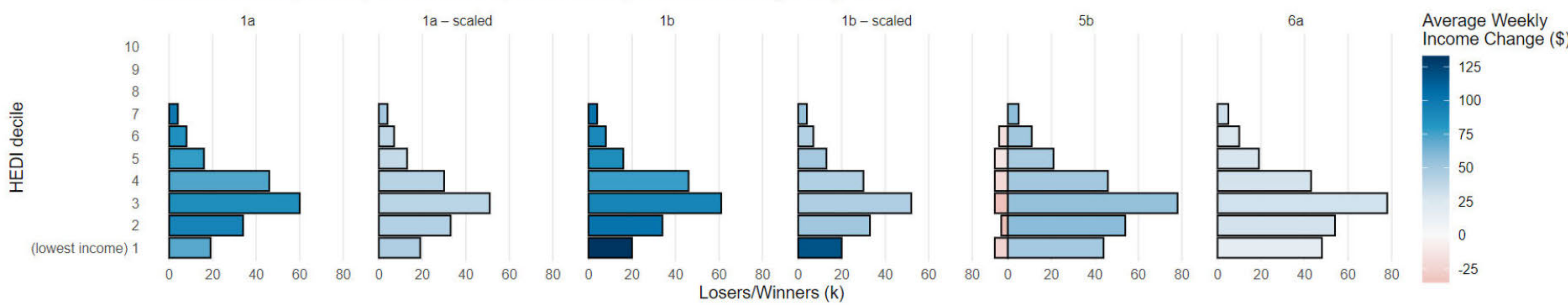


Income by hours worked for a **couple** with 2 children



Level of work/income		Sole parents: Amount better off in work						Couples: Amount better off in work					
Hours worked at min wage	Annual Income	Status quo	Option 1a/b	Option 1a/b scaled	Option 5b	Option 5b (phased – 1st yr)	Option 6a	Status quo	Option 1a/b	Option 1a/b scaled	Option 5b	Option 5b (phased – 1st yr)	Option 6a
0	0	**$972pw**	**$972pw**	**$972pw**	**$1,000pw**	**$995pw**	**$980pw**	**$1,083pw**	**$1,083pw**	**$1,083pw**	**$1,112pw**	**$1,107pw**	**$1,092pw**
10	$12,480	+$170pw	+$170pw	+$170pw	+$170pw	+$170pw	+$170pw	+$123pw	+$138pw	+$138pw	+$138pw	+$138pw	+$138pw
20	$24,960	+$251pw	+$235pw	+$285pw	+$200pw	+$200pw	+$200pw	+$141pw	+$168pw	+$168pw	+$169pw	+$167pw	+$168pw
30	$37,440	+$247pw	+$358pw	+$348pw	+$238pw	+$235pw	+$235pw	+$159pw	+$218pw	+$213pw	+$202pw	+$185pw	+$197pw
40	$49,920	+$316pw	+$447pw	+$377pw	+$303pw	+$322pw	+$355pw	+$207pw	+$335pw	+$270pw	+$228pw	+$213pw	+$270pw
50	$62,400	+$355pw	+$479pw	+$409pw	+$395pw	+$361pw	+$394pw	+$315pw	+$435pw	+$370pw	+$355pw	+$321pw	+$353pw
60	$74,880	-	-	-	-	-	-	+$386pw	+$500pw	+$434pw	+$431pw	+$392pw	+$424pw
70	$87,360	-	-	-	-	-	-	+$455pw	+$565pw	+$496pw	+$498pw	+$461pw	+$493pw
80	$99,840	-	-	-	-	-	-	+$521pw	+$623pw	+$555pw	+$570pw	+$530pw	+$560pw

Distributional impacts by Household Equivalised Disposable Income (HEDI) Decile



* The graphs above show the distribution of households who gain (the longer the bars, the more families who gain), and the size of the average gains (the darker the bars, the greater the income gains). For all the options, the average weekly income gain is relatively even across the income distribution except for option 1b. For option 1b, the average gains are greater than $125pw for those off-benefit with relatively low earnings. Options 5b and 6a provides income increases to more households in income deciles 1 and 2 as these options also increase the incomes of non-working families. Option 5b has relatively more households worse off, and further advice on this is included in the substantive report.

Appendix Three: Tax changes and the impact on work incentives

1 After the Income Support Minister's meeting on 5 October, Ministers requested advice on whether a change in tax would have an impact on work incentives for Option 5. The options in this paper have different impacts on financial work incentives, with all options (apart from scaled or phased) improving work incentives for sole parents working minimum wage compared to the status quo. However, the options are not particularly favourable for second earners for some hours of work.

2 Options 1a, 1b, and 6 retain an in-work payment, whereas Option 5 does not have an in-work payment. Comparing Option 5 (which has no in-work payment) with the other options, more people will receive a combination of FTC and benefits (without any change in their working behaviour). It is difficult to quantify how many people might change their behaviour because this depends on their preferences and choices available, but Option 5 may have weaker financial work incentives than Options 1a or 1b for a sole parent working minimum wage.

The tax system and work incentives

3 Personal tax settings can impact work incentives, and should be considered alongside social policy decisions as taxes and transfers interact. The impact of any tax changes, including on financial work incentives, will depend on the nature of the change (for example, which rate or threshold is changed and by how much) and the individual's circumstances (whether they are a beneficiary or working, a single or couple family, and their interaction with the transfer system).

4 The interaction between taxes and transfers is particularly complicated, as the tax system is individually based while the transfer system is largely based on the family unit. As a result, two families with the same total income but a different income mix may be affected differently by a given tax change, and the impacts on work incentives may be different in each case. Consideration should be given to how families are distributed by income to understand the aggregate impact on labour supply.

5 Tax reductions can have different impacts on work incentives. They will typically allow a person to retain more of their income (all else equal) and the person may feel that this means that they have sufficient income and not feel incentivised to earn more (the income effect). A tax cut may also allow a person to keep more of their additional income if they take on more work (if the tax cut applies to their additional income), lowering their effective marginal tax rate, which may improve their work incentives (the substitution effect). A tax cut will not provide this second type of improvement in work incentives if it occurs at a level below the affected person's existing income level. For example, if the 10.5% rate was reduced

but a person already earns over $14,000, they will already receive the full benefit of the tax reduction in their existing income and the reduction would not reduce the tax burden on any additional income that they earn. Therefore, to improve work incentives through personal tax reductions, it is important to understand who the groups intended to benefit would be and how they would be affected by changes to particular rates and/or thresholds.

6 Another consideration is that personal tax changes do not automatically flow through to main benefit payments because main benefits are set on a net basis (i.e., gross payments are adjusted, but recipients do not see the effect of that if they do not work). However, benefit rates will increase over time via net wage indexation because the average wage will increase as a result of a reduction in tax.

7 Some illustrative examples below consider the impact of a few different tax changes in isolation and based on specified family income mixes. However, there are many different types of families and income mixes where the impacts would be different. Understanding the full impacts of any given tax change would require microsimulation modelling.

Example one – Tax Working Group scenario - $7,000 tax free threshold

8 A single person receiving the main benefit (and getting a main benefit of more than $7,000) would not get any immediate increase, as their benefit is calculated net of tax. Benefit rates will increase over time via net wage indexation because the average wage will increase as a result of a reduction in tax.

9 A single parent with no benefit income, who is working 20 hours a week on $24 an hour (around the minimum wage expected from 1 April 2023), would earn $24,960 per annum. They would receive an increase in take home pay of $735 per annum, or around $14 a week. The personal income tax changes would not affect their WFF entitlement as this is based on their income before tax, therefore could increase financial work incentives.

10 Everyone earning taxable income of more than $7,000 would receive the same increase in their take home pay with a $7,000 tax free threshold. For example, a person earning $250,000 per annum would receive the same increase in take home pay of $735 per annum, or around $14 a week as the single parent earning $24,960.

Example two - reduction in the 17.5% rate to 15%

11 A single parent with no benefit income, who is working 20 hours a week on $24 an hour (around the minimum wage expected from 1 April 2023) would earn $24,960 per annum. They would receive an increase in take home pay of $274 per annum, or around $5 a week. They would also reduce their

effective marginal tax rate (EMTR) by 2.5 percent in the income range of the tax change.

12 The personal income tax changes would not affect their WFF entitlement as this is based on their income before tax, therefore could increase financial work incentives.

Example three – reduction in the 30% rate to 25%

13 A couple with two children and one earner working 40 hours per week on $30 an hour (around the average wage) would earn $62,400 per annum. They would receive an increase in take home pay of $720 per annum (around $14 a week). The specific effect on the earner's EMTR would depend on whether they were the Principal Caregiver for WFF, but would reduce by 5%.

Impacts of a tax- free threshold on work incentives for Option 5

14 As the benefit is treated as the primary source of income, having a tax-free threshold (at a level lower than their benefit entitlement) has no impact for people receiving a main benefit.

15 Having a tax-free threshold that is greater than a person's benefit entitlement will increase take home pay, but it is unlikely to address EMTR concerns as the EMTR is the combination of the tax rate and any abatement rate applying to the last dollar that a person earns. If a person is subject to benefit abatement, their benefit abates at a rate of 70% and this comprises the most significant part of their EMTR. A tax-free threshold would have a comparatively small effect compared to the abatement rate.

16 A tax-free threshold is typically set at a relatively low level and is therefore usually below the last dollar that a person earns. Adjustments to higher tax rate thresholds such as the 30% tax rate threshold ($48,000) may have more impact on EMTRs as they would be more likely to reduce the tax rate applying to a person's last dollar of income (ie shifting the 30% tax rate threshold to $58,000 would reduce the EMTR of a person earning $50,000 by 12.5%). However, the nature of those changes will affect where those gains are felt, and also depends on factors such as income levels, benefit rates and abatement settings.

There are other ways to impact on work incentives in the WFF system that may be more cost effective than tax changes

17 While the impacts of any given tax change depend on the specifics, we consider it unlikely that small changes to the marginal tax rates would have a material impact on financial work incentives for low-income families. The impacts faced by families who consider working more include reductions in entitlements including Accommodation Supplement and WFF. On current settings, families lose 25c in the dollar through the withdrawal of the FTC

and IWTC, on top of what they lose through personal tax (this depends on the family, but could be 30-33c). In combination, this means most families receiving WFF have EMTRs of at least 55-58%, and 80-83% if they also start losing the Accommodation Supplement.

18 Work incentives can also be impacted by more than just the financial return from work. They are influenced by availability and affordability of childcare, work availability, and personal preferences.

19 As tax settings apply to all income earners, any changes have far-reaching effects, including broader distributional impacts and fiscal costs. Any tax changes would create new winners and/or losers depending on what the specific tax changes are. In general, there will always be trade-offs between which groups of individuals to incentivise, with income distribution being a key consideration, and balancing objectives (e.g., increasing income adequacy or incentivising work, fiscal costs).

20 There are other ways to improve financial work incentives than through changes to the tax system, including adjusting abatement rates of tax credits, which could have a more pronounced financial impact for low-income families and can be designed to target financial work incentives at different pinch points. Different abatement rates for the WFF options are being considered.

Appendix A
Document 3

Inland Revenue
Te Tari Taake

MINISTRY OF SOCIAL DEVELOPMENT
TE MANATŪ WHAKAHIATO ORA

POLICY AND REGULATORY STEWARDSHIP

Policy report: Working for Families Review – administrative options

Date:	15 November 2022	**Priority:**	Medium
Security level:		**Report number:**	IR2022/512 REP/22/11/1111

Action sought

	Action sought	**Deadline**
Prime Minister/Minister for Child Poverty Reduction	**Agree** to recommendations **Note** the contents of this report	22 November 2022
Minister of Finance	**Agree** to recommendations **Note** the contents of this report	22 November 2022
Minister for Children	**Agree** to recommendations **Note** the contents of this report	22 November 2022
Minister for Social Development and Employment	**Agree** to recommendations **Note** the contents of this report	22 November 2022
Minister of Revenue	**Agree** to recommendations **Note** the contents of this report	22 November 2022

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**
Eina Wong	Principal Policy Advisor, Inland Revenue	s 9(2)(a)
Kahu Te Kani	Policy Analyst, Ministry of Social Development	s 9(2)(a)

15 November 2022

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

Working for Families Review – administrative options

Executive summary

This report provides you with a progress update on policy options for improving the administration of Working for Families (WFF) and seeks your decisions on whether to progress some of these options. It is intended to be a companion piece to the report on policy reform options *Working for Families Review: Further advice on options to progress for Budget 2023 and beyond* (DPMC-2022/23-547, T2022/2489, REP/22/11/1097 and IR2022/511 refer).

A key issue resulting from the administration of WFF is overpayments. They arise from the underlying WFF policy and interaction between the benefit and tax credit systems. Overpayments can be exacerbated by changes in family circumstances and the joint administration of WFF by Inland Revenue and the Ministry of Social Development (MSD). We estimate that around 20 percent of overpayments arise as a result of joint administration. Improved information collection and sharing between agencies can help to address existing issues.

Officials therefore recommend that this be further investigated as a first call for improving administration of WFF, by assessing the existing Inland Revenue–MSD Approved Information Sharing Agreement (AISA). This would proceed on a longer timetable than the other options outlined in this report and would need to be prioritised by both agencies given current resource constraints. As such, we are seeking your agreement that this work should be prioritised.

Other options that we recommend include:

- Providing a four-week grace period for the death of a child to recipients of Family Tax Credit (FTC) and In-Work Tax Credit (IWTC) (and Minimum Family Tax Credit (MFTC), if it remains in place) to align with the settings for the Best Start Tax Credit.
- Repealing the grandparented Child Tax Credit (CTC) – this would simplify the WFF administration and would only affect seven families.

If progressed, both options could be effective from 1 April 2024 at the earliest, but this depends on other priorities that Inland Revenue and MSD are asked to deliver.

After further consideration, we have determined that some options are not feasible, or are not recommended given the trade-offs and implications. These include:

- Introducing a Buffer Tax Credit (BTC) – not feasible in the short term because it would require improved information collection and exchange as a prerequisite. These changes are still yet to be fully scoped and prioritised by MSD and Inland Revenue, and therefore changes to enable a BTC cannot be implemented in the short term.
- Introducing an automatic debt write-off for WFF overpayments – feasible, but not recommended because of equity issues.

- Excluding income earned outside of certain relationship periods for WFF calculations – not recommended because it would be complex and compliance-heavy.
- Paying the Independent Earner Tax Credit (IETC) to WFF customers – not recommended because it would be complex and does not resolve fundamental issues with the IETC.

Next steps

If you wish to progress any options, we will provide you with further advice on implementation implications and fiscal costs.

In addition to the administrative options outlined in this report, we have several minor remedial WFF amendments that could be progressed in a bill in 2023 for example. If you are interested in progressing some minor remedial amendments in a bill next year to improve the administration of the WFF scheme and clarify the legislation, we will report to you on what our suggested changes are in February 2023.

Recommended action

We recommend that you:

1. **note** that underpayments and overpayments of WFF entitlements are primarily caused by changes to family circumstances and the joint administration of WFF, and these can be improved with better information collection and sharing;

Noted

2. **agree** that officials assess the existing information exchanged under the Inland Revenue–MSD AISA and determine the scope and feasibility of potential changes (recommended);

Agreed/Not agreed

3. **note** that recommendation 2 will proceed on a longer timetable than the other options in this report and would need to be prioritised by both agencies given current resource constraints;

Noted

4. **agree** to provide a four-week grace period when a child dies for the FTC and IWTC (and MFTC, if it remains in place) (recommended);

Agreed/Not agreed

5. **note** that officials will provide you with a fiscal costing if you agree to recommendation 4;

Noted

6. **agree** that a general grace period for other changes in circumstances should not be progressed at this stage (recommended);

Agreed/Not agreed

7. **note** that a BTC would require changes to the exchange of information between MSD and Inland Revenue and, as a result, a BTC cannot be implemented in the short term;

Noted

8. **indicate** whether you want further advice on a BTC and, if so, the process and timing for the advice (not recommended);

Yes/No

9. **indicate** whether you want further advice on a WFF-specific automatic debt write-off and, if so, the process and timing for the advice (not recommended);

Yes/No

10. **agree** to repeal the grandparented CTC (recommended);

Agreed/Not agreed

11. **note** the fiscal implications of recommendation 10 are nil;

Noted

12. **note** that the earliest that recommendations 4 and 10 can be implemented is 1 April 2024, and that this effective date will ultimately depend on other priorities that Inland Revenue and MSD are asked to deliver at the same time;

Noted

13. **agree** *not* to progress work on excluding non-salary or wage income earned outside the relevant relationship periods from the calculation of family scheme income (recommended);

Agreed/Not agreed

14. **agree** *not* to progress allowing Inland Revenue to grant families the IETC where their entitlement to it would be greater than their WFF entitlement (recommended);

Agreed/Not agreed

15. **note** that officials propose to undertake a review of the IETC at a later date after the completion of the WFF Review;

Noted

16. **indicate** whether you want further advice in February 2023 about remedial amendments that could be included in a bill in 2023 (recommended).

Yes/No

s 9(2)(a) [redacted]

Polly Vowles
Policy Manager
Ministry of Social Development

s 9(2)(a) [redacted]

Maraina Hak
Policy Lead
Inland Revenue

Hon Jacinda Ardern
Minister for Child Poverty Reduction
/ /2022

Hon Grant Robertson
Minister of Finance
/ /2022

Hon Kelvin Davis
Minister for Children
/ /2022

Hon Carmel Sepuloni
Minister for Social Development and Employment
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Purpose

1. As part of the Working for Families (WFF) Review, we previously identified potential administrative improvements to the WFF scheme that could be implemented in the short to medium term (DPMC-2021/22-2539, T2022/1644, REP/22/7/682 and IR2022/145 refer). You requested further advice on all administrative options outlined in the July report, except for extending protected entitlements for the Minimum Family Tax Credit (MFTC).

2. This report provides you with a progress update on the options and seeks your decisions on whether to progress some of these options. It is intended to be a companion piece to the report on policy reform options, *Working for Families Review: Further advice on options to progress for Budget 2023 and beyond* (DPMC-2022/23-547, T2022/2489, REP/22/11/1097 and IR2022/511 refer).

Background

3. A key issue with administering WFF is the incidence of underpayments and overpayments. Inland Revenue's administrative data shows an almost equal proportion of WFF customers being underpaid as there are being overpaid. Most of the options presented in this report address overpayments.

4. Previous engagement with stakeholders highlighted that WFF debt is a particular concern for customers. Families are fearful of incurring debt, which acts as a barrier to them receiving the financial support they need. Yet, the system for assessing WFF entitlements is complex, relying on estimations. This is particularly difficult for families whose income is volatile. A late Child Support payment, for example, would trigger an increased entitlement for the period in which the Child Support was not received, and a probable overpayment when the Child Support eventually arrives.

5. Where families incur debt, they experience increased stress and can end up in hardship trying to repay it. Interest and penalty arrangements for WFF overpayments are the same as those for income tax debt. An automatic write-off applies under the annual 'auto calculation' process for combined WFF and income tax debt below $50. The existing law also provides the ability for customers to apply for a write-off of their debt due to serious hardship.

6. Debt arising from WFF overpayments has also been identified as a focus area for the Debt to Government project. This project has the dual focuses of:

   6.1 ensuring debt recovery is fair, effective, and avoids exacerbating hardship, and

   6.2 preventing debt from occurring so that it does not create future problems for those in hardship.

7. Early next year we will look at interest rate and penalty settings and ask Ministers whether it is appropriate to treat WFF debt in the same way as income tax debt. With low (or no) interest it would be feasible for overpayments to be recovered over a longer period of time, which might reduce the burden on recipients. Changes to the interest regime have not been costed but officials expect that any proposal for change would need to go through the Budget process.

8. We note that the options presented in this report are a response to the WFF policies that are currently in place and the existing complexity in the system. More substantive prevention of overpayments (and underpayments) could occur through reform options which simplify the system, discussed in the companion report. If instead, complexity of the system increases following reform decisions, these administrative options may not adequately address subsequent overpayment issues, apart from improving information exchanged discussed below.

Causes of overpayments

9. In the 2021 tax year, WFF overpayments totalled $136 million. As of September 2022, $71 million of these overpayments has either been repaid[1] or written off, leaving an outstanding balance of $65 million. As of July 2022, approximately 57,000 customers had accumulated WFF debt of almost $250 million (comprised of $178 million of overpayments and $71 million of penalties and interest).

10. There are two primary causes of debt. The first is in regard to changes in circumstances for families, and the second is the joint administration of WFF payments by Inland Revenue and the Ministry of Social Development (MSD). Further detail is provided in Appendix 1.

11. Changes in circumstances (that is, life events such as partnering or splitting with a partner, having children, or working or not) affect customers' entitlements. As there is a natural lag depending on when someone notifies Inland Revenue of a change in their circumstances and when that change is updated in the system, payments received in the interim may be incorrect. These can result in the customer being in debt at the end of the year.

12. Joint administration can create overpayments in two main ways. The first reflects the underlying policy interaction of the main benefits and tax credit abatement rules, and the requirements to be off benefit and working to be eligible for certain tax credits. The second reflects MSD administering WFF payments to their clients, which can create overpayments because of lack of information collected and shared between agencies. This is exacerbated by changes in circumstances of MSD clients, as described above for Inland Revenue's customers.

13. For example, when MSD clients work more and their information is not updated with Inland Revenue, MSD would have paid them a full WFF entitlement, but they should have been paid an abated amount. Administrative data show that in the 2022 tax year, nearly 5,000 MSD clients had family scheme income above the WFF abatement threshold and had a resulting overpayment. Approximately 21 percent had not been squared up by Inland Revenue.

14. Data shows that around 20 percent of all WFF recipients with overpayments occur because of joint administration. These families are among the lowest-income WFF recipients, and their WFF debt for the 2021 tax year was approximately $20 to $25 million as of September 2022.

15. Officials are not proposing to change joint administration of WFF at this time – that would be a significant change and further consideration of the implications to doing so would need to be undertaken. However, customers' outcomes could be improved by changing the information collected and sharing arrangements between agencies as discussed below.

Options to reduce incidence of overpayments

16. There are two proposals that could help to mitigate overpayments before they are incurred so that customers could have a net smaller debt owing at the end of the year. While these options may not eliminate all potential debt, they would improve customer outcomes.

Improvements in information exchanged

17. MSD currently provides information to Inland Revenue about their clients' benefit receipts, WFF payments paid by MSD, and occasionally their circumstances. In

[1] In this context, "repaid" includes instances where an income tax refund was offset against the overpayment.

relation to customers' circumstances, details are provided when a customer moves on or off a benefit. Inland Revenue also provides information to MSD on beneficiaries' income data for use in checking against their declared income.

18. Even with these exchanges, information to determine entitlement can be missing or inefficiently exchanged. For example, Inland Revenue does not receive updates of MSD customers' changes in family circumstances (for example, relationships or dependent children) unless their beneficiary status has also changed. There are currently multiple exchanges between the agencies, which can result in missed information that is relevant.

19. Improving the exchange of information between Inland Revenue and MSD would improve the accuracy of WFF payments by ensuring Inland Revenue has access to more timely, complete and accurate information about customers' circumstances and would reduce the current reliance on customers to advise changes in their circumstances. This would not just reduce the incidence of overpayments but should also result in fewer customers being underpaid. Improved information sharing would also support the reform options being considered as part of the wider WFF Review.

20. As noted in the July report, there are various options for improving the flow of information between Inland Revenue and MSD. This could include, for example, collecting new information, streamlining the existing exchanges by reducing the number of exchanges, and/or increasing the frequency. Specific changes that could be considered are:

    20.1 Ensuring Inland Revenue gets updates from MSD of child and partner changes and payer details even when the customer's benefit status is unchanged.[2]

    20.2 Better information sharing to manage situations where MSD has one partner as the principal caregiver and Inland Revenue has the other partner in the principal caregiver role.

    20.3 Increasing the frequency of information sharing to two or three times a week (currently it is sent to Inland Revenue weekly).

21. Any changes to the exchange of information between the two agencies would require system changes for both agencies, the extent of which would depend on the nature and scale of the changes. The outcome could potentially establish longer-term benefits to the administration of transfer payments (both main benefits and WFF).

22. We propose to assess the existing Inland Revenue–MSD Approved Information Sharing Agreement (AISA) and determine the scope and feasibility of potential changes that could be progressed. This would proceed on a longer timetable than the other options outlined in this report and would need to be prioritised by both agencies given current resource constraints. As such, we are seeking your agreement that we should prioritise this work.

23. We consider this workstream has the potential to improve outcomes for WFF customers, particularly those who are lower-income and working. We recommend that Ministers prioritise this as part of future WFF improvements.

[2] Currently, Inland Revenue only receives this information when the customer's beneficiary status changes. 'Payer details' refers to who pays the customer their WFF entitlement – the customer elects to be paid by either Inland Revenue or MSD. Essentially, enabling updates of payer details to be exchanged would enable customers to more easily change who pays them their WFF (at present, they have to contact both agencies in order to make this change).

Grace periods

24. Improved information exchanges would help to mitigate debt for customers who are paid WFF by MSD and squared up by Inland Revenue at the end of the year. However, overpayments can arise in other contexts as a result of life changes that are not foreseeable, resulting in overpayments that are unavoidable. To address this, an option is to introduce grace periods for customers who have a change in their circumstances that reduces their WFF entitlement.

25. Currently, if a WFF customer has such a change in their circumstances they need to inform Inland Revenue or MSD before their next WFF payment. With a grace period, customers would have an extension of time to notify Inland Revenue of a relevant change – meaning they would not be liable to repay any overpayment made in the intervening period.

26. A two-week grace period currently applies for the In-Work Tax Credit (IWTC) component of WFF. The grace period allows families to continue to receive the IWTC when earners have short gaps in their paid work.[3] Data to analyse the impacts of this change is not yet available. Grace periods are also provided for the Best Start Tax Credit (BSTC) and Paid Parental Leave (PPL) when a child passes away.[4]

Changes in circumstances, including income, can be difficult to identify

27. Some changes in circumstances are readily foreseeable based on the information that Inland Revenue holds and are adequately dealt with through proactive management. An example is when a customer has a child in their care who is about to turn 18, Inland Revenue will contact the customer to confirm if their child will be attending secondary school or a tertiary institution beyond their eighteenth birthday to determine if they will continue to be entitled for that child until the end of the year.

28. In cases such as relationship changes, a child becoming financially independent or changes in shared care arrangements, it is not easy for customers or Inland Revenue to identify when a change in the customer's circumstances occurred.

29. Some changes in circumstances that are relatively straightforward to verify when they occurred but are particularly sensitive, such as the death of a child or partner, would also affect a family's entitlement. However, informing Inland Revenue of such changes is unlikely to be the customer's top priority when they are going through a difficult time.

30. Administrative data show that the lag between a change occurring and it being updated in Inland Revenue's system is typically three weeks or less for all types of changes, except for those relating to MFTC eligibility which have a median lag of 33 days to be updated. The types of changes that would typically be updated within three weeks or less include:[5]

    30.1 partner changes (median lag of 15 days);

    30.2 child changes (median lag of 22 days or less); and

[3] This applies for workers whose employment has ended, those taking unpaid leave but who are still employed, and the likes of teacher aides or support staff in schools or universities who are unpaid during school holidays or university breaks.
[4] If a child is born alive and dies or passes away before their third birthday, payments of the BSTC generally continue for four weeks following the date of the child's death. For other WFF tax credits there is currently no grace period when a child dies. For PPL entitlements, if the customer was eligible for PPL and the child died or was miscarried or stillborn, they are still entitled to the full amount of PPL until their entitlement ceases.
[5] Lags were calculated only for updates that were made within the same tax year that the change occurred.

30.3 changes affecting the customer's entitlement to the IWTC (median lag of 15 days). Note that a two-week grace period already exists for the IWTC, which may affect this figure.

31. We note that these lags are the amount of time between when the change occurred and when it was updated in Inland Revenue's system, not the amount of time between the change occurring and Inland Revenue being notified of the change.

This makes implementing a grace period complex and presents integrity issues

32. Grace periods become administratively cumbersome when a customer has multiple different changes in circumstances, as multiple grace periods for different changes (and different start and end dates) may apply for the same customer, and may overlap. This could be very difficult to implement and administer, and may not improve customers' experience.

33. There are integrity risks with providing grace periods for changes that also affect other WFF recipients, such as changes in shared care arrangements.[6] Providing a grace period to the caregiver whose WFF entitlement has decreased– while at the same time backdating the change for the other caregiver whose WFF entitlement has increased – would mean that there would be a greater than 100 percent WFF entitlement paid for the same child for the duration of the grace period. This could be easily gamed by ex-partners looking to obtain a financial advantage.

34. There would be similar issues for changes in income. For example, changes to self-employment or shift work dates would not be easily determined by Inland Revenue and would therefore present challenges to identify when a grace period should apply from.

35. Even if a grace period was designed to only apply for a very limited set of changes in circumstances (for example, for partner changes or when a child becomes financially independent), this could be confusing to customers if a grace period applies for some types of changes in circumstances and not others.

We recommend extending the existing grace period that applies to the BSTC for death of child

36. We recommend extending the four-week grace period for the death of a child that already exists for the BSTC so that it also applies for the IWTC and Family Tax Credit (FTC) (and the MFTC if it remains in place). This is consistent with the recommendation of the Welfare Expert Advisory Group, which recommended aligning the timeframes for stopping income support payments when a child has died. The earliest possible application date for this option is 1 April 2024, as this change would need to have prospective (rather than retrospective) effect. This will depend on other priorities that Inland Revenue and MSD are asked to deliver at the same time.

37. Based on administrative data from the 2020–21 year, the proposed four-week grace period should be sufficient to ensure the vast majority of customers in this situation do not have an overpayment from this unfortunate event. We would expect approximately 400 families to benefit from the proposal each year.

[6] Under the shared care rules, a child is considered to be in shared care if the principal caregiver has a minimum of five days of care per fortnight. In most cases, a second caregiver is attributed the remainder of the care during the fortnight. The second caregiver may also have an entitlement to WFF tax credits for their care of the child and for any other children in their care.

38. If Ministers are interested in extending the grace period for the death of a child to other WFF tax credits as suggested above, we can provide you with a fiscal costing and further implementation details.

39. At this stage, we do not recommend providing a general grace period for other changes in circumstances, due to the administrative complexity and integrity risks that it would present.

Managing WFF debt once incurred

40. We have also considered options that could address WFF overpayments after they have been made. Analysis of administrative data shows that a substantial proportion of overpayments are low value – 45 percent of overpaid customers in 2021 received overpayments totalling $500 or less. Appendix 2 provides more detail on overpayments.

41. These low-level overpayments are usually repaid. However, low-level overpayments are significantly less likely to be repaid when the customer's main or only income source is a benefit, and these overpayments are more likely to be written off compared to other WFF customers.

Buffer Tax Credit

42. We previously suggested that one possible way to provide relief from low-level debt amounts resulting from WFF overpayments is to introduce a new tax credit that would act as a 'buffer' or supplement at the end of the year, referred to as the Buffer Tax Credit (BTC).

43. The primary purpose of a BTC is to reduce WFF customers' end of year debt. However, as a means of ensuring that it would not create perverse incentives by rewarding noncompliant behaviour, it would also be provided to customers that have no WFF debt. As a refundable tax credit, any excess after offsetting against overpayments and end of year income tax debt would be paid to the customer as a lump sum. This means customers with no WFF overpayments or income tax to pay at the end of the year would receive the full amount of the credit. It would effectively be an additional entitlement to all WFF customers.

44. As payment of the BTC would require that customers are first squared up, and MSD does not have processes in place to do such a square up, this proposal would require Inland Revenue to square up all MSD clients and pay the BTC. In turn, this would require improved information exchanges.

45. Without accurate and up to date information, a square up of MSD clients could potentially lead to an assessment of overpayments. For example, if MSD clients do not have IRD numbers for their children, Inland Revenue would consider that they were not entitled to receive WFF for those children.[7]

46. For these reasons, a BTC would not be implementable in the near future until the information collected and exchanged between MSD and Inland Revenue is improved, as discussed above.

47. We considered whether a BTC could be implemented in a way that avoids the problems that would arise if Inland Revenue was to square up all MSD customers, such as paying these customers the BTC as a lump sum without squaring them up or simply excluding these customers from receiving the BTC. However, we would not recommend either of these options on equity grounds. In particular, if MSD was to pay the BTC to their full-year clients, there would be a risk that some MSD clients

[7] Legislation requires that Inland Revenue pay WFF for children who have IRD numbers. The legislation does not require MSD to do the same.

could be paid the BTC by MSD, but for various reasons are subsequently squared up by Inland Revenue. Depending on the timing, they could be overpaid their BTC.

48. If Ministers would like to do something quickly to provide relief from low-level debt amounts resulting from WFF overpayments, an automatic WFF debt write-off could be introduced with application from 1 April 2023 at the earliest. As shown below, this option would be significantly less expensive than a BTC, although it would also be less equitable.

Fiscal implications and impact on customers

49. We have prepared costings for variations of a BTC. The costings are based on the initially proposed application date of 1 April 2023 and so are indicative only. The main options we have costed are a fixed BTC of $250 or $500 per customer and a BTC calculated as five percent of the customer's WFF entitlement.

49.1 A BTC of $250 per WFF customer would cost approximately $70–80 million each year.

49.2 A $500 BTC would cost approximately $140–160 million each year. Targeting the $500 option to families with incomes of $60,000 or less produces a similar fiscal cost to the $250 option.

49.3 A BTC calculated as five percent of the customer's WFF entitlement would cost approximately $140–170 million each year.

Automatic debt write-off threshold

50. An alternative to the BTC is to provide an additional automatic debt write-off threshold specifically for WFF overpayments. The write-off would apply to offset overpayments up to the amount of the threshold. As this would only apply to families with overpayments, the fiscal cost of this option is lower in comparison to the BTC.

51. However, at the same time, it is less equitable and could create perverse compliance incentives. Customers who have complied with obligations or taken steps to ensure they are not overpaid would be worse off compared to those who receive a write-off. Customers who have had their entitlements adjusted downwards during the year to avoid overpayments would similarly be disadvantaged.

52. This option could create an incentive for customers to create an overpayment up to the write-off threshold. However, we expect that with a relatively low threshold, such as $250 or $500, there would not be as much scope for customers to deliberately create an overpayment.

53. An automatic write-off of the first $250 of overpayments would cost around $10 million per annum. Increasing the threshold to $500 would cost around $13–15 million per annum.

Comparison of BTC and automatic debt write-off

54. The BTC and automatic write-off of the same amount will impact the same number of debt-holders. Based on administrative data, we estimate that approximately 40,000 customers each year with WFF overpayments would have the entire balance of their overpayments cancelled out by either a $500 BTC or a $500 automatic WFF debt write-off (without means testing). If set at $250, around 30,000 customers each year would have their overpayments reduced to zero. (There are in total around 80,000 to 90,000 customers each year who are overpaid their WFF entitlements.)

55. A $500 BTC or a $500 automatic write-off without means testing would reduce the amount of overpayments at the end of each tax year by approximately $25 million. Approximately $10 million of the $25 million would likely be written off through existing write-off provisions, meaning that the proposals would address $15 million in overpayments annually (hence the $500 write-off costing between $13 and $15 million each year). Given the difference in cost between the two options (a $500 BTC is approximately $125–145 million more expensive each year than an automatic WFF debt write-off of $500), this makes the $500 BTC option a very expensive one for eliminating low-level overpayments. An automatic debt write-off would be a comparatively cost-efficient option to achieve the same debt outcome.

56. We note that both the BTC and automatic write-off provide a small amount of debt relief at an individual customer level. Overpayments of $500 or less comprise just two percent of the total value of overpayments each year, whereas overpayments of more than $1,000 are more likely to become long term debt. Overpayments over $1,000 account for 95 percent of the total value of 2021 overpayments still outstanding. (See Appendix 2.)

57. If an automatic debt write-off for WFF overpayments is preferred, consideration should first be given to how other reform options could reduce overpayments before choosing a threshold. We note that option 1b and option 5 in the companion report would likely help to reduce overpayments, depending on the implementation design details. If Ministers are interested in this option, officials can provide more information.

Miscellaneous amendments

58. A number of miscellaneous administrative changes were also suggested as possible options for further analysis in the July report. Our recommendations in relation to these options are outlined below.

Repealing the Child Tax Credit *(recommended)*

59. The Child Tax Credit (CTC) was replaced by the IWTC on 1 April 2006 but was grandparented for some existing customers who did not qualify for the IWTC. There are currently seven families that still receive the payment.

60. After further consideration, we recommend repealing the CTC to simplify the WFF scheme. While small, this change would improve the simplicity and coherence of the scheme from a legislative and policy perspective. It would also simplify customer interactions for front-line Inland Revenue staff.

61. Repealing the CTC would make these families worse off unless they are directly compensated. If Ministers want to ensure these customers are not immediately worse off, they could be compensated by way of a one-off lump sum payment for the remainder of their entitlement. However, we would not recommend this because it affects only a very small group of customers who have already benefited from the CTC being grandparented for 16 years. In any event, we expect most of these customers to have their last child age out of eligibility for Working for Families within the next two years.

62. As at 31 October 2022, $0.481 million was accrued for final CTC claims. Appropriations since October 2022 for the CTC have been nil. Repealing the CTC will not change this.

63. On balance, we recommend repealing the CTC effective on 1 April 2024. This means the last year for entitlement would be the 2023–24 income year.

Calculation of family scheme income: Deemed derivation at uniform daily rate *(not recommended)*

64. We indicated that you could amend the calculation of family scheme income to exclude non-salary or wage income earned outside the relevant relationship periods.[8] This can raise fairness concerns. However, after further consideration we do not recommend this.

65. Administratively, it would increase compliance costs because customers would be asked to provide start and stop dates for various income types and adjustments, including self-employed income, partnership income, estate/trustee income, shareholder salaries and rental income. There would also be an integrity risk in that Inland Revenue would not have a way to verify the dates provided by customers in many cases. Disagreements between principal caregivers and ex-partners on dates would also have to be managed somehow.

66. Rather than a systematic approach, an alternative could be to allow for a discretionary application. However, we would not recommend this approach on equity grounds as it would benefit only those customers who complain. It is also undesirable from a policy and legal perspective for a person's entitlements or obligations to be determined on a discretionary basis.

67. We recommend that the provision remains as it is currently.

Independent Earner Tax Credit and Working for Families interaction *(not recommended)*

68. The Independent Earner Tax Credit (IETC) is a $10 per week entitlement for individuals who earns between $24,000 and $48,000.[9] To be eligible, the person or their partner must not be entitled to WFF. This rule applies even if the family's entitlement to WFF is less than the IETC they would otherwise be entitled to. For those affected, this raises fairness concerns about the interaction between the IETC and the WFF scheme.

69. The issue largely affects around 2,600 relatively higher-income couples where at least one partner's income falls within the income thresholds.

70. After further consideration, we recommend that this proposal not be considered further. While it would be feasible to implement this for couples who do not have a change in their relationship status, it would be relatively complex to account for any changes to relationships during the year. In applying an either/or payment (that is, either an IETC or WFF payment) to each ex-partner, this would increase confusion on which payment to give each person depending on shared care arrangements.

71. We are already aware of more fundamental issues with the IETC settings, particularly as the income thresholds have not been adjusted since its introduction in 2009. Rather than address a relatively minor issue, we recommend instead that a review of the IETC be undertaken. This could be at a later date after substantive decisions have been made on the WFF Review and any related and relevant policy changes.

Financial implications

72. The costings provided in this report are indicative and do not include costs of implementation. Should Ministers be interested in progressing any of these options,

[8] A new 'relationship period' begins at the start of each tax year, but will also begin or end during the tax year with partner changes or when the customer's entitlement starts or stops due to having their first dependent child or no more children in their care.
[9] The IETC abates between $44,000 and $48,000 at 13 cents in the dollar.

we will refine the costings based on any updated parameters or information and will also provide operational costings.

Administrative implications

73. All these changes would require legislative changes, systems changes and testing, staff training, updating guidance for the public and for Inland Revenue staff, and would have potential impacts on other business as usual activities. The BTC would have significant impacts and would also have information sharing implications. The grace period and repealing the CTC would require mostly the same types of changes but to a lesser degree.

74. While we have provided indicative application dates for each of the options recommended in this report for further consideration, these will also depend on other priorities that Inland Revenue and MSD are asked to deliver at the same time.

75. We strongly recommend that changes are effective from 1 April of any tax year to ensure full year calculations can be made. While it would be possible for any changes to be implemented in the middle of a tax year, these changes would be complex and may negatively impact accuracy of the payment. This could result in both overpayments and underpayments which may exacerbate debt and income adequacy.

Consultation

76. The Department of the Prime Minister and Cabinet and The Treasury were consulted on this report.

Next steps

77. At your request, we will provide you with further advice on options discussed in this report.

78. If you wish to progress any reform options in the companion report for Budget 2023, as well as introduce a four-week grace period for the FTC and IWTC that would apply when a child dies, and/or repeal the CTC through the Budget 2023 process, we will provide you with subsequent advice in early 2023.

79. In addition to the administrative options outlined in this report, we have several minor remedial WFF amendments that could be progressed, potentially in a bill in 2023 for example. If you are interested in potentially progressing some minor remedial amendments in a bill next year to improve the administration of the WFF scheme and rectify technical errors with the legislation, we will report to you on what our suggested changes are in February 2023.

Appendix 1 – Causes of overpayments

1. Based on Inland Revenue's administrative data, overpayments are largely due to income changes and co-administration of the WFF scheme by two separate government agencies (refer Table A1 below). Other factors, such as changes in relationships, also play a role.

Table A1: Contributing causes of WFF overpayments

Overpayment amount	No eligible children all year[10]	Reduction in no. of children	MSD–IR interface	Change in partner	Family income increase >10%	Family income decrease >10%	Income change <10% (increase or decrease)
$1–$250	0%	10%	18%	2%	40%	10%	19%
$251–$500	1%	15%	22%	3%	32%	7%	19%
$501–$1,000	1%	16%	20%	3%	36%	8%	17%
$1,001–$2,500	2%	16%	19%	3%	40%	7%	13%
$2,501–$5,000	2%	15%	22%	3%	42%	5%	10%
$5,001+	5%	13%	22%	3%	44%	5%	8%
Overall	1%	14%	20%	3%	39%	8%	16%

2. As Table A1 also shows, the degree of overpayment does not seem to vary significantly for a given reason. In other words, families do not tend to be more overpaid because they have had a change in partner, for example. The notable exception is when a family has no eligible children, for which overpayments tend to be more than $5,000. This occurs, for example, when children or families leave the country but have not notified Inland Revenue. Improved information sharing could help in this regard.

[10] This refers to the situation where a customer receiving upfront WFF payments did not have any eligible dependent children in their care for the entire year and did not tell Inland Revenue.

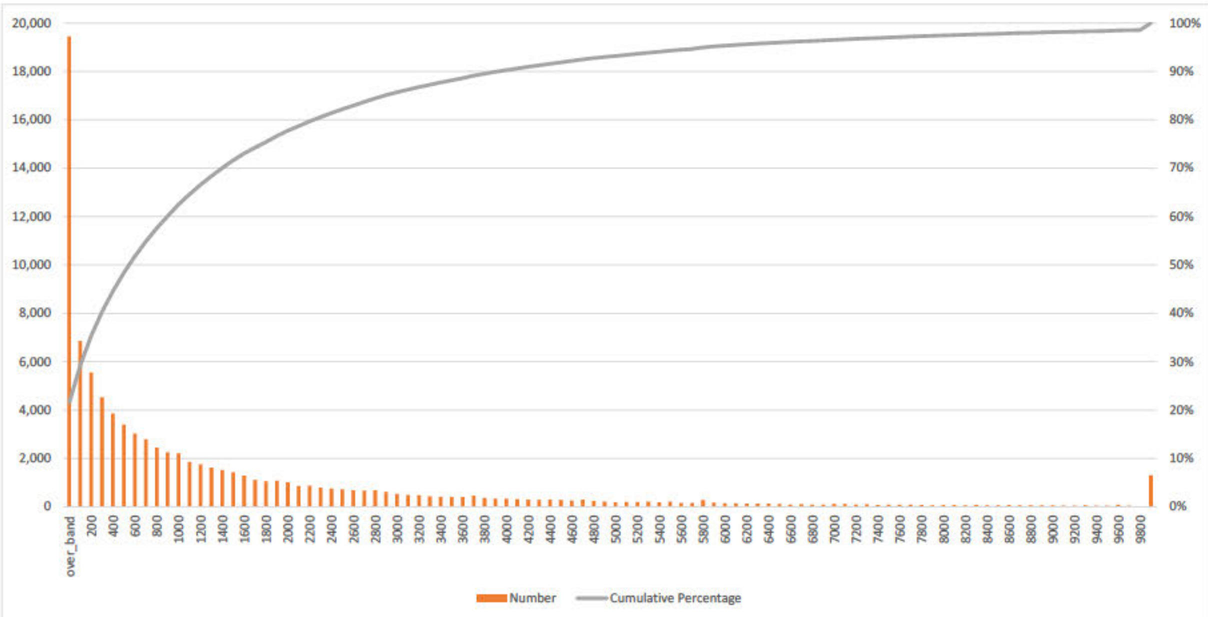
Appendix 2 – Analysis of WFF overpayments

1. This appendix looks at WFF overpayments in the 2021 tax year, including the distribution of overpayment amounts and the proportion of overpayments that are still outstanding. The specific focus is on low-value overpayments that might have been more effectively managed upfront through the provision of an automatic write-off for WFF debt or a Buffer Tax Credit.

Distribution of overpayment amounts

2. In the 2021 year, 45 percent of customers with WFF overpayments received total overpayments of $500 or less. After taking repayments and write-offs into account, the total of these WFF low-value overpayments comprise just two percent of the total value of WFF overpayments made in the 2021 year that were still outstanding in late 20 September 2022. The overwhelming majority of overpayments (95 percent) are more than $1,000 and are more likely to become long-term debt, as shown in Figure A1.

Figure A1: Distribution of overpayment amounts



3. Table A1 below shows the number of WFF customers for the 2021 year with overpayments in various dollar ranges who, as of September 2022 had fully repaid the overpayments they had received that year, had their overpayments written off,[11] had a combination of repayments and write-offs, or had not yet fully repaid their overpayments.

[11] 'Written off' is defined as where at least 80 percent of the balance was written off.

Table A1: Number of WFF overpayments repaid or written off

Overpayment amount	Paid	Written off	Mix Paid/Write-off	Not yet repaid	Total
$1–$250	20,293 *(68%)*	5,003 *(17%)*	1,959 *(7%)*	2,522 *(8%)*	29,777
$251–$500	7,168 *(63%)*	1,527 *(13%)*	719 *(6%)*	2,038 *(18%)*	11,452
$501–$1,000	7,612 *(54%)*	1,962 *(14%)*	1,031 *(7%)*	3,557 *(25%)*	14,162
$1,001–$2,500	8,451 *(44%)*	1,280 *(7%)*	786 *(4%)*	8,809 *(46%)*	19,326
$2,501–$5,000	3,263 *(31%)*	872 *(8%)*	144 *(1%)*	6,167 *(59%)*	10,446
$5,001+	1,474 *(24%)*	527 *(8%)*	53 *(1%)*	4,178 *(67%)*	6,232
All	48,261 *(53%)*	11,171 *(12%)*	4,692 *(5%)*	27,271 *(30%)*	91,395

4. For overpayment amounts of $250 or less, 92 percent had repaid these amounts and/or had them written off, and for overpayments between $250 and $500 the proportion of customers that had their overpayments repaid and/or written off was 82 percent. For overpayment amounts of $250 or less, 68 percent had repaid these amounts. In contrast, the proportion of customers that received overpayments above $5,000 that repaid these amounts was only 23 percent.

5. Salary and wage earners and self-employed people are the most likely to have repaid any WFF overpayments they received over the year. Repayment rates are the lowest for beneficiaries, and write-off rates for that group are the highest. Table A2 below shows the breakdown of WFF customers in the 2021 year who received a benefit as their only source of income.

6. While 60 percent of beneficiaries who were overpaid in 2021 have either repaid the overpayments they received or had these amounts written off, 83 percent of the total value of overpayments made to beneficiaries remains unpaid. For the 2021 return period, 18 percent of the beneficiaries that were overpaid had repaid the balance by late September 2022, while 32 percent had their overpayments written off. In total, 58 percent of beneficiaries had repaid their 2021 overpayments and/or had them written off.

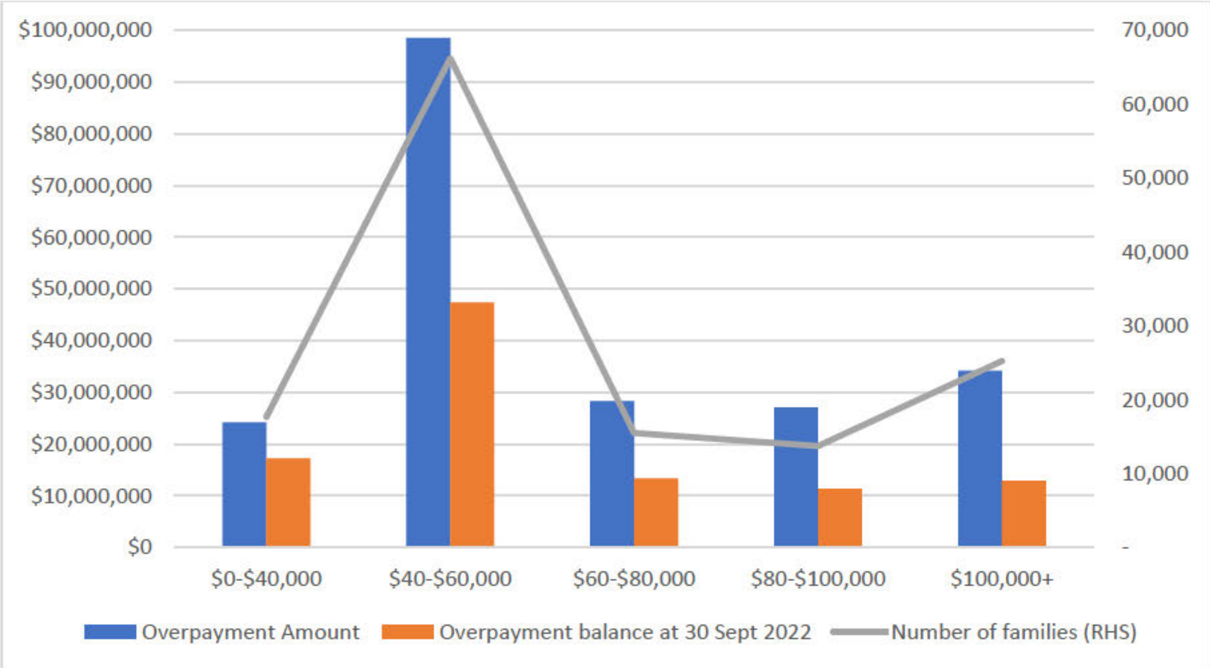
Table A2: WFF overpayments for customers on benefit only

Overpayment amount	Paid	Written off	Mix Paid/Write-off	Not yet repaid	Total
$1–$250	656 *(35%)*	672 *(36%)*	272 *(14%)*	273 *(15%)*	1,873
$251–$500	111 *(17%)*	337 *(51%)*	44 *(7%)*	175 *(26%)*	667
$501–$1,000	62 *(9%)*	355 *(51%)*	40 *(6%)*	234 *(34%)*	691
$1,001–$2,500	63 *(4%)*	227 *(14%)*	12 *(1%)*	1,368 *(82%)*	1,670
All	892 *(18%)*	1,591 *(32%)*	368 *(8%)*	2,050 *(42%)*	4,901

7. Across all income source types, lower value overpayments are more likely to have been repaid than higher value ones, although repayment rates are still lower for beneficiaries (35 percent of WFF overpayments below $250 made to beneficiaries have been repaid, compared with 71 percent for self-employed customers and 74 percent for salary and wage earners).

8. Figure A2 below shows the overpayment amounts by income bands.

Figure A2: Overpayment amounts by income bands



9. Clearly, the largest number and highest cumulative value of overpayments occur for customers in the $40,000 to $60,000 income bracket. Note that the income distribution analysis reflects the findings regarding the source of income/customer type, in that lower-income groups are more likely to have benefits as their main income source.

Inland Revenue
Te Tari Taake

MINISTRY OF SOCIAL DEVELOPMENT
TE MANATŪ WHAKAHIATO ORA

Report

Date: 14 March 2023 **Security Level:**

To: Hon Carmel Sepuloni, Minister for Social Development and Employment

Hon David Parker, Minister of Revenue

Working for Families: Improving support for working families and Budget 2023

Purpose of the report

1 This advice provides:

- High-level modelling of Working for Families (WFF) changes based around a new, enhanced in-work payment (labelled in previous advice as Option 1B) to inform the decision about whether this is the desirable direction for the WFF reforms.
- Options for simpler changes to In-Work Tax Credit (IWTC) settings that could be announced in Budget 2023 that are broadly consistent with the direction of travel towards the new in-work payment design, and that could be implemented in either July 2023 or April 2024.
- An update on the administrative options workstream.

2 Note that we have provided indicative implementation timeframes in this paper, but these in part depend on other Budget priorities that IR and MSD are asked to deliver over the same timeframes.

Executive summary

3 We understand that your preferred direction for WFF reform is the introduction of a new in-work payment to replace the IWTC and Minimum Family Tax Credit (MFTC) – Option 1B from previous advice.

4 Officials have determined, however, that there is insufficient time to develop and model the detailed settings for Option 1B in order to be able to provide comprehensive advice for Budget 2023. It would also not be possible to

implement Option 1B by 1 April 2024, even if it were funded through Budget 2023, given the complexity of the changes involved.

5 For this reason, we have explored options for simpler changes to IWTC settings that could be announced in Budget 2023 to provide immediate support to working families. These are broadly consistent with the direction of travel towards the new in-work payment design, while also being sensible standalone options. They could be implemented in either July 2023 or April 2024, depending on the nature of the changes and other priorities IR and MSD are asked to deliver over the same timeframes.

Shifting towards a new, enhanced in-work payment

6 Option 1B introduces a new in-work payment for working families with children who are off-benefit. It aims to ensure families are better off off-benefit once they are working more than 20 or 30 hours a week[1], similar to the MFTC currently, but with more gradual abatement. This payment does not have an 'hours test', so families off-benefit can receive the full payment if they work less, as long as they are in employment and receiving some employment income.

7 In this paper, we have included illustrative modelling of, and advice on, some different versions of this option to inform the decision about whether this is the desirable high-level direction of travel for the WFF reforms.

8 We have updated the modelling for Option 1B for implementation in 2025/26, with revised parameters that take into account the latest decisions and other recent factors. We have re-modelled both the full option ($1,055m), and the scaled option with a two-tier abatement regime to reduce cost and more tightly target income increases to working families on relatively lower incomes ($703m).

9 This option has a strong focus on making work pay and would provide real gains to low-income working families. It would support families with variable working hours, reduce debt to Government, and help to simplify the system. However, there are also a number of considerations to take into account:

- Ideally, the margin between benefit and work should be maintained over time, which would require indexation of some settings which would come with higher annual costs, and would also mean discretionary increases to benefit levels would carry greater fiscal cost.
- The abatement changes increase targeting, but have a mixed impact on effective marginal tax rates (EMTRs), being more gradual for a small group of former MFTC recipients, but higher for most other WFF recipients.

[1] Equivalent to 20 hours a week of work on the minimum wage for sole parents, and 30 hours a week for couples.

- Not introducing an hours test would be a significant shift in approach around obligations associated with a payment of this size, creating a tension with the benefit system given the obligations required in return for a similar payment on a main benefit (for example, the requirement for clients to be actively looking for, or preparing for, part or full-time work).

10 There are likely to be other variations you could consider as the advice on this high-level option progresses. The estimated costs for both the full and the scaled option, which were already significant, are now estimated to be higher due to a later implementation date and updated economic and fiscal forecasts. We could explore design changes to reduce these costs though these are likely to have trade-offs. You could also explore reducing the impact on EMTRs for middle-income families by introducing more gradual abatement settings (though this is likely to increase costs, rather than decrease them).

11 We have also identified a number of other detailed policy matters that would need to be worked through for the new payment design, including settings for parents in shared care situations; eligibility for the self-employed, and for recipients of Orphans Benefit, Foster Care Allowance, Unsupported Child's Benefit (OB/FCA/UCB); and detailed rules about how income and abatement settings are operationalised.

12 Given the complexity of the change, there may be other policy issues that are yet to be identified, and officials do not recommend you announce the change in Budget 2023. At most, we recommend you indicate that a new in-work payment is a *possible* direction of travel that is being explored further.

13 In order for the option to be implemented by April 2025, work would also need to continue to progress at pace. In-principle decisions would need to be made at the end of this year with funding ideally provided through a pre-commitment against Budget 2024, and detailed parameters would need to be confirmed by April 2024. A detailed example timeline is provided in para 45, though final implementation timeframes will depend on the final design of the option chosen and what other priorities IR and MSD are asked to progress over the same timeframes.

Announcing immediate changes in Budget 2023

14 There are options for simpler changes to the IWTC settings or the WFF abatement threshold that could be announced in Budget 2023 to provide more immediate support to working families.

15 You have requested advice on progressing option '6B' from past advice, which:

- keeps the FTC and IWTC in its current form, but removes the MFTC
- increases the IWTC rate by $25 per week (pw) to improve income adequacy

- increases the WFF abatement threshold from $42,700 to $50,000 per annum (pa) to help make work pay and avoid overlapping abatement with benefits.

16 This option could be announced in Budget 2023 and implemented by April 2024. Because it includes the removal of the MFTC, however, our advice on whether to progress it depends on the ultimate direction of the WFF reforms. Officials recommend maintaining the MFTC using its current formula until decisions about the longer-term direction of WFF are made:

- If you wish to ultimately progress to a system based around option 1B or something similar, we do not recommend you progress this option. Removal of the MFTC in the intervening period would likely create difficulty and confusion for those currently in receipt of the payment and result in a small number of very low-income families being financially disadvantaged in the interim.
- If you wish to make this option the 'end-point' for the reforms, then this option could be progressed, though the removal of the MFTC would mean more working families receiving a benefit and would likely result in some families being financially disadvantaged from the change.

17 We have also modelled other simpler changes, all of which retain the MFTC, including:

- increases to the IWTC rate of $25 and $15 pw as stand-alone options
- an abatement threshold increase ($50,000 pa) as a stand-alone option, and
- a combination of a $10 pw IWTC rate increase with an increase in the abatement threshold to $50,000 pa.

18 These simpler changes could likely be implemented on 1 July 2023 or 1 April 2024. However, given the complexity of the tax and transfer system, and the significant number of interactions between payments, a later implementation date will provide agencies with more time to manage these. Other Budget priorities may also make the earlier implementation date more challenging. For these reasons, officials recommend a 1 April 2024 implementation date for these changes.

19 The costs and impacts on incomes and measured child poverty of these simpler options are set out in the summary table below. As with Option 1B, the gains and impacts would be for working families only. Note that the costs do not include operational costs – these will be completed for the Budget Cabinet paper if any of these options progress. The costs below are from Treasury's Tax and Welfare Analysis (TAWA) model. Inland Revenue (IR) have also costed these options and a comparison between the two is provided in Appendix 1. Five-year costings by IR are also in Appendix 1 and include costings for both 1 July 2023 and 1 April 2024 implementation dates for the Budget 2023 options.

Trade-offs between Budget 2023 options

20 If fiscal constraints necessitate a choice between an increase to the IWTC payment rate and an increase to the WFF abatement threshold, then you may wish to consider the relative merits of the two options:

- Of the options modelled, the increase to the abatement threshold carries a higher fiscal cost, but has a greater impact on incomes and child poverty.
- An IWTC rate increase is slightly more targeted at those on the lowest incomes.
- An abatement threshold increase would reduce the overlapping abatement of benefits and WFF, and mean that single minimum wage earners do not face abatement of their payments.

21 The option that best addresses income adequacy and lifts the most children out of poverty on the AHC50 measure[2] per dollar of fiscal cost combines an IWTC increase of $10 per week with an increased abatement threshold (option 6B5). This option reduces child poverty by 17,000 on the AHC50 measure at a cost of $309 million.

22 If any of these simpler options became an end-point for the WFF Review, they would still align with the objectives of supporting income adequacy and reducing child poverty, and improving financial incentives to work. They are not focused on simplifying the system however, and some of the issues identified in past reports that related to the MFTC and the complexity of the tax/benefit interface would remain.

Consequential impacts of B23 options

23 Given the complexity of the tax and transfer system there are a number of interdependencies and flow-ons between payments. Constrained modelling timeframes mean that these have not yet been fully quantified, but will be included in the Budget Cabinet paper. These will have minor impacts on estimated gains and losses for families and fiscal costs.

24 One consequential impact will require a later decision from Ministers. These changes will count as income for the Community Services Card (CSC), so a decision will be required on whether to increase the CSC income threshold to maintain eligibility for families. Officials recommend seeking Cabinet agreement to delegate authority for the Minister for Social Development and Employment, Minister of Finance and Minister of Health to make decisions on any consequential changes to the CSC income thresholds.

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[2] The number of children living in households that have an after-housing-costs income that is less than 50 percent of the (2017/18) baseline year’s median after-housing-costs household income, after adjusting for inflation.

Update on administrative and operational improvements

25 Ministers previously agreed to further advice on administrative and operational improvements, including the potential for additional changes to information sharing to reduce overpayments and improve customer experience, the introduction for a ‘grace period’ for FTC and IWTC when a child dies, the removal of the Child Tax Credit, and remedial amendments that could be included in a bill in 2023.

26 Further advice on other administrative improvements (some of which have fiscal costs) has been delayed to focus on the substantive advice for WFF for Budget 2023. Treasury has advised that those initiatives that have fiscal costs should not be progressed as part of the Budget 2023 package. However, it may be possible to implement some initiatives with no fiscal implications for April 2024. Additionally, we could continue to progress this workstream and seek to fund the other initiatives with fiscals as part of the larger reforms for Budget 2024, or progress specific initiatives through the Debt to Government work.

Next steps

27 If you wish to progress one of the simpler IWTC changes in this paper for Budget 2023 and/or you wish to seek further advice on Option 1B for Budget 2024 or later, officials can prepare material for you to seek the agreement of your colleagues at Cabinet.

Possible options for Budget 2023: summary of modelling

Option	Tax Year Cost (24/25)	Average gains/losses	Poverty impacts	Implementation
Option 6B $25 pw IWTC increase + WFF abatement threshold to $50,000 pa + MFTC removed	$406m	173,000 HHs gain $46pw 6,000 HHs lose $35pw	8,000 (BHC50) 19,000 (AHC50)	April 2024
Option 6B2 $25 pw IWTC increase only	$166m	160,000 HHs gain $20pw	4,000 (BHC50) 6,000 (AHC50	July 2023 or April 2024
Option 6B3 $15 pw IWTC increase only	$97m	153,000 HHs gain $12pw 4,000 HHs lose $3pw	3,000 (BHC50) 4,000 (AHC50)	July 2023 or April 2024
Option 6B4 Abatement threshold to $50,000 pa only	$238m	152,000 HHs gain $30pw	4,000 (BHC50) 11,000 (AHC50)	July 2023 or April 2024
Option 6B5 $10 pw IWTC increase + abatement threshold to $50,000 pa	$309m	173,000 HHs gain $34pw	6,000 (BHC50) 17,000 (AHC50)	July 2023 or April 2024

Updated modelling of Option 1B for 2025/26 implementation

Option	Tax Year Cost (25/26)	Average gains/losses	Poverty impacts	Implementation
Option 1B - full option	$1,055m	190,000 HHs gain $106pw	21,000 (BHC50) 37,000 (AHC50)	April 2025
*Option 1B2 - s*caled option, two-tier abatement	$703m	170,000 HHs gain $79pw	18,000 (BHC50) 29,000 (AHC50)	April 2025
Option 1B3 – two-tier variation with more gradual abatement	$923m	191,000 HHs gain $93pw	19,000 (BHC50) 33,000 (AHC50)	April 2025

Recommended actions

It is recommended that you:

1 **note** that this paper provides you with illustrative modelling and high-level analysis of Working for Families changes based around a new, enhanced in-work payment ('Option 1B') to inform the decision about whether this is the desirable direction of travel for the Working for Families reforms

2 **note** that there is insufficient time to develop and model the detailed settings for Option 1B in order to be able to provide comprehensive advice for Budget 2023, and that it is not possible to implement this option by April 2024, given the complexity of the changes involved

3 **note** that simpler changes to the In-Work Tax Credit and/or Working for Families abatement threshold settings could be announced in Budget 2023, and implemented by April 2024 to provide earlier support to working families

4 **note** that if you wish to progress to Option 1B or a similar option in Budget 2024 or beyond, as per recommendations 9 and 10 below, officials do not recommend you remove the Minimum Family Tax Credit in the interim

Options for Budget 2023

5 **note** that Option 6B, which increases the In-Work Tax Credit and abatement threshold, and removes the Minimum Family Tax Credit, can be implemented by April 2024, but officials do not recommend you proceed with this option if you wish to shift to Option 1B as it removes the Minimum Family Tax Credit

6 **agree** to recommend one of the following options to Cabinet in Budget 2023:

- a $25pw In-Work Tax Credit rate increase only [Option 6B2];

AGREE / DISAGREE

OR

- a $15pw In-Work Tax Credit rate increase only [Option 6B3];

AGREE / DISAGREE

OR

- an increase in the Working for Families abatement threshold increase to $50,000 only [Option 6B4];

AGREE / DISAGREE

OR

- a $10 pw In-Work Tax Credit rate increase and an increase in the Working for Families abatement threshold to $50,000, and the MFTC retained [Option 6B5];

AGREE / DISAGREE

7 **agree** to an implementation date of 1 April 2024 for the chosen option above

AGREE / DISAGREE

8 **agree** to maintain the Minimum Family Tax Credit using its currently agreed formula until decisions are made on the long-term direction of Working for Families

AGREE / DISAGREE

Option 1B for consideration for Budget 2024 or beyond

9 **indicate** if you wish to progress further advice on Option 1B, with the intention of developing the change for implementation in April 2025 at the earliest

YES / NO

10 **agree** to officials developing material for Cabinet indicating your preference for further work in the direction of Option 1B, how the future direction for Working for Families will be signalled as part of Budget 2023 announcements and seeking your colleagues' agreement to progress to the next stage of more detailed advice

AGREE / DISAGREE

11 **note** that, for Option 1B (or similar) to be implemented by April 2025, further work will need to continue at pace with in-principle decisions made by the end of 2023 and detailed parameters confirmed by April 2024

Consequential impacts and decisions for B23 options

12 **agree** to seek Cabinet agreement to delegate authority for the Minister for Social Development and Employment, Minister of Finance and Minister of Health to make decisions on any consequential changes to the CSC income thresholds

AGREE / DISAGREE

Update on administrative and operational improvements

13 **note** in November 2022, you agreed to three options for administrative improvements for Working for Families and noted further advice would be provided in early 2023

14 **note** further advice on other administrative improvements has been delayed to focus on the substantive advice for Working for Families for Budget 2023

15 **note** that officials will provide advice on administrative improvements with no fiscal implications, including whether any of these improvements could be potentially implemented for April 2024

16 **note** that officials will provide further advice on administrative improvements with fiscal implications for future Budgets, including whether they could be progressed as part of the wider debt to Government work programme

17 **agree** to forward a copy of this report to the Prime Minister, Minister of Finance, Minister for Children, Minister for Child Poverty Reduction, and Associate Minister of Revenue.

AGREE / DISAGREE

s 9(2)(a)

Fiona Carter-Giddings
General Manager, Welfare System and Income Support

Ministry of Social Development

Date

s 9(2)(a)

14/03/2023

Maraina Hak
Policy Lead

Inland Revenue

Date

Hon Carmel Sepuloni
Minister for Social Development and Employment

Date

Hon David Parker
Minister of Revenue

Date

Part One: Background and context

1 In July last year, officials provided Ministers with a summary of evidence and issues related to WFF tax credits, as well as a selection of high-level options to address some of the key issues identified. Subsequent advice on narrowed down options in November essentially came down to introducing a new, enhanced in-work payment (Option 1); more modest changes that retain the existing IWTC (Option 6); or a single tax credit with no separate in-work payment (Option 5).

2 The advice presented two versions of Option 1 – Option 1A provides an in-work payment, with a partial amount available with 'no hours test' (as with the IWTC, which has 'no hours test' currently), and the full amount available subject to an hours test (as with the MFTC currently); and Option 1B, which provides the full amount with no hours test.

3 Option 6 made complementary changes within the existing structure of WFF, maintaining a more modest IWTC payment, removing the MFTC, and increasing the WFF abatement threshold. There were also two versions of Option 6 presented – Option 6A provides a small Family Tax Credit (FTC) increase ($5pw) but still leads to relatively larger income gains to working households; and option 6B provides a $25pw IWTC increase.

4 Following the November advice, officials were asked to provide further advice on Options 6A and 5B. More recently, the Minister for Social Development and Employment as lead Minister for the review has requested commissioning be refocused towards further advice on an enhanced in-work payment (Option 1B) and, if this option cannot be implemented quickly, Option 6B if it can be an interim step towards option 1B.

5 The table below shows the options that are the subject of the advice in this paper (in green) alongside the broader range of recent options presented.

<table>
<tr><td rowspan="4">Option 1: new more generous in-work payment</td><td rowspan="2">1A) Partial hours test</td><td>(i) Full cost</td></tr>
<tr><td>ii) Scaled</td></tr>
<tr><td rowspan="2">1B) No hours test</td><td>i) Full cost</td></tr>
<tr><td>ii) Scaled</td></tr>
<tr><td colspan="3">Option 2 New MFTC payment</td></tr>
<tr><td colspan="3">Option 3: IWTC phase-in</td></tr>
<tr><td colspan="3">Option 4: Change benefit abatement settings</td></tr>
<tr><td rowspan="2">Option 5: A single tax credit with no in-work payment</td><td colspan="2">5A) full amount</td></tr>
<tr><td colspan="2">5B) phased</td></tr>
<tr><td rowspan="2">Option 6: retain the IWTC with other changes</td><td colspan="2">6A) FTC increase</td></tr>
<tr><td colspan="2">6B) IWTC increase</td></tr>
</table>

Supporting low-income working families

6 In April 2021, given the recent and proposed increases to beneficiary families at the time, Income Support Ministers agreed that there be a focus in the Review on:

- Low-income working families, while maintaining support for beneficiary families.
- Options that shift more towards targeting support to low-income families rather than more universal support.
- The principle of people being better off in work, and assisting with costs for people in work [CAB-21-MIN-0167 refers].

7 Recent changes to WFF have focused on increases to both working and beneficiary families through the Families Package, which included FTC increases, a new Best Start payment, and the Winter Energy Payment. Inflation has triggered further increases to both FTC and Best Start over two consecutive years, and an additional FTC increase was timed to coincide with the CPI increase last year. In addition, there have been consecutive increases to main benefits in 2020, 2021, and 2022, increases to the benefit abatement thresholds, and the indexation of main benefits to wages.

8 The IWTC, on the other hand, was last increased in Budget 2015, from $60 to $72.50 pw alongside a benefit rate increase for families with children. There are no requirements to automatically increase the rate of the IWTC, meaning its real value has decreased over time, and the numbers of families eligible for the payment have decreased as wages have risen. The IWTC is the key instrument to 'make work pay' within the wider context of the WFF package and it was designed to address in-work poverty.

9 As noted in past advice, in-work poverty is an increasing issue in New Zealand, particularly for sole earners (both sole parents and couples with only one parent working). Rates of poverty have been increasing for this group, indicating a single income is becoming a less viable option for providing economic security and meeting basic needs [REP/22/7/682 refers].

10 There is also a strong case for supporting working families in the current climate. For a significant number of working families, the cost of living will have risen faster than incomes this past year. Inflation, as measured by the all-groups CPI, was 7.2% for 2022, whereas the net average wage increased by 6.2%. There are scheduled increases to the minimum wage, but many low-middle income workers above the minimum wage will be experiencing worsening income adequacy – where costs are rising faster than pay. In contrast, families receiving a main benefit will gain from a discretionary increase to main benefits to match the rate of CPI (rather than wages) from 1 April 2024.

The child poverty targets

11 Previous advice noted that the WFF Review is likely to present the best opportunity in the coming years to achieve substantial reductions in measured child poverty.

12 The simpler options in this paper that could potentially be implemented by July 2023 would have a partial impact on progress towards the second intermediate child poverty targets. Options that would be implemented in April 2024 or April 2025 would contribute to progress in the third target period, which covers the 24/25, 25/26, and 26/27 years. After this, there is one more financial year before the ten-year targets are due to be achieved (2027/28).

13 Modelled estimates of child poverty impacts have been included throughout this paper. Reductions for the Budget 2023 initiatives are generally in the order of 5,000-10,000 children on each measure, whereas the versions of 1B included in this paper are much larger - closer to 20,000 on BHC50[3] and 30,000-40,000 on AHC50. Even with these impacts, significant further policy interventions will likely be required to reach the ten-year child poverty targets.

14 All the options in this paper provide gains for working families only. Broadly half of children in poverty live in working households, so the benefits of these options are confined to this group. The other half of children in poverty are in households that rely on income from main benefits. The gains are lower on the BHC50 measure as there are fewer working families in poverty under this measure (and fewer families in poverty overall under this measure). This means there is a limit on how much BHC50 reductions can be achieved through increases to in-work payments alone.

Part Two: Shifting to a new, enhanced in-work payment

15 We understand that your preferred direction for WFF reform is ‘option 1’ from past advice. As a reminder, option 1:

- introduces a new in-work payment that replaces the MFTC and IWTC and is available for working families who are off-benefit.
- ensures families are better off off-benefit, like MFTC currently, but with more gradual abatement.

16 The Minister for Social Development and Employment has further indicated their current preference for settings that allow families to receive the full in-work payment ($386 pw) when they are in paid work (1B, ‘no hours test’); rather than settings that allow families to receive a partial payment with ‘no

[3] The number of children living in households that have less than 50 percent of the median equivalised disposable household income before housing costs.

hours test' (e.g. $100 pw), which gets topped up to the full amount when the hours test is met (1A, 'partial hours test').

17 Previous advice included two versions of this option, with different abatement settings and fiscal cost:

- The 'full' option with a single abatement rate of 30%, which was previously estimated to cost an estimated $955m per annum.
- The 'scaled' option with a two-tiered abatement regime that reduces cost and targets increases more to lower-income working families.

Modelling: Costs and impacts for families

18 We have updated the modelling for both variations of Option 1B for implementation in 2025/26, with revised parameters that take into account the latest decisions and other recent factors. For both the 'full' and the 'scaled' option, the existing MFTC and IWTC are replaced with a new in-work payment set at a rate of $386 pw.

19 Under the 'full option', the new in-work payment abates at 30% over $26,500 pa, and once this is fully abated the FTC abates at the same rate. Modelling indicates that this would:

- cost $1,055m in 2025/26
- see 190,000 households gain an average of $106 per week, and
- reduce child poverty by 21,000 children on the BHC50 measure and 37,000 on the AHC50 measure.

20 Under the 'scaled option', a two-tier abatement regime is introduced: a first tier of abatement above $26,500 pa, where the new IWP withdraws much more quickly at 55%, and a second tier of abatement above $49,500 pa, where WFF payments abate at 30%. Modelling indicates that the 'scaled' option would:

- cost $703m in 2025/26
- see 170,000 households gain an average of $79 per week, and
- reduce child poverty by 18,000 children on the BHC50 measure and 29,000 on the AHC50 measure.

21 The fiscal cost of the scaled options has increased significantly compared with previous advice due to the implementation date being shifted to a year later, and other changes including the impact of the upcoming benefit increases on 1 April and updated macroeconomic assumptions. Note that the above costs are from Treasury's TAWA modelling and do not include operational costs or all flow-on impacts. TAWA's costs are for the income tax year, starting 1 April. Modelling by IR, including five-year costs and fiscal years, is provided in Appendix 1.

Other considerations related to Option 1B

22 In both cases, Option 1B has a strong focus on making work pay and would provide real gains to low-income working families. The payment ensures families are better off when in work, addresses a number of issues created by the current MFTC, and should encourage movement off benefit more strongly than current settings.

Having no hours test has simplification benefits

23 On current settings, families with children are eligible for the IWTC ($72.50 pw) as long as they are off-benefit and in paid work; there is no hours test. Families are eligible for the MFTC once they are working a minimum number of hours (20 hours for sole parents, 30 hours for couples).

24 There are simplification benefits to having no hours test – families would not have to notify changing hours to IR at a lower level of hours worked, which makes the payment simpler to administer, reduces debt to Government, and better supports families with variable work hours.

25 Families may be less likely to experience gaps in support or need to move on/off a main benefit, reducing the need to navigate between MSD and IR. Having no hours test could also encourage people to leave benefit to take up small amounts of work, and there is evidence that some participation in the labour market encourages people to work more

Not including any hours test with a payment of this size creates a tension with the benefit system

26 As noted in past advice, having a large payment ($386 pw) with minimal work requirements (i.e. as little as an hour a week) creates a tension with aspects of the benefit system, given the work obligations and sanctions attached to the receipt of main benefits. This option would mean working families can receive the new payment at lower hours of work if they choose not to be on benefit. The payment rate ($386 pw) is close to the level of main benefits ($440 pw for sole parents), which require clients to be actively looking for part- or full-time work or, for those with a child under three, preparing or planning for work.

In general, the option means higher effective marginal tax rates for most WFF recipients, particularly with a two-tier abatement regime

27 The impact of Option 1B on effective marginal tax rates (EMTRs) is different for different family types and depends on a range of factors, including family type, income, and the combination of payments they receive. For those earning below $50,000 pa:

- Those currently receiving the MFTC would shift to the new in-work payment, which would abate more gradually, rather than withdrawing on a dollar-for-dollar basis. This would mean a reduction in EMTRs for this group of people.

- Those who are not receiving the MFTC (the majority of WFF recipients) would see a substantial increase in EMTRs, particularly under the scaled option, where their EMTRs increase from around 20% to around 75%.

28 Families earning above $50,000 pa would see a smaller increase (3ppt), but for some of these higher income families this would be on top of already high ETMRs. These are families who are receiving other payments, such as the Accommodation Supplement or Best Start, which abate at the same time as WFF.

Some families with very high EMTRs currently will see these increase even more

29 In order to minimise issues with overlapping abatement, the abatement settings for the new in-work payment were based in part on other settings in the tax and transfer system:

- The first abatement threshold of $26,500 pa is set at a level where they could receive the full payment when working 20 hours on the minimum wage. Above that threshold, the payment abates at 55%.
- The second abatement threshold of $49,500 pa was set around the point where Accommodation Supplement begins abating at 25%.[4] Above this threshold, the WFF abatement rate is 30%, which means the combined abatement rate for Accommodation Supplement and WFF above this threshold would be 55%.

30 Working families with incomes above the second threshold who are receiving both the Accommodation Supplement and Working for Families already face very high EMTRs, and this option would see these increase further. Once personal tax and ACC are taken into account, their EMTRs approach 90%.

31 For people in some specific circumstances, EMTRs would be even higher, and could exceed 100%:

- Those also with student loan debt earning above $21,000 pa need to contribute a further 12c in the dollar for every additional dollar earned above this level.
- Those receiving Best Start with family income above $79,000 pa have their payment abate at the same time as Working for Families payments, at 21c in the dollar.

32 These very high EMTRs would only apply to some families receiving specific combinations of payments – for example, there are relatively few families

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[4]If this option progresses, we also recommend a change to the Accommodation Supplement abatement threshold for sole parents, which is currently based on the full-time abatement regime which used to apply to sole-parents on Job-Seeker Support. Without this change, there would be an income range (between $42,000 and $52,000) for sole parents receiving both WFF and AS where the combined abatement of the two payments is 85%, and whose EMTRs would exceed 100% once tax and ACC is included.

receiving AS who earn over $79,000 pa, and even fewer with children under 3.

33 We have also modelled a variant with more gradual abatement settings, which withdraws at 50% and then 27%, rather than 55% and then 30%. As well as meaning less of an increase on EMTRs, this would mean higher gains for families and child poverty impacts – but with a higher accompanying cost.

34 The gradual abatement version of Option 1B would:

- cost $923m in 2025/26
- see 191,000 households gain an average of $93 per week, and
- reduce child poverty by 19,000 children on the BHC50 low income measure and 33,000 on the AHC50 measure.

35 We could also consider increasing the abatement threshold for Best Start – an increase to $100,000 pa would reduce the overlap between Accommodation Supplement and Best Start abatement and likely cost around $40-50m. We can provide confirmed costings and further advice on any key considerations with this option as part of the next stage of advice.

To maintain the margin between benefit and work, indexation of some settings would likely be required, and discretionary increases to benefit levels could potentially carry greater fiscal cost

36 One of the features of the design of Option 1B is that the new in-work payment ensures that a family is better off in work than on benefit, a role in the payment system currently occupied by the Minimum Family Tax Credit. In order to maintain these relativities, we recommend that an automatic adjustment mechanism of some kind is introduced each year to ensure work (supplemented by the in-work payment) continues to pay more than the benefit.

37 There are a range of options that could be considered, with different strengths and weaknesses. An instrument designed solely for this purpose would take into account the levels of both benefit rates and the minimum wage, and apply to both the payment rate and the first abatement threshold of the new payment. However, this would be complex and may have unintended consequences – for example, decisions around minimum wage or benefit increases would have broader implications for WFF and fiscal cost. The shift to indexing some settings would mean that the WFF payment system would carry higher costs over time, relative to current settings.

38 Another option would be simply to index the payment threshold only using the growth in net average wages, the same mechanism currently used to adjust benefit levels. This would be simpler but would not necessarily guarantee that relativities are preserved. Settings could gradually become out-of-date, particularly if the minimum wage is increased faster than average wages.

39 Another related policy question with Option 1B is whether to also 'lock together' benefit rates with WFF settings, so that any *discretionary* increases to main benefits also change settings for the new in-work payment, as they do currently with the MFTC. If WFF settings were automatically adjusted to preserve the margin between benefit and work, this would mean any future benefit increases would carry a higher fiscal cost.

There are a number of detailed policy questions and operational complexities that need to be worked through

40 The introduction of a new in-work payment, and the reversal of the order of abatement so that the FTC withdraws after the new in-work payment, creates a number of policy questions that need to be worked through:

- **Eligibility for the self-employed** - Officials are likely to recommend that the new IWP would include self-employed people, but we would need to do further work to confirm this and examine its specific implications. Under the status quo, self-employed people are eligible for the IWTC only and not the MFTC, for reasons that are partly historical in nature, and because of the increased risk of gaming with self-employment. Self-employed people are more likely to be able to exercise choice with their hours of work, and would be expected to self-declare their hours.
- **Shared care** - Currently the full amount of IWTC is available for each parent with shared care of a child, whereas the FTC is apportioned between parents depending on the level of care. There is a question as to how the shared care rules would apply to the new in-work payment, and whether the same rules would apply as for the IWTC.
- **OB/UCB/FCA recipients -** Caregivers cannot currently receive OB/UCB/FCA and the FTC for the same child, as these payments are considered analogous, whereas they can receive both the IWTC and OB/UCB/FCA, if they qualify. Decisions would be required on whether the same settings apply to the new in-work payment.
- **4+ IWTC rate** - the current In-Work Tax Credit includes a per-child rate of $15 pw for the 4th and subsequent children, which did not feature in the original design of Option 1B included in past advice. There is a policy question as to whether to retain the rate, or remove it (and potentially disadvantage some larger working families).
- **Detailed abatement and ringfencing rules** – the shift from IWTC/MFTC to the new payment may have implications for various rules about how income and abatement settings are operationalised in practice, and detailed policy settings need to be confirmed. There may be some families who are financially disadvantaged from the changes.

41 Detailed advice and decisions are likely required on the above issues. The above issues are just those identified through initial analysis, and there may be others that are yet to be identified.

Timing

42 As noted earlier in this report, officials have determined that there is insufficient time to develop and model the detailed settings for Option 1B in order to be able to provide comprehensive advice for Budget 2023. It would also likely not be possible to implement Option 1B by 1 April 2024, even if it were funded through Budget 2023, given the complexity and scale of the changes involved. At most, we recommend you indicate that a new in-work payment is a *possible* direction of travel that is being explored further.

43 You could signal the possibility of change through the release of a discussion document, given it would be such a significant change to the system. However, officials' view is that the timing of the election would make this very challenging and would likely overlap with the pre-election period which begins on 14 July 2023. Officials are also unlikely to be able to resource the development of a discussion document and public consultation at the same time as continuing the policy work required.

44 In order for the option to be implemented by April 2025, work would also need to continue at pace. In-principle decisions would need to be made at the end of this year, and detailed parameters would need to be confirmed by April 2024, with funding provided through a precommitment on Budget 2024. Implementation timeframes will also depend on the final design of the option chosen and what other priorities IR and MSD are asked to progress over the same timeframes.

45 An illustrative timeframe based on this approach is as follows:

- April 2023 – Cabinet agreement to progress further work on exploring options in the direction of option 1B, including how this will be signalled in Budget 2023 announcements
- June/July 2023 – further advice on options
- November 2023 – detailed advice ready as part of Briefings to Incoming Ministers
- December 2023 – in-principle decisions made, Budget 2024 pre-commitment
- April 2024 - detailed parameters confirmed
- 2024 - legislation passed
- 1 April 2025 – option implemented.

46 Officials note that the above timeframes are tight for decisions and there is also insufficient time for any further public consultation.

Part Three: Immediate changes for Budget 2023

47 There are options for simpler changes to settings that could be announced in Budget 2023 that are broadly consistent with the direction of travel towards the new in-work payment design.

48 Note that we have provided indicative implementation timeframes below but these in part depend on other Budget priorities that IR and MSD are asked to deliver over the same timeframes.

49 The costs below are from Treasury's TAWA model and do not include operational costs or all flow-on impacts. TAWA's costs are for the income tax year, starting 1 April. Modelling by IR, including five-year costs and fiscal years, is provided in Appendix 1.

Modelling: Costs and impacts for families

50 You have expressed interest in the introduction of option 6B from the November advice, as an initial step towards option 1B. As a reminder, this option:

- keeps the FTC and IWTC in its current form
- removes the MFTC
- increases the IWTC rate by $25 pw to improve income adequacy, and
- increases the WFF abatement threshold to $50,000 pa to help make work pay and avoid overlapping abatement with benefits.

51 The costs and immediate impacts on incomes and measured child poverty are set out in the table below.

	Tax Year Cost (24/25)	Average gains/losses	Poverty impacts	Implementation
Option 6B $25 pw IWTC increase + WFF abatement threshold to $50,000 pa + MFTC removed	$406m	173,000 HHs gain $46pw 6,000 HHs lose $35pw	8,000 (BHC50) 19,000 (AHC50)	April 2024

Key considerations with Option 6B

52 If you wish to ultimately progress to a system based around 'Option 1', we do not recommend you remove MFTC now, as this would likely create difficulty and confusion for those currently in receipt of the payment. To ensure these clients are not worse off, agencies would advise them to transfer to benefit, but then they would need to transfer back to the in-work payment the following year. A small group of very low-income working families would also likely not be eligible for benefit and would be financially disadvantaged. For these reasons, officials recommend maintaining the MFTC using its current formula, until decisions about the longer-term direction of WFF are made.

53 If you wish to implement Option 6B as the 'end-point' for the reforms, then the removal of the MFTC could be considered, but it is worth keeping in mind the downsides noted in previous advice. While this option maintains an in-

work payment through the IWTC, it does not guarantee low-income families are better off receiving it and going off-benefit at 20/30 hours of work. It may mean more working families, mainly sole parents, would stay on benefit for longer, as they would be better off receiving an abated benefit when working part time.

54 As noted in previous advice, complementary changes to the benefit system would also be required if you opt to remove the MFTC. These include moving sole parents with children over 14 from Job Seeker Support to Sole Parent Support, to enable them to receive an abated benefit for longer, and changes to work requirements and obligations for couples receiving Job Seeker Support. These changes would not be able to be implemented by MSD until April 2025 at the earliest.

55 The removal of MFTC is also likely to result in some families being financially disadvantaged from the change:

- Treasury's TAWA modelling for Option 6B shows 6,000 households would lose $35 per week on average.
- IR modelling of those who are estimated to be financially disadvantaged (which is not directly comparable to the TAWA modelling above) indicates around 3,000 current families receiving MFTC would be worse off by an average of $79pw.

56 To some extent, these numbers of families who are financially disadvantaged are likely to be over-stated, as both estimates do not take into account the fact that many of affected families would be eligible to shift to receiving an abated benefit to offset their losses. However, there would be a small group of families who would not be eligible for benefits, for example, due to working more than 30 hours a week.

Other simple IWTC and/or abatement threshold changes for Budget 2023

57 We have also modelled other simple IWTC changes that retain the MFTC and could be considered for Budget 2023, including:

- increases to the IWTC rate of $25 and $15 pw as stand-alone options
- an abatement threshold increase ($50,000 pa) as stand-alone option, and
- a combination of a $10 pw IWTC rate increase with an increase in the abatement threshold to $50,000 pa.

	Tax Year Cost (24/25)	Average gains/losses	Poverty impacts	Implementation
Option 6B2 $25 pw IWTC increase only	$166m	160,000 HHs gain $20pw	4,000 (BHC50) 6,000 (AHC50	July 2023 or April 2024
Option 6B3 $15 pw IWTC increase only	$97m	153,000 HHs gain $12pw 4,000 HHs lose $3pw	3,000 (BHC50) 4,000 (AHC50)	July 2023 or April 2024
Option 6B4 Abatement threshold to $50,000 pa	$238m	152,000 HHs gain $30pw	4,000 (BHC50) 11,000 (AHC50)	July 2023 or April 2024
Option 6B5 $10 pw IWTC increase + abatement threshold to $50,000 pa	$309m	173,000 HHs gain $34pw	6,000 (BHC50) 17,000 (AHC50)	July 2023 or April 2024

58 These options could likely be implemented on 1 July 2023 or 1 April 2024. However, given the complexity of the tax and transfer system, and the significant number of interactions between payments, a later implementation date will provide agencies with more time to manage these. Other Budget priorities may also make the earlier implementation date more challenging. For these reasons, officials recommend a 1 April 2024 implementation date for these changes.

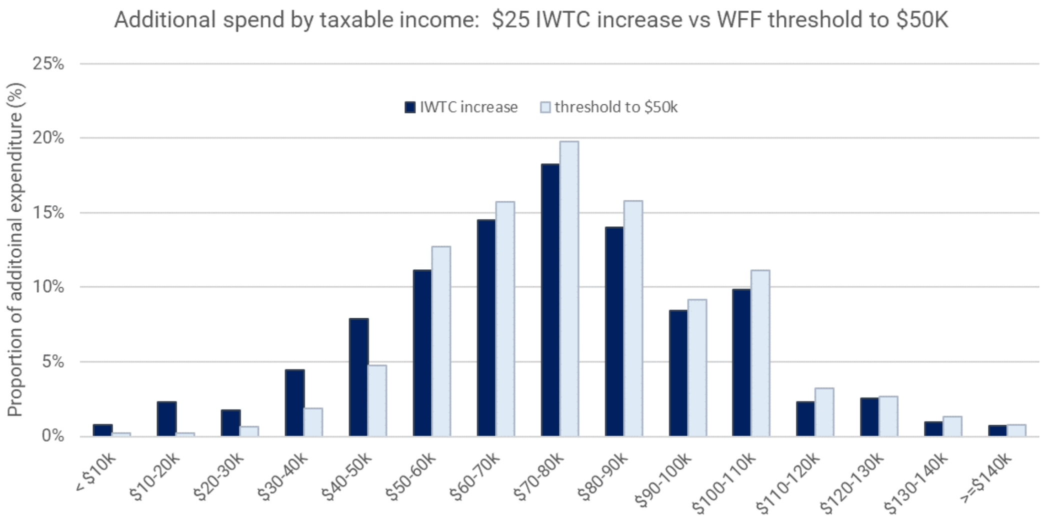
59 These changes will have impacts on the MFTC that are not included in the above costings. For example, increases to the rate of the IWTC will generally result in a decrease in the MFTC threshold. Detailed costs and impacts will be provided in the Budget Cabinet paper if one of these options progresses.

Comparing impacts: IWTC payment rate vs WFF abatement threshold

60 If fiscal constraints necessitate a choice between an increase to the IWTC payment rate and an increase to the WFF abatement threshold, then you may wish to consider the relative distributional impact of the two options:

- of the options modelled, the increase to the abatement threshold carries a higher fiscal cost and, commensurate with this, has a greater impact on incomes.
- as shown in the graph below, an IWTC rate increase is slightly more targeted at those on the lowest incomes – families below $50,000 gain a greater proportion of the additional expenditure – whereas a threshold increase impacts more on low-middle income families.

- an abatement threshold increase has slightly higher child poverty impacts, with the AHC measure reducing by 11,000 children, compared with 6,000 children for the $25 pw IWTC increase.



61 There are other reasons why you may wish to consider an abatement threshold increase. This increase reduces the extent to which abatement of benefits and WFF overlap. IR estimate that this would reduce WFF debt for approximately 2,400 beneficiary families and eliminate it for approximately 1,200 beneficiary families. This increase also ensures that a single earner on the minimum wage does not face abatement of WFF payments (as 40 hours of work a week means the current minimum wage is equivalent to around $47,000 pa).

62 The option that best addresses income adequacy and lifts the most children out of poverty on the AHC50 measure per dollar of fiscal cost combines an IWTC increase of $10 pw with an increased abatement threshold (option 6B5). This option reduces child poverty by 17,000 on the AHC50 measure at a cost of $309 million.

63 If any of these simpler options became an end-point for the WFF Review, they would still align with the objectives of supporting income adequacy and reducing child poverty, and improving financial incentives to work. They are not focused on simplifying the system however, and some of the issues identified in past reports related to the MFTC and the complexity of the tax/benefit interface would remain.

Consequential impacts and detailed policy decisions

64 Given the interdependencies between payments in the welfare system, there are some consequential impacts of increasing the IWTC and/or the WFF abatement threshold that need to be considered for Budget 2023. Constrained timeframes for modelling mean that impacts have not yet been fully quantified and further flow-ons may be identified. All flow-ons will be included in the Budget Cabinet paper, if an option progresses.

65 Both options will increase the income people receive from either the IWTC or FTC,[5] which are considered income for some types of assistance:

65.1 **Community Services Card (CSC):** When the rate of FTC or IWTC increases, families close to the income threshold for CSC may be pushed over the income threshold and lose eligibility to the card. This flow on occurred in 2018 as a result of the Families Package. At that time, Cabinet agreed to increase the CSC income thresholds to ensure no families lost eligibility to the CSC as a result [CAB-17-MIN-0516 refers]. This will occur under all of the proposed options for Budget 2023, however further work is required to estimate how many families could be impacted, though fiscal impacts are likely to be minor. Officials recommend this decision is delegated by Cabinet to a group of Ministers to make subsequent decisions.

65.2 **Temporary Additional Support (TAS) and Special Benefit:** These are temporary payments made to top up a person's weekly income to meet essential costs. FTC is chargeable income for Special Benefit, while all WFF tax credits are chargeable income for TAS. This means all of the proposed options for Budget 2023 may reduce the amount of TAS or Special Benefit a person receives. However, it is expected that people receiving these payments will still generally receive an increase in their income overall. The exception to this is those who lose entitlement to TAS because their deficiency is less than a dollar, therefore the loss is less than a dollar of TAS.

65.3 **Independent Earner Tax Credit (IETC):** If a family is entitled to WFF then they are not eligible to receive IETC ($10 pw). Any increase in entitlement to WFF from these changes will mean some individuals within families are no longer eligible to IETC.

Part Four: Update on administrative options workstream

66 In July 2022, you agreed to further advice on administrative and operational improvements to improve client experience and reduce debt. The resultant administrative workstream focuses on the third objective of the original WFF reform, namely, supporting people into work (and to remain in work) by making sure they get the assistance they are entitled to in a timely manner.

67 In November 2022, you agreed to the following recommendations, and noted that further advice would be provided on implementation and fiscal costs in a report in early 2023:

- that officials assess the existing information exchanged under the Inland Revenue-Ministry for Social Development Approved Information Sharing

[5] Increasing the abatement threshold will increase the rate of IWTC and/or FTC that people receive at various income levels.

Agreement and determine the scope and feasibility of additional changes that would reduce overpayments and improve customer experience;

- to provide a four-week grace period when a child dies for the FTC and IWTC; and
- to repeal the grand parented Child Tax Credit.

68 The fiscal impact of providing a four-week grace period when a child dies for the FTC and IWTC has now been costed. This would be $0.48 million over the forecast period, and then $0.156 million for out years. This is based on a 1 April 2024 application date, and the number of cases whereby IR has been advised of the death of a child during the year.[6]

69 You also indicated that you would want further advice about remedial amendments that could be included in a bill in 2023. Officials have developed proposals for remedial amendments, as well as additional administrative and operational improvements. However, this advice has been delayed to focus on the substantive advice for WFF for Budget 2023. Some of these additional proposals have small fiscal costs while other proposals do not.

70 Treasury has advised that the WFF administrative options with fiscal costs should not be progressed as part of the Budget 2023 package. If Ministers wish, officials could provide advice on the administrative and remedial initiatives with no fiscal implications, and whether they could be implemented for April 2024, through a tax bill enacted by the end of 2023.

71 Additionally, we could continue to progress this workstream and seek to fund the other initiatives with fiscals as part of the larger WFF reforms for Budget 2024. Alternatively, items that relate to debt reduction could be progressed as part of the wider debt to government work. As part of the debt to government work, changes to penalties and interest settings are progressing on a similar timeframe, and changes will likely form a bid for Budget 2024.

Next steps

72 If you wish to progress one of the simpler IWTC changes in this paper for Budget 2023, officials can prepare material for you to seek the agreement of your colleagues – either through a dedicated Cabinet paper, or through the overall Budget Cabinet paper. We can engage with your office on the most appropriate mechanism for progressing Cabinet decisions.

73 If you wish to progress to further advice in the direction of Option 1B, we also recommend you seek agreement from your colleagues via Cabinet paper – this could be through the same Budget paper, or separate to it. This will include how the future direction of WFF will be signalled as part of Budget 2023 announcements.

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[6] This is currently 326 children per annum.

74 As noted above, in order for an option like 1B to be implemented by April 2025, detailed parameters would need to be confirmed by April 2024, with funding provided through a precommitment on Budget 2024. Work would also need to continue to progress at pace, with in-principle decisions made by the end of this year.

MSD REP/23/3/169 - IR2023/018

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Appendix 1: Comparison of IR and TAWA costings

The tables below show the TAWA and IR modelling of the cost of the WFF options.

TAWA's costs are for the income tax year, starting 1 April. IR's costs are for fiscal years (starting 1 July) and include costs over the forecast period (five-year costs).

IR's model is currently costing the WFF options around 10% higher than Treasury's TAWA model. This is largely due to differences in the underlying populations between the models – with IR's model based on administrative data and TAWA's based on the Household Economic Survey. Officials will determine the most appropriate costings to use in the Budget Cabinet paper.

The five-year costings by IR include costings for both 1 July 2023 and 1 April 2024 implementation dates for the Budget 2023 options.

It is also worth noting that IR's model also captures some more detailed flow-on impacts that TAWA does not, and is based on a larger population, which generally means that it may identify more families that are financially disadvantaged by changes.

For example, TAWA has suppressed results for families who are financially disadvantaged by the variations of Option 1B. For these same variations, IR modelling suggests there may be up to around 5,000 families who are financially disadvantaged.

Neither model shows any families financially disadvantaged by the options for Budget 2023 that retain the MFTC.

Modelling of implementing the Budget 2023 options in 2023 before Option 1B is implemented in 2025 suggests that progressing these options before implementing option 1B may increase the number of families who are financially disadvantaged. Further advice can explore these results.

Table 1 – Costings for Option 1B variations

Option	**TAWA annual Tax Year (25/26)**	**IR annual fiscal year (25/26)**	**IR five-year cost**
Option 1B – full	$1,055m	$1,139	$2,612m
Option 1B2 – two tier / scaled	$703m	$792m	$1,885m
Option 1B3 – two tier / scaled (gradual)	$923m	$933m	$2,177m

Table 2 – Costings for Option 6B variations

Option	TAWA annual Tax Year (24/25)	IR annual fiscal year (24/25) implemented 1 July)	IR five-year cost (implemented 1 July 2023)	IR five-year cost (implemented 1 April 2024)
Option 6B – IWTC +$25, $50k abatement threshold, remove MFTC	$406m	$457m	$1,769m	$1,427m
Option 6B2 – IWTC +$25pw	$166m	$192m	$737m	$593m
Option 6B3 – IWTC +$15pw	$97m	$114m	$438m	$352m
Option 6B4 – $50k abatement threshold	$238m	$263m	$1,025m	$829m
Option 6B5 – IWTC +$10, $50k abatement threshold	$309m	$346m	$1,342m	$1,084m

Appendix A
Document 5

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Inland Revenue
Te Tari Taake

MINISTRY OF SOCIAL DEVELOPMENT
TE MANATŪ WHAKAHIATO ORA

Report

Date: 20 July 2023 **Security Level:**

To: Hon Carmel Sepuloni, Minister for Social Development and Employment

Hon Dr Deborah Russell, Associate Minister of Revenue

Working for Families Review: Preferred approach for December Cabinet report back

Purpose of the report

1 The purpose of this report is to seek decisions on the preferred option for the Working for Families (WFF) Review. This will enable a Cabinet report back by the end of 2023 on the next steps of the Review.

Executive summary

2 The decisions in this report on the preferred option/s for the WFF Review will enable a report back to Cabinet in December 2023. If Ministers would like to progress a WFF option for consideration in Budget 2024, timely decisions on the advice in this report will be required.

3 Ministers have indicated that their preferred direction for structural reform was a scaled version of an option referred to in previous advice as Option 1B – a new in-work payment. Previous options considered by the Review are set out in Appendix One.

4 Through further work on the Review, officials have determined that there is insufficient time to develop a structural reform option for Budget 2024 (with an implementation date of 1 April 2025), though smaller-scale changes within the current system could still be considered. Options for structural reform could be considered in Budget 2025, with an implementation date of 1 April 2026. This report presents:

- a set of structural reform options illustrating key choices about the design of the in-work payment, and
- a set of smaller-scale changes within the current system focused on addressing issues with the current abatement threshold.

Structural reform of Working for Families - a new in-work payment

5 This new in-work payment combines the current work-related tax credits – the Minimum Family Tax Credit (MFTC) and In-Work Tax Credit (IWTC) into a single, more generous in-work payment. This new system also retains the Family Tax Credit (FTC) and the Best Start Tax Credit (BSTC) which go to both beneficiary and non-beneficiary families with children.

6 The new in-work payment would continue to be available for low to middle-income working families not receiving a main benefit. It also switches the order of abatement compared to the current system, with the new in-work payment abating first from a lower starting point, and the FTC abating after the in-work payment. This is illustrated in a diagram in **Appendix Two**.

7 The new in-work payment provides significant income gains to low and middle-income working families (meeting a key objective of the Review). At the same time, it would reduce the number of children in poverty. A core improvement of the new in-work payment is that it removes effective marginal tax rates (EMTRs) of above 100% created by the MFTC, improving work incentives for the approximately 3,000 current MFTC recipients.

8 The full-cost version of Option 1 was estimated in previous advice to cost around $1,055m per year (not including operational costs). Given this significant cost, a scaled option was also provided that reduced the annual fiscal cost to $703m[1] by increasing abatement settings to target increases more to lower-income working families, consistent with the objectives of the Review.

In-work payment variations

9 This report provides updated costings of the scaled option provided in previous advice[2] – referred to in this report as the "base case" (**IWP(base)**) – as well as four variations that adjust key parameters to address issues with the base option that:

- further reduce the high fiscal cost
- reduce high effective marginal tax rates (EMTRs), and
- reduce tensions with the benefit system.

[1] This costing was prepared for the March 2023 advice using a different Economic and Fiscal forecast update than the forecast update used for this paper.
[2] REP/23/3/169; IR2023/018

10 A key parameter that is varied to reduce cost is the payment rate - the IWP(base) option for the in-work payment option has a **high payment rate**.

11 The variations:

- Address the high cost of the IWP(base) option - **IWP(a)** and **IWP(b)**: A **medium or low payment rate** set in relation to **sole parents** receiving a broadly equivalent amount of income as the current system
- Address the high EMTRs of the IWP(base) option - **IWP(c)**: A **medium payment rate** with more **gradual abatement**
- Address the tension with the benefit system and high cost of the IWP(base) option - **IWP(d)**: A **medium payment rate** and a **partial hours test**.

12 The table below provides a summary of the main impacts of each in-work payment option. Costings in this report do not include operational costs – these will be provided in further advice.

	IWP(base)- high IWP	**IWP(a) – medium IWP**	**IWP(b) – low IWP**	**IWP(c) – medium IWP + gradual abatement**	**IWP(d) – medium IWP + partial hours test**
Fiscal impact[3] **Tax year 25/26**	$690m	$343m	$221m	$617m	$240m
Average gains/losses	170,000 HHs gain $78pw	148,000 HHs gain $45pw 5,000 HHs lose $20pw	136,000 HHs gain $33pw 11,000 HHs lose $18pw	173,000 HHs gain $68pw	142,000 HHs gain $34pw 11,000 HHs lose $20pw
Child poverty reduction	21,000 (BHC50) 26,000 (AHC50)	14,000 (BHC50) 14,000 (AHC50)	8,000 (BHC50) 7,000 (AHC50)	19,000 (BHC50) 23,000 (AHC50)	9,000 (BHC50) 10,000 (AHC50)

13 The base option for the new in-work payment and the variations presented in the report still meet the objectives of the Review outlined in paragraph 41 of

[3] Fiscal costs in this report use outputs from Treasury's Tax and Welfare Analysis model. Inland Revenue have also modelled these costs. There is some variance between the two modelling outputs, largely due to the differences in underlying populations between the models. Officials will determine the best source of costings for Cabinet papers and Budget proposals.

the main body of the report. However, when making choices between these options, the key trade-offs relate to managing fiscal cost against:

- the impact a reduced payment rate has on couples
- impacts on effective marginal tax rates and financial incentives to work, and
- achieving significant reductions in child poverty.

14 The variations are intended to illustrate the key choices about the parameters of the new in-work payment in order for Ministers to indicate their preferred settings in this advice and enable the next report to focus on detailed design issues.

15 Further assessment of each of the variations of the in-work payment is provided in **Appendix Three**, and **Appendix Four** provides further detail on the parameters of each option.

Variations - payment rate and impacts on couples

16 Setting the payment rate in relation to sole parents – at a **medium or low payment rate** (IWP (a) – (d)) – compared to the **high payment rate** in IWP(base), reduces the overall costs of the payment but perpetuates an existing issue with the benefit system in relation to the MFTC. With the current rate of MFTC, couples are not necessarily better off leaving the benefit system at 30 hours of work at the minimum wage than they are receiving an abated benefit.

17 The lower the payment rate is set, the more that couples would need to work to be better-off receiving it. Also, the "30-hour rule" in the benefit system means that a small number of couples may not be able to continue to receive Jobseeker Support beyond 30 hours of work a week, so may need to come off benefit and be worse off. To ensure these couples aren't worse off at 30 hours, changes to primary legislation are recommended to enable couples to continue to receive an abated benefit for longer.

18 Officials will provide further advice on this issue depending on the option chosen.

Variations - abatement settings and targeting of fiscal costs

19 The IWP(base) option and most of the variations have abatement settings that increase EMTRs compared to the current system for most recipients of WFF tax credits (other than current MFTC recipients). Providing more **gradual abatement** rates (IWP(c)) maintains the EMTRs at or below the current levels (maintaining financial incentives to work). However, the more gradual abatement means that this option is significantly costlier than the other variations and has a similar scale of fiscal costs compared to the base option. Further, the large fiscal costs are less targeted towards low-income working families compared to other options.

Variations - introducing an hours test to reduce tension with the benefit system

20 The new in-work payment provides a level of income that is much closer to what is received by a main benefit compared to the current system. Having a large payment with minimal work requirements creates a tension with the benefit system given the work obligations and sanctions attached to the receipt of main benefit. Without an hours test, the new payment could be argued to undermine the purpose and principles of the benefit system and in particular the work obligations and sanctions laid out in the Social Security Act 2018.

21 However, it is not easy to address this issue without facing significant trade-offs. The key advantage of an hours test is that it mitigates tensions with the work obligations and sanctions in the benefit system and provides greater incentives to work more by retaining the hours test for the full amount of weekly payment.

22 The key disadvantages of an hours test are that it would reintroduce complexity, uncertainty and potentially increase debt for a larger number of WFF recipients who have fluctuating employment arrangements. For this reason, Inland Revenue (IR) do not recommend this option as it would be unlikely to improve the current system overall.

Considerations to be worked through in subsequent advice on structural reform with a new in-work payment

23 There are further considerations for the new in-work payment that will be provided in subsequent advice. These considerations require a considerable amount of further detailed policy work.

24 These include: indexation of the in-work payment rate and/or abatement settings, implications for the costs of any future discretionary increases to main benefits or the FTC, eligibility of self-employed families; how shared care arrangements are dealt with; eligibility for Orphans Benefit/ Unsupported Childs Benefit /Foster Care Allowance recipients; consideration of 4+ children rate, detailed abatement and ring-fencing rules (including abatement thresholds), and payment settings in relation to the MFTC within the transition period.

25 Ministerial decisions on many of these aspects would be needed to inform a future Budget Bid.

Emerging issues to address if structural reform is not progressed

26 If no changes are made to Working for Families in the next two years, overlapping abatement will increasingly undermine the functioning of the system. It is anticipated that by 1 April 2026 the MFTC and the WFF abatement thresholds will overlap, creating effective marginal tax rates (EMTRs) of over 100% for a small group of low-income working families that would grow without continual adjustments.

27 In addition, an increasing number of beneficiaries will also face overlapping abatement of their main benefits and the Family Tax Credit (FTC). Finally, inflation and wage growth have been significant since the WFF abatement threshold was last adjusted in 2018. Increases in the abatement threshold are recommended by officials to both address overlapping abatement and ensure that WFF continues to support both low and middle-income working families. These issues could be addressed by either structural reform or smaller-scale changes to Working for Families progressed in Budget 2025 at the latest.

Options to address overlapping abatement thresholds

28 There are four options that are presented that address the abatement threshold overlap and progress complementary increases to IWTC and/or remove the MFTC completely. These are summarised in the table below.

	AT(a) Abatement threshold to $50,000 pa only	**AT(b)** $10 pw IWTC increase + abatement threshold to $50,000 pa	**AT(c)** $25 pw IWTC increase + WFF abatement threshold to $50,000 pa + MFTC removed	**AT(d)** $10 pw IWTC increase + WFF abatement threshold to $50,000 pa + MFTC removed
Fiscal impact **Tax Year (24/25)**[4]	$238m	$309m	$406m	$291m
Average gains/losses	152,000 HHs gain $30pw	173,000 HHs gain $34pw	173,000 HHs gain $46pw 6,000 HHs lose $35pw	167,000 HHs gain $35pw 7,000 HHs lose $36pw
Child poverty reduction	4,000 (BHC50) 11,000 (AHC50)	6,000 (BHC50) 17,000 (AHC50)	8,000 (BHC50) 19,000 (AHC50)	5,000 (BHC50) 16,000 (AHC50)

29 The abatement threshold options could be progressed in lieu of wider structural reform or as a first step progressed in either Budgets 2024 or 2025, and structural reform options considered through later Budgets.

30 As with the in-work payment options, further assessment of each of the variations of the in-work payment is provided in **Appendix Three**, and **Appendix Four** provides further detail on the parameters of each option.

Preferred approach for December Cabinet paper

31 Choices between higher and lower-cost options depend primarily on the Government's wider fiscal strategy and desired progress towards the ten-year child poverty reduction targets.

[4] Fiscals costs only, does not include implementation or operational costings.

32 **Appendix Three** sets out key trade-offs for consideration of the in-work payment options and the abatement threshold options discussed in this report:

- High-cost options for an in-work payment: IWP(base) / IWP(c)
- Lower-cost options for an in-work payment: IWP(a) / IWP(b) / IWP(d)
- Abatement threshold increase and complementary changes: AT(a) – (d).

33 When considering between the IWP options, variations have been provided to reduce costs and address key issues with the base option. However these variations also introduce more trade-offs. While the in-work payment removes effective marginal tax rates (EMTRs) of above 100% for the small number of MTFC recipients, the overall impact of the new IWP is that it increases EMTRs for the much larger group of FTC recipients. However, maintaining EMTRs at current levels results in significantly higher fiscal costs and less targeting to lower-income families.

34 Some of the variations of the IWP also create losers (IWP(a), IWP(b) and IWP(d)) and provide lower child poverty reductions. The higher cost options, IWP(base) and IWP(c) provide the largest child poverty reductions. Finally, there are differing agency views on whether or not there is an hours test with the in-work payment.

35 IR do not recommend re-introducing a partial hours test as it would reintroduce complexity, uncertainty and potentially increase debt for a larger number of WFF recipients who have fluctuating employment arrangements. For MSD, the decision on whether or not to introduce an hours test is finely balanced but given the large in-work payment, providing it without an hours test represents a large philosophical change to the welfare system as noted in paragraph 20 above.

36 If Ministers are interested in progressing changes that cost between $200 - $400m then the trade-offs and losers associated with the lower cost IWP options begin to outweigh the benefits associated with the new in-work payment. For a similar fiscal envelope, officials recommend considering the abatement threshold options, AT(a) or AT(b), instead.

37 While the abatement thresholds options do not provide large structural reform, they help to maintain the policy intent of WFF by adjusting the abatement thresholds to allow for recent wage and inflation increases. Abatement threshold options also provide a key change that most stakeholders are interested in. By not removing the MFTC, option AT(a) and AT(b) do not create any losers and are comparatively simpler to administer. Officials do not recommend abatement threshold options that remove the MFTC unless further changes are made to reduce the number of families financially disadvantaged.

38 The implementation dates outlined in this report are indicative. Once policy and implementation dates are available, consideration of the deliverability of

this initiative within MSD and Inland Revenue's wider policy change portfolio would need to be made.

Next steps

39 Given the scale of some of the options presented in this report, we recommend this advice is forwarded and discussed with a group of Ministers that replicates the previous Income Support Ministers. This group would include the Prime Minister, Minister for Children, Minister of Finance, Ministers of Child Poverty Reduction and the Minister of Revenue.

Recommended actions

It is recommended that you:

1 **note** that as requested by Ministers, this report provides further advice on options for structural reform of Working for Families focussed on a new in-work payment

2 **note** you are expected to report back to Cabinet outlining the next steps for the Working for Families Review by the end of 2023

3 **note** a new in-work payment has a strong focus on making working pay and would provide significant gains in incomes for low-income working families and simplification of the system for working families

4 **note** the new in-work payment also has high fiscal costs and it also represents a fundamental shift in the welfare system, with flow-on impacts that may need to be addressed within benefit settings

5 **note** although costings for the new in-work payment have assumed a 1 April 2025 implementation date, officials do not consider there is sufficient time between now and the election to undertake the detailed design and analysis on the preferred option that will be required to progress a Cabinet paper by the end of 2023

6 **note** that if Ministers would like to progress a new in-work payment, officials will provide advice in late 2023 or early 2024 to enable decisions in Budget 2025 with an implementation date on or after 1 April 2026

7 **note** if a structural reform option is not progressed due to fiscal constraints or implementation timings, officials recommend progressing an option to increase the abatement threshold of WFF to avoid overlapping abatement thresholds and ensure that WFF continues to support both low and middle-income working families

8 **agree** to progress as an end-point of the review an option that either:

8.1 results in structural reform of the Working for Families system by introducing a new in-work payment

AGREE / DISAGREE

OR

8.2 addresses an anticipated issue related to overlapping abatement thresholds for Working for Families tax credits

AGREE / DISAGREE

If you agree to structural reform options for a new in-work payment

9 **note** that, due to the high cost of the new in-work payment proposed in previous advice [REP/23/3/169; IR2023/018 refers], officials have outlined variations to the proposed new payment

10 **note** that these options scale costs and address key issues of high effective marginal tax rates and tensions with the benefit system

11 **note** alternative options for the new in-work payment vary across the following parameters:

11.1 how the payment rate is set;
11.2 how the payment will abate;
11.3 how the payment will interact with main benefits

12 **note** recommendations 13 - 16 below seek your preferred approach within these parameters

13 **indicate** whether the payment rate should be set:

13.1 at a high payment rate to ensure that couples are better off off-benefit at 30 hours of work on the minimum wage: IWP(base)

YES / NO

OR

13.2 a medium or low payment rate to ensure that sole parents would be better off off-benefit when working at least 20 hours of work on the minimum wage: IWP(a), IWP(b), IWP(c), IWP(d)

YES / NO

14 **note** the dollar figures for the medium and low rates are illustrative and can vary depending on exact parameters

15 **indicate** whether the two-tier abatement settings should:

15.1 increase EMTRs but target the payment towards low-income families: IWP(base), IWP(a), IWP(b), IWP(d)

YES / NO

OR

15.2 provide lower abatement rates to maintain EMTRs at or just below current levels: IWP(c)

YES / NO

16 **indicate** whether, in order to address interactions with main benefits, there should be:

16.1 no hours test: IWP(base), IWP(a), IWP(b), IWP(c) [Inland Revenue preferred option]

YES / NO

OR

16.2 a partial hours test: IWP(d)

YES / NO

17 **note** that based on preferences indicated in recommendations 13 - 16 further advice will be provided on detailed design issues related to the payment

If you agree to addressing the anticipated overlapping abatement of Working for Families tax credits

18 **note** that to address anticipated overlapping abatement thresholds of the Working for Families tax credits by 2026, there are options to increase abatement thresholds with or without increases to the IWTC and removal of the MFTC

19 **note** consistent with previous advice, options to increase abatement thresholds could be progressed as a first step to further structural reform, in particular because the new in-work payment cannot be implemented until on or after 1 April 2026

20 **note** the costings in the report for the abatement threshold (AT) options are the same costings used in the March advice and assumed a 1 April 2024 implementation date

21 **indicate** your preferred approach to address the overlapping abatement thresholds by:

21.1 increasing the abatement threshold to $50,000 only [AT(a)]

YES / NO

OR

21.2 increasing the abatement threshold to $50,000 and a $10 per week increase to the IWTC [AT(b)]

YES / NO

OR

21.3 increasing the abatement threshold to $50,000 and a $25 per week increase to the IWTC and removal of the MFTC [AT(c)]

YES / NO

OR

21.4 increasing the abatement threshold to $50,000 and a $10 per week increase to the IWTC and removal of the MFTC [AT(d)]

YES / NO

22 **agree** that officials provide advice on further changes to mitigate the issue of overlapping abatement thresholds in future, such as indexing the WFF abatement threshold, and potentially increasing or indexing the threshold for the Best Start Tax Credit

AGREE / DISAGREE

23 **note** options AT(a) and AT(b) set out in recommendation 21 could be implemented from 1 April 2024 if a Budget 2024 pre-commitment is agreed

24 **note** options AT(c) and AT(b) set out in recommendation 21 could not be implemented before 1 April 2025 due to the removal of the MFTC within these options

25 **indicate** your preferred implementation date of the preferred option in recommendation 21, either:

25.1 1 April 2025, with funding sought through Budget 2024

YES / NO

OR

25.2 1 April 2026, with funding sought through Budget 2025

YES / NO

Next steps

26 **note** officials will provide further advice to the Minister for Social Development and Employment and the Associate Minister for Revenue on the administrative/operational improvements for Working for Families when officials next report back on the wider package

27 **agree** to forward a copy of this report to the Prime Minister, Minister for Children, Minister of Finance, Minister for Child Poverty Reduction, and the Minister of Revenue

AGREE / DISAGREE

28 **agree** that a meeting is set up with the Ministers outlined in recommendation 27 to discuss the advice in this report.

AGREE / DISAGREE

s 9(2)(a)

20/07/2023

Polly Vowles
Policy Manager, Ministry of Social Development

Date

s 9(2)(a)

20/07/2023

Maraina Hak
Policy Lead, Inland Revenue

Date

Hon Carmel Sepuloni
Minister for Social Development and Employment

Date

Hon Dr Deborah Russell
Associate Minister of Revenue

Date

Advice to date on Working for Families

40 The Working for Families Review (the Review) has been progressing since April 2021 and has provided advice on a range of options to improve the system based on a review of evidence and literature.[5]

41 In 2021, given recent and proposed increases to rates of main benefits for beneficiary families at the time, Income Support Ministers[6] agreed that there be a focus of the Review on:

- Low income working families, while maintaining support for beneficiary families
- Options that shift more towards targeting support to low-income families rather than more universal support
- The principle of people being better off in work, and assisting with the costs for people in work [CAB-21-MIN-0167].

42 Income Support Ministers also agreed that the original WFF objectives of supporting income adequacy and reducing child poverty, improving financial incentives for low-income earners to enter the labour market, and providing timely and accurate entitlement remain important.

43 Further details on the options previously considered in the Review can be found in paragraphs 120 - 123 below, and a full list of options is provided in **Appendix One**.

44 Based on advice provided in November 2022, the Minister for Social Development and Employment and the Minister of Revenue received advice in March 2023 [REP 23/3/169] outlining:

- a potential Budget 2023 initiative for smaller-scale changes to current settings
- high-level advice for longer term-term structural change for Budget 2024 in the form of a new in-work payment.

45 The Working for Families Budget 2023 initiative was not successful. In May 2023, the Minister for Social Development and Employment and the Associate Minister of Revenue took a paper to Cabinet, providing an update on the progress of the Review to date [CAB-23-MIN-0178].

46 The paper noted that the next steps of the Review will consider exploring a potential new in-work payment (IWP) to support working families alongside consideration of other changes to current settings. The paper also noted the

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[5] March 2023 (REP/23/3/169; IR2023/018); November 2022 (REP/22/11/1097; DPMC-2022/23-547; T2022/2489; IR2022/511); July 2022 (REP/22/7/682; T2022/1644; IR22/145; DPMC-2021/22-2539)

[6] Income Support Ministers included the Minister for Child Poverty Reduction, Minister of Finance, Minister of Social Development and Employment and the Minister of Revenue.

Review provides the best opportunity to make progress on meeting the Government's long-term child poverty targets. The Minister for Social Development and Employment and the Associate Minister of Revenue were invited to report back to Cabinet by the end of the year on the next steps of the Review.

Purpose and structure of this report

47 The decisions in this report on the preferred option/s for the WFF Review will enable a report back to Cabinet in December 2023. If Ministers would like to progress a WFF option for consideration in Budget 2024, timely decisions on the advice in this report will be required.

48 Through further work on the Review, officials have determined that there is insufficient time to develop a structural reform option for Budget 2024 (with an implementation date of 1 April 2025), though smaller-scale changes within the current system could still be considered. Options for structural reform could be considered in Budget 2025, with an implementation date of 1 April 2026.

49 Furthermore, if no changes are made to Working for Families in the next two years overlapping abatement will increasingly undermine the functioning of the system. This issue could be addressed by either structural reform or smaller-scale changes to Working for Families progressed in Budget 2025 at the latest.

50 Officials note that these initiatives will need to be considered as part of the Government's wider policy work programme to mitigate potential deliverability risk, particularly where agencies are asked to deliver other changes within a similar timeframe.

51 This report is separated into four parts to address the above issues and related work:

- Section One: Options for structural reform of Working for Families
- Section Two: Smaller scale options to address anticipated overlapping abatement thresholds
- Section Three: Economic and fiscal context and the child poverty reduction targets
- Section Four: Further work and timeframes for Cabinet report back

Section One: Options for structural reform of Working for Families

52 Option 1 introduces a new in-work payment, which combines the MFTC and IWTC into a single, more generous payment, and retains the FTC. It would continue to be available for low to middle-income working families not receiving a main benefit. It also switches the order of abatement compared to the current system, with the new in-work payment abating first, from a lower

starting point and the FTC abating after the in-work payment. This is illustrated in a diagram in **Appendix Two**.

53 Option 1 provides significant income gains to low and middle-income working families (meeting a core objective of the Review) and reductions in child poverty. A core improvement of the new in-work payment is that it removes effective marginal tax rates (EMTRs) of above 100% created by the MFTC, improving work incentives for the roughly 3000 families currently receiving MFTC. Previous advice has canvassed two variations of this option:

- Option 1A: allows families to receive some of the payment before the hours test[7] is met, before being topped up to the full amount.
- Option 1B: allows families to receive all of the payment without an hours test.

54 It is worth noting that a new payment that is targeted towards families off benefit is not the preferred direction of the Review for a large group of stakeholders. From public engagement conducted in 2022, around half of stakeholders and submitters, including the Child Poverty Action Group, argued that the IWTC should be paid to all families regardless of work and benefit status to support child poverty reduction.

55 In the March advice, Option 1B was estimated to cost $1,055m a year in 2025/26.[8] Ministers previously indicated that a fiscal envelope of $200m to $400m a year was likely to be appropriate in Budget 2023. Updated advice on the current economic and fiscal context is provided later in the report in paragraphs 146 - 147.

56 A scaled version of Option 1B was also provided to reduce costs to closer to the suggested envelope. The scaled version of Option 1B had the same payment rate but had higher abatement compared to the full-cost version of Option 1B, targeting the increase in payments more towards lower-income families, consistent with the objectives of the Review. However, the scaled version also provides for smaller income gains and reductions in child poverty and increases EMTRs slightly for many families compared to the current system. The scaled version of Option 1B was estimated to cost $703m in 2025/26 [REP 23/3/169].

57 Ministers have indicated that their preferred direction for structural reform of WFF was a scaled version of Option 1B. This section provides updated costings of the scaled Option 1B (with a higher two-tier abatement regime)

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[7] The hours test relates to the minimum number of hours a family needs to work before they are eligible for the full rate of payment. For this payment the hours test is 20 hours a week for sole parents and 30 hours a week for couples. For families that work below the hours test are eligible for a partial payment.
[8] Costings for this report used the Half Year Economic and Fiscal Update 2022 (HYEFU 22) as a base.

which will be referred to as the "base case" in-work payment option – IWP(base) - for the remainder of the report.[9]

58 The key parameters of the IWP(base) are:

- A **high payment rate** of $384 per week (set at a level so that couples are better off receiving the IWP working 30 hours on minimum wage[10])
- The payment abates at 55% from working 20 hours a week on minimum wage ($26,500 per annum (pa)), reducing to 30% from the Accommodation Supplement abatement threshold ($49,500 pa)[11]
- has no hours test.

59 It also presents four alternative options related to this option which adjust key parameters of the new in-work payment to address issues with the current IWP option – its high cost, high abatement rates and tension with the benefit system. All of these options have a lower payment rate that only ensures that sole parents are better off moving off-benefit at 20 hours of work on the minimum wage and does not ensure that couples are better off. This issue is described in more detail in paras 76 - 79 below.

60 The report presents four alternative options to the IWP(base). These are set out below with the key differences to the parameters of the base option described in paragraph 58 bolded:

- To address the high cost - IWP(a) and IWP(b): A **medium payment or low payment rate** set in relation to **sole parents** receiving broadly equivalent amount of income as the current system
- To address the high EMTRs - IWP(c): A **medium payment rate** with more **gradual abatement**
- To address the tension with the benefit system - IWP(d): A **medium payment rate** and a **partial hours test** to address tension with the benefit system.

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[9] Costings have used the Budget and Fiscal Update 2023 (BEFU 23) forecasts and an implementation date of 1 April 2025 and do not include operational costings.
[10] The modelling for the IWP options has assumed a minimum wage of $25.50 per hour from 1 April 2025.
[11] This is to avoid EMTRs over 100% once the Accommodation Supplement starts to abate at 25c/$1.

61 A summary of key impacts of the parameters of each option is provided in Appendices Two and Three and in the table below:

	IWP(base)-high IWP	IWP(a) – medium IWP	IWP(b) – low IWP	IWP(c) – medium IWP + gradual abatement	IWP(d) – medium IWP + partial hours test
Payment rate	High - $384pw	Medium - $335pw	Low - $316pw	Medium - $335pw	Medium - $335pw
Payment rate – who is better off	Couple	Sole parent	Sole parent	Sole parent	Sole parent
Abatement rates	Base	Base	Base	Less severe	Base
Hours Test	No	No	No	No	Yes
Fiscal impact (25/26)	$690m	$343m	$221m	$617m	$240m
Average gains / losses	170,000 HHs gain $78pw	148,000 HHs gain $45pw 5,000 HHs lose $20pw	136,000 HHs gain $33pw 11,000 HHs lose $18pw	173,000 HHs gain $68pw	142,000 HHs gain $34pw 11,000 HHs lose $20pw
Child poverty reductions	21,000 (BHC50) 26,000 (AHC50)	14,000 (BHC50) 14,000 (AHC50)	8,000 (BHC50) 7,000 (AHC50)	19,000 (BHC50) 23,000 (AHC50)	9,000 (BHC50) 10,000 (AHC50)

62 Fiscal costs in this report use outputs from Treasury's Tax and Welfare Analysis model. Inland Revenue have also modelled these costs. There is some variance between the two modelling outputs, largely due to the differences in underlying populations between the models. Officials will determine the best source of costings for Cabinet papers and Budget proposals.

63 The base option for the new in-work payment and the variations presented in the report still meet the objectives of the Review outlined in paragraph 41. However, when making choices between these options, the key trade-offs relate to managing fiscal cost against:

- achieving significant reductions in child poverty
- impacts on effective marginal tax rates and financial incentives to work, and
- the impact a reduced payment rate has on couples.

64 Another key tension the new in-work payment creates is with the benefit system if there is no hours test. Without an hours test, the new payment could be argued to undermine the purpose and principles of the benefit system and in particular the Social Security Act 2018, which is centred around work with strong obligations and sanctions. However, an hours test would reintroduce complexity, uncertainty and potentially increase debt for a larger number of WFF recipients who have fluctuating employment arrangements.

65 These trade-offs are summarised in a table in **Appendix Three** and discussed further in each section of the alternative options below.

In-work payment, base option - IWP(base): A new, enhanced in-work payment, with two-tier abatement

66 The IWP(base) option provides the new in-work payment for working families with children who are off-benefit. The payment is set at $384 pw (high payment rate). This payment rate is set at this level to ensure that couples with a single earner working 30 hours a week at the minimum wage will be better off receiving the payment than remaining on a main benefit. These are similar payment settings to the MFTC prior to 2021, but with more gradual abatement.

67 The high payment rate means that the number of hours of work where sole parents are better off will be much lower. Assuming a minimum wage of $25.50 at 1 April 2025, a sole parent would be better off moving off-benefit working 15 hours a week.

68 The key feature of the base option is that there is no hours test meaning that families would receive the full in-work payment ($384 pw) when they are in paid work and off-benefit. This means that there are no minimum number of hours of work required to receive the full amount like the current IWTC, but unlike the MFTC.

69 Modelling[12] indicates that IWP(base) (scaled from the full option 1B) would:

- Cost $690m in 2025/26 (the first full year of payments)
- See 170,000 households gain an average of $78 per week, and
- Reduce child poverty by 21,000 children on the BHC50 measure, and 26,000 on the AHC50 measure.

70 The base option meets the objectives of the Review and provides the greatest reduction in child poverty and the greatest weekly gain to households of the options costed for this report.

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[12] In the March Report, this option cost $703m. Fiscal modelling provided in the March report has been updated using BEFU 23.

71 Despite the benefits of this option, the main trade-offs related to this option are:

- **Cost** – even with the two-tier abatement settings this option still has a high fiscal cost of $690m per year which may not be feasible. Options IWP(a) and IWP(b) present ways to reduce the payment rate and lower the overall cost of this option.
- **Effective marginal tax rates** – the rate at which the in-work payment abates creates higher EMTRs for many families. Option IWP(c) provides an alternative setting for the two-tier abatement to lower EMTRs (noting that this increases the cost)
- **Tension created with the benefit system** – having a large weekly payment with no hours test creates tensions with the benefit system in relation to work obligations and sanctions for a near-equivalent rate of payment in the benefit system. To mitigate this, Option IWP(d) includes a partial hours test.

Lower payment rates to address the overall costs of the base option: IWP(a) and IWP(b)

72 The two lower payment rate options costed for this report are:

- A **medium payment rate** of $335 per week – IWP(a), and
- A **low payment rate** of $316 per week – IWP(b).

73 Assuming a 1 April 2025 implementation date, IWP(a) would:

- cost $343m in 2025/26
- see 148,000 households gain an average of $45 per week and see 5,000 households lose an average of $20 per week[13], and
- reduce child poverty by 14,000 children on the BHC50 measure and 14,000 on the AHC50 measure.

74 Assuming a 1 April 2025 implementation date, IWP(b) would:

- cost $221m in 2025/26
- see 136,000 households gain an average of $33 per week and see 11,000 households lose an average of $18 per week[14], and
- reduce child poverty by 8,000 children on the BHC50 measure and 7,000 on the AHC50 measure.

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[13] The losers for this option are in-work couple families who lose more in IWTC than the gain in the combined new in-work payment plus the FTC. This includes anyone not receiving a full year of the IWP (for example those with shared care arrangements and higher income families with more than four children).

[14] The losers for this option are in-work couple families who lose more in IWTC than the gain in the combined new in-work payment plus the FTC.

75 These lower cost options still largely meet the objectives of the reform (see **Appendix One**) with much lower fiscal costs. IWP(a) is approximately 50% of the cost of the base option for the first full year of payment and IWP(b) is approximately 32% of the cost.

76 However, both IWP(a) and IWP(b) provide for more modest gains for families and smaller reductions in child poverty than IWP(base), with the lower payment rate resulting in the smallest income gains and lowest reductions in child poverty.

Trade-offs for payment rates - couples

77 Both the medium and low payment rates reflect the current MFTC settings which have prioritised the payment rate towards sole parents being better off, due to decisions to only partially increase the MFTC abatement thresholds in 2020 [CAB-20-MIN-0152 refers].

78 Sole parents make up around 86% of current MFTC recipients. Setting the payment at a rate that means sole parents will be better off will likely meet the policy intent for the majority of recipients. Previous advice has also noted that the available evidence in New Zealand and overseas suggest that sole parents have more significant responses to changes in financial incentives to work than primary earners in couples. This evidence also suggests that greater in-work payments can work in the opposite direction for couples, by reducing the labour force participation of secondary earners in couples overall.

79 However, a key trade-off with a payment rate below $384 per week means that a couple will no longer be better off moving off-benefit and receiving the IWP working 30 hours a week on minimum wage. The lower the rate, the more couples will need to work – for example, a couple with a single earner on the minimum wage would need to work for 38 hours a week on the minimum wage[15] to be better off receiving the IWP (with a medium payment rate). For an IWP with the lower payment rate, a couple with a single earner on the minimum wage would need to work 41 hours a week on the minimum wage to be better off off-benefit.

80 Further, the "30-hour rule" in the benefit system means that a small number of couples may be ineligible for Jobseeker Support at this point, so may need to come off benefit (before it fully abates) and be worse off because their employment earnings alone are not equivalent to the amount received through the benefit system.[16] To ensure these couples aren't worse off at 30

[15] Assuming a minimum wage of $25.50 on 1 April 2025

[16] Jobseeker Support recipients cannot continue to receive the benefit if they are working full-time, which is deemed to be 30 hours or more per week. There are exceptions for sole parents and grandparented clients who were transferred to Jobseeker Support during Welfare Reform, who can work full time for up to 26 weeks.

hours of work or more, changes to primary legislation are recommended to enable couples to continue to receive an abated benefit for longer (ie. remaining eligible when working more than 30 hours per week). Officials will provide further advice on this issue depending on the option chosen.

Trade-offs for payment rates – between medium and low payment rates

81 The exact dollar figures of the medium and lower rates are illustrative and can vary, both higher and lower, depending on other variables. The two key considerations for how payment rates could be set are comparisons with existing levels of payments (MFTC and IWTC) and the minimum wage.

82 The **medium payment rate** provides families working 20 hours a week on the minimum wage with an equivalent amount of support from the IWP as the combined value of the MFTC and IWTC on 1 April 2024.

83 The **low payment rate** provides these families with a lower amount of IWP than the current system would on 1 April 2025. However, if there are increases in the minimum wage (for the purposes of these costings we have assumed a minimum wage on 1 April 2025 of $25.50), then sole parents overall incomes would not fall and they would still be better off overall off-benefit at 20 hours of work.

84 For this report the **low payment rate** means that sole parents working 20 hours a week at the minimum wage would see a $5 increase in net weekly income on 1 April 2025, compared to what they would be receiving on 31 March 2025 if they were working 20 hours and receiving the MFTC and IWTC, because they receive higher income from the minimum wage increase. However, this effectively means they do not gain from the increase in the minimum wage. **The medium payment rate** means that these families retain more of the gain from an increase in the minimum wage and are $24 per week better off, comparing 31 March and 1 April 2025.

85 If the payment rate is set even lower, below $310 per week, then sole parents would see a reduction in income on 1 April 2025, compared to 31 March 2025. Lower payment rates reduce the fiscal cost considerably - based on modelling, a $10 per week reduction in the payment rate translates roughly to a decrease in the fiscal cost of around $65 to $75 million per year.

A medium payment rate with more gradual abatement settings to address high EMTRs: IWP(c)

86 The two-tier abatement settings of the base option (outlined in paragraph 58) were introduced to reduce costs for the full-scale Option 1B. However, the rates of the two-tier abatement settings creates higher EMTRs for families earning above $50,000 per year and receiving both the Accommodation Supplement and WFF. High EMTRs reduce the amount of income that families retain from increases in wages – and this means that financial incentives to work are reduced.

87 There are also some scenarios where families could face EMTRs that exceed 100% particularly if they are repaying Student Loan debt (which is repaid at 12c in the dollar for income above $21,000) and/or receiving Best Start (abates at 21% for family income above $79,000 at the same time as WFF payments).

88 One option to reduce the high EMTRs of the base option is to have more gradual abatement settings. IWP(c) has the same weekly payment rate as IWP(a) ($335 pw) and two-tier abatement settings, however for income above $26,500 the payment would abate at 50% (instead of 55%) and for income above $49,500 the payment would abate at 27% (instead of 30%).

89 Assuming a 1 April 2025 implementation date, IWP(c) would:

- cost $617m in 2025/26
- see 173,000 households gain an average of $68 per week
- reduce child poverty by 19,000 children on the BHC50 measure and 23,000 on the AHC50 measure.

90 The key benefit of this option is that it reduces the very high EMTRs for people earning above $50,000 a year. It also has the greatest reductions in child poverty of all the scaling options.

91 However this option provides only an 11% reduction in fiscal costs ($73 million) for 2024/25 compared to the base option, which may not be sufficient.

92 In addition to the high fiscal costs, this option has a greater proportion of gains going to higher-income families so it targets less of the overall fiscal cost towards working families on the lowest incomes.

- For IWP(c), approximately 38% of the total fiscal cost goes to households with income under $42,700 (the lowest two income deciles), with an average gain across all households of $68 per week.
- In comparison, IWP(a) which has the same payment rate, has 47% of the total fiscal costs going to households in two lowest income deciles and an average gain across all households of $45 per week, at a considerably lower fiscal cost.

93 This option, as with IWP(a) and (b) maintains an existing issue where couples are not necessarily better off leaving the benefit system at 30 hours of work at the minimum wage and receiving a payment for people in work (either the MFTC or a new IWP), than they are receiving an abated benefit.

To address tensions with the benefit system: IWP(d)

94 Having a large payment with minimal work requirements (i.e. as little as an hour a week) creates a tension with the benefit system given the work obligations and sanctions attached to the receipt of main benefit.

95 IWP(d) reintroduces a partial hours test[17] and would allow families with children off-benefit to receive a portion of the payment ($100 pw) before the hours test is met, then receive a higher amount (up to $335 pw) if the hours test is met (20 hours a week for sole parents, 30 hours a week for couples). This mirrors the current system, where families can receive $72.50 pw[18] from the IWTC with no hours test but must meet an hours test to receive the MFTC (up to $253 per week).

96 The payment rate for IWP(d) is set at the same point as IWP(a) and IWP(b) described above, the medium payment rate. It also has the base settings for the two-tier abatement regime (55% and 30%).

97 Assuming a 1 April 2025 implementation date, IWP(d) would:

- cost $240m in 2025/26[19]
- see 142,000 households gain an average of $34 per week and 11,000 households lose an average of $20 per week[20]
- reduce child poverty by 9,000 children on the BHC50 measure and 10,000 on the AHC50 measure

98 IWP(d) is one of the lowest cost options of the Option 1 variations and is 35% of the costs of the base option. IWP(d) largely meets the objectives of the reform, however there are smaller reductions to child poverty and significant additional complexity in customer compliance and administration.

Tensions with the benefit system – obligations and sanctions

99 Under the base rate and variants, working families could receive up to $335 per week but would have no work obligations beyond being in paid work in a given week.[21] Work obligations in the benefit system require sole parents (and partners in couples with children) to be seeking part-time work (20 hours a week) when their youngest child is aged between 3 and 13 years and to seek full-time work (30 hours a week) once they reach 14 years of age. For couples, the primary recipient of Jobseeker Support must have full-time work obligations, unless they have reduced work capacity because of a health

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[17] The hours test was removed from the IWTC from 1 July 2020 but remained for the MFTC.
[18] Families with four or more children can receive an additional $15 per child with the IWTC.
[19] IR have provided a costing estimate of $393m for this option. The variability between IR and the Treasury's costing for this option will be investigated as part of further work to develop this option.
[20] As with IWP(a) and IWP(b) those that lose assistance are couple families who lose more in the IWTC than they gain in the IWP + FTC and there are also single and couple families that lose because they work fewer hours than the hours test.
[21] To be eligible for the current IWTC, a principal caregiver and/or their partner must normally be an earner and derive an income in the week they are an earner (e.g., be in paid work in a week). This paragraph assumes the IWP would operate in the same way if there is no hours test.

condition, injury or disability, in which case they either have part-time work obligations or have their work obligations deferred.

100 The example below illustrates the scale of change from the current system if the full payment rate is available without an hours test.

- Under the current system, at one hour of work a week a sole parent on the minimum wage will be better off receiving a main benefit by **$441.97 pw**. This is a strong incentive to remain on a main benefit despite its more stringent requirements.
    - They would get $591.77 pw[22] without receiving a main benefit and $1,033.74pw if receiving a main benefit.
- Under the new IWP with a medium payment rate (IWP(a)), they are better off receiving a main benefit by only **$179.47 pw** as they now can receive $854.27[23] without receiving a main benefit.

101 With no hours test, MSD also considers that there are increased incentives for the self-employed to manipulate their hours to be eligible for the payment. This is essentially exacerbating an existing risk with the IWTC, but with a much larger payment.

102 The hours test in IWP(d) provides greater incentives to work more hours and better manages benefit system integrity, by requiring a certain level of hours worked to receive the full amount of the significantly higher new payment. From a proportionality perspective, the partial hours test is also fairer as it targets a higher payment rate towards recipients who work more hours and who would likely have higher in-work costs.

Trade-offs with an hours test – compliance costs and complexity

103 However, there are considerable trade-offs associated with an hours test. It would mean higher compliance costs for clients with fluctuating hours and is significantly more complex to administer than the current system.

104 Introducing an hours test for the new IWP creates greater complexity for recipients as there is an increased likelihood that they would need to navigate between MSD and IR systems as hours change. If a recipient has variable or unpredictable hours, they may experience gaps in support for the IWP and would be better off switching to a main benefit. This is demonstrated by the example provided below.

[22] This assumes they are receiving Accommodation Supplement from MSD as a non-beneficiary client. This also includes the FTC and IWTC.
[23] As above, this assumes they are receiving Accommodation Supplement from MSD as a non-beneficiary client. This also includes the FTC and new IWP.

> ***Example: Hospitality worker receiving IWP with variable hours***
>
> *Kate is a sole parent working casually at a Dunedin restaurant on minimum wage. Her hours of work vary week to week depending on the time of year and availability of other staff.*
>
> *During the university term, the restaurant is busy, and she is generally rostered on for 25 hours per week. This means she earns $567.50 per week before tax. As she meets the hours test of 20 hours per week, she also receives the full $386 per week of IWP.*
>
> *However, the restaurant is very quiet during university holidays, so Kate is only rostered to work 10 hours per week. Her income reduces to $227 per week before tax, and as she no longer meets the hours test, she only receives a partial IWP of $100 per week.*
>
> *The gap in support created by the varying rate of IWP means she would be better off going on benefit (and continuing to work, reporting her income, and getting an abated sole parent support payment) during the quiet period. Kate would then need to navigate between MSD and IR's systems when her hours picked up* again.

105 Further, evidence suggests that generally people respond more to incentives to enter work (the extensive margin) than incentives to increase hours of work (intensive margin). Accordingly, an hours test may not be a well-targeted payment.

106 In addition to the increased complexity for clients, there are operational considerations for Inland Revenue and potentially some additional compliance costs for employers. Primarily, Inland Revenue does not hold or collect data to administer an hours test well. This is an existing design issue for the MFTC (and for the IWTC previously), however this issue is limited to 3,000 people. Introducing an hours test for the new IWP would extend the issue for a broader group of families.

107 Inland Revenue modelling indicates that between 15,000 – 30,000 families would fall below the threshold of a 20 hours per week test for at least one month of the tax year[24]. If ceasing to qualify (even temporarily) is not proactively declared by recipients, it may be picked up by IR's early intervention process or at the end of year square up. This creates an increased likelihood of overpayments because these checks must be retrospective in nature. If (as with the previous IWTC hours test) the hours test was required to be met weekly, the administrative burden and associated costs for IR and for recipients would be substantial.

108 Because an hours test would reintroduce complexity of the system policies, complexity for recipients, increase the uncertainty of outcomes for families, and potentially increase debt for a larger number of WFF recipients who have

[24] Based on IR using minimum wage multiplied by 20 hours per week as a proxy for meeting the hours test.

fluctuating employment arrangements, Inland Revenue do not recommend this option as it would be unlikely to improve the current system overall.

Further considerations for introducing a new in-work payment

109 There are a set of further choices about the settings of these options that will be covered in future advice but are set out at a high level here. These considerations require a considerable amount of further detailed policy work.

Indexation of the in-work payment

110 Indexation of the new IWP should maintain the policy intent of payments as benefits increase. The policy intent of the IWP is that work pays more than being on benefit. For this report, we have costed the indexation of IWP(a) only for the 2026/27 year and have assumed the IWP is maintained in line with benefit and wage increases, which is a relatively complex interaction.

111 For tax year 2026/27 it is estimated that IWP(a) will cost $361m for the second full year of payment, an $18m increase on the first year costs.

112 Indexation could apply to either the payment rate or the lowest abatement threshold, or indexation could be applied to both settings. Once a preferred option has been identified, further consideration and modelling of indexation options will be included in the next set of advice.

113 It should be noted that this effectively indexes the FTC as well and would eventually have a threshold cross-over with the BSTC. The FTC abatement threshold in the highest-cost IWP(base) option is already only $5,000 below the BSTC threshold in 2025/26.

Implications for discretionary benefit and/or Family Tax Credit increases

114 In the past, when discretionary increases to main benefit rates have been made (i.e. in 2020 and 2021), an equivalent increase to the MFTC has also been made to ensure that low-income working families remain better off off-benefit at 20 hours of work a week on the minimum wage.

115 To maintain the work incentives for the group of families who previously received the MFTC and the policy intent of the payment, similar increases would need to be applied to the new IWP. It is estimated approximately 50 – 80,000 families would receive the new IWP. This would represent a much larger flow-on fiscal cost compared to the status quo.

116 Officials have not costed the fiscal impacts for the new IWP of discretionary increases to benefits or the FTC, however scenarios using the preferred option can be provided in the next round of advice.

Flow on impact of the new in-work payment

117 As indicated in previous advice [REP 23/3/169] the new IWP and the two-tier abatement settings will create interactions and policy issues with other forms of assistance that will need to be worked through. The key areas of further advice relate to eligibility for the self-employed, shared care,

OB/UCV/FCA, 4+ IWTC and detailed abatement and ring-fencing rules. **Appendix Five** provides further advice on these flow-ons.

118 As officials work through the detailed design for the new IWP, decisions are likely to be required on the above issues. Additional issues may also arise during the detailed design process.

s 9(2)(h) [redacted]

A single WFF tax credit with no in-work payment has previously been considered as a significant structural change option

120 In previous advice, an alternative option for significant structural change was considered - a single tax credit with no IWP (referred to as Option 5 in previous advice). The single tax credit removes all in-work payments and redirects the funding into the FTC. The option supports income adequacy for families with children (both in-work and on benefit) and aims to make work pay by making FTC abatement settings more generous, instead of having an IWP.

121 Compared to the new IWP, the single tax credit would be simpler, both from a client's perspective and for agencies to administer, but would be likely to cost more in the long term. It would also mean that low-income working families would remain on an abated benefit for longer.

122 The key impacts of this option were:

- comparable gains to both beneficiary and non-beneficiary families
- reductions in child poverty of 24,000 children on the BHC50 measure and 27,000 children on the AHC50 measures
- Costings provided in the November report estimated the cost of the first year of the full option would be $686m in 2024/25, but if the option was phased in, the first full year cost would reduce to $365m in 2024/25.
    - Note these costings used BEFU 22, so are likely to underestimate the fiscal costs compared to the options provided in this advice.

123 **Appendix One** provides further information about the single tax credit option and the other options that have been considered as part of the Review.

Section Two: Smaller scale options to address anticipated overlapping abatement thresholds

124 If you do not want to progress structural reform for the Review, or fiscal conditions do not allow for significant investment in WFF in Budget 2025, options could be progressed to help future proof WFF.

125 Inflation and wage growth have been significant since the WFF abatement threshold was last adjusted in 2018. Increases in the abatement threshold are recommended by officials to ensure that WFF continues to support both low and middle-income working families.

126 In addition, officials estimate that by 1 April 2026 the MFTC and the WFF abatement threshold will overlap, creating EMTRs over 100% for a small group of low-income working families. With strong wage growth and increases to the MFTC, this could occur even earlier than anticipated. This would undermine the function and policy intent of the MFTC.

127 An increasing number of beneficiaries will also face overlapping abatement of their benefit and the FTC. At a minimum, changes to the WFF abatement threshold are needed to address this in the absence of structural reform.

128 Indicative modelling from March 2023 of potential changes to current settings that address the anticipated overlapping abatement is used in this section. These costings are calculated using the 2022 Half-Year Economic Fiscal Update and assume a 1 April 2024 implementation date. If you wish to progress an option to help future proof WFF in lieu of structural reform, updated modelling and advice on implementation dates could be provided in subsequent advice.

An increase to the WFF abatement threshold would help future proof WFF and could be progressed alongside complementary changes to current settings

129 The WFF abatement threshold, currently $42,700 per annum (pa), was last increased from 1 July 2018 and is not periodically adjusted. This means that the annual increases to the MFTC[25] will continue to lift the MFTC until it overlaps with the WFF abatement threshold, causing some low-income working families to be financially disadvantaged. It also means that WFF payments effectively become more targeted over time as wage growth pushes families out of eligibility.

130 An increase to the WFF abatement threshold is needed to mitigate these issues. As per previous advice[26], officials recommend the threshold is increased to $50,000 to ensure that a single earner on the minimum wage

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[25] To reflect anticipated wage growth indexation of benefits.
[26] March 2023: REP/23/3/169; IR2023/018

does not face significant abatement of WFF payments (as 40 hours of work a week means the current minimum wage is equivalent to $47,216 pa and future increases to the minimum wage will increase this annual income further).

131 Alongside addressing anticipated overlapping thresholds, changes to the WFF abatement threshold would also reduce the extent to which abatement of benefits and WFF overlap. IR estimate this would reduce debt for approximately 2,400 beneficiary families and eliminate it for approximately 1,200 beneficiary families.

Summary of options to address anticipated overlapping and modelling from March 2023

132 A summary of the options to address abatement thresholds is provided in **Appendix Three** and in the table below.

	AT(a) Abatement threshold to $50,000 pa only	**AT(b)** $10 pw IWTC increase + abatement threshold to $50,000 pa	**AT(c)** $25 pw IWTC increase + WFF abatement threshold to $50,000 pa + MFTC removed	**AT(d)** $10 pw IWTC increase + WFF abatement threshold to $50,000 pa + MFTC removed
Fiscal impact Tax Year (24/25)[27]	$238m	$309m	$406m	$291m
Average gains/losses	152,000 HHs gain $30pw	173,000 HHs gain $34pw	173,000 HHs gain $46pw 6,000 HHs lose $35pw	167,000 HHs gain $35pw 7,000 HHs lose $36pw
Child poverty reduction	4,000 (BHC50) 11,000 (AHC50)	6,000 (BHC50) 17,000 (AHC50)	8,000 (BHC50) 19,000 (AHC50)	5,000 (BHC50) 16,000 (AHC50)

133 The March 2023 advice presented the following options for consideration through Budget 2023, which assumed a 1 April 2024 implementation date:

- **AT(a)**: increase the WFF abatement threshold to $50,000 pa.
- **AT(b)**: increase the WFF abatement threshold to $50,000 pa + a $10 pw increase to the IWTC rate.

134 These options were presented as both potential interim measures broadly consistent with further structural change and also sensible standalone options to address anticipated overlapping abatement if structural reform is not

[27] Fiscal costs only, does not include implementation or operational costings.

desirable. Compared to the IWP options, there are lower fiscal costs associated with these changes, but also smaller reductions in child poverty.

135 The Review objectives of supporting income adequacy and reducing child poverty, as well as improving financial incentives to work, are met under both options. However, they are not focused on simplifying the system, so do not address the core design issues with the MFTC and the complexity of the tax/benefit interface would remain.

136 The option that best supports income adequacy and lifts the most children out of poverty on the AHC50 measure per dollar of fiscal cost combines an IWTC increase of $10 pw with an increased abatement threshold (AT(b)). This option is estimated to reduce child poverty by 17,000 on the AHC50 measure at a cost of $309 million in 2024/25.[28]

137 Increasing the abatement threshold only means that overlap is likely to occur again in the future without further changes being made to mitigate this, such as indexing the WFF abatement threshold. Increasing or indexing the threshold for the BSTC could also be considered as overlapping abatement will increase with these options. Officials can provide further advice on this if requested.

138 These options (AT(a) and AT(b)) could be implemented from 1 April 2024 if urgent legislation is passed before the end of 2023.

139 You may also wish to remove the MFTC, but this is not recommended without changes to avoid families being worse off. In the absence of structural reform, core design issues with the MFTC remain, including its high EMTRs. You may wish to address these by removing the MFTC, alongside the required changes to address anticipated overlapping abatement.

140 Previous advice explored options that remove the MFTC alongside increasing the WFF abatement threshold to $50,000 pa and increasing the IWTC. These options were:

- **AT(c)**: remove the MFTC, increase the WFF abatement threshold to $50,000 pa and increase the IWTC rate by $25 pw. This option:
  - had a cost of $406 million in 2024/25
  - was estimated to reduce child poverty by 19,000 on the AHC50 measure.
- **AT(d)**: remove the MFTC, increase the WFF abatement threshold to $50,000 pa and increase the IWTC rate by $10 pw. This option:
  - reduced the cost to $291 million but had slightly smaller reductions in child poverty – 16,000 on the AHC50 measure.

[28] Costings from March 2023 do not include operational costs.

141 While still meeting the objectives of supporting income adequacy and reducing child poverty, as well as improving financial incentives to work, these options (AT(c) and AT(d)) would also help to simplify the system. As these options include the removal of the MFTC they would require longer to implement than AT(a) and AT(b) and could be implemented by 1 April 2025.

142 Officials recommend against removing the MFTC unless further changes are made to reduce the number of families financially disadvantaged. Removing the MFTC would create difficulty and confusion for those currently in receipt of the payment and is likely to result in some families being financially disadvantaged. Previous modelling[29] estimates that AT(c) would result in:

- 6,000 households losing on average $35 pw (using TAWA modelling)
- 3,000 families currently receiving the MFTC would lose on average $79 pw (using IR modelling, which is not directly comparable to the TAWA modelling above).

143 To reduce the number of people made worse off by the changes, agencies would advise those eligible to transfer to benefit. This would likely eliminate most of the losses estimated above, as The Treasury and IR's models cannot estimate families moving onto benefit. A small group of very low-income working families would not be eligible for benefit and would be financially disadvantaged, for example Jobseeker Support couples, due to working 30 or more hours a week. As noted earlier, complementary changes to the benefit system would be required to enable couples to receive an abated benefit for longer.

144 An alternate option to removing the MFTC completely is to freeze the rate of MFTC or alternatively grandparent the current recipients and eventually remove the payment when all families have moved off. These types of options would have lower fiscal costs but would increase administrative complexity and have negative impacts for MFTC customers. Officials have not costed these options but can do so if Ministers are interested in future advice.

Section Three: Economic and fiscal context and child poverty reduction targets

145 Choices between higher and lower cost options depend on the Government's wider fiscal strategy and progress towards the ten-year child poverty reduction targets.

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[29] The number of families estimated to be financially disadvantaged are likely to be over-stated, as both estimates do not account for the fact that many affected families would be eligible to receive an abated benefit to offset their losses. However, there would be a small group of families who would not be eligible for benefits, for example, Jobseeker Support due to working more than 30 hours a week.

146 In the Budget Economic and Fiscal Update 2023, The Treasury estimated that the Budget 2024 operating allowances should be sufficient to cover cost pressures to existing services but will leave limited headroom for other operating investments. Further to this, pre-existing challenges such as demographic changes are expected to put pressure on the public finances in the coming years. As such, ongoing fiscal discipline and potentially difficult choices will be necessary to ensure a sustainable operating balance before gains and losses (OBEGAL) trajectory both during the forecast period and over the medium term.

147 This means that available funding for any potential changes to WFF in Budget 2024 will be significantly constrained, as spending will need to remain within allowances to maintain the fiscal strategy and help ensure a sustainable fiscal trajectory across the short and medium-term

148 **Appendix Three** sets out key trade-offs for consideration of the in-work payment options and the abatement threshold options discussed in Sections One and Two of this report:

- high-cost options for an in work payment: IWP(base) / IWP(c)
- lower-cost options for an in work payment: IWP(a) / IWP(b) / IWP(d)
- abatement threshold increase and complementary changes: AT(a) – (d).

Child Poverty targets

149 As officials have noted in previous advice, this review presents the biggest opportunity to make further progress towards child poverty targets in the coming years. Substantial investment since the targets were first set in 2018 has helped to make considerable progress in reducing child poverty, but sizeable reductions are still needed to reach the ten-year targets.

150 This is particularly the case on the before-housing-cost primary measure, which currently needs to be reduced by a further 7 percentage points or ~80,000 children. Large reductions are also still required on the after-housing-cost and the material hardship primary measures – in the order of 4-5 percentage points or ~50-60,000 children on each.

151 All the options in this report provide gains for working families only. Broadly half of children in poverty live in working households, so the benefits of these options are confined to this group. The other half of children in poverty are in households that rely on income from main benefits.

Section Four: Further work and timeframes for Cabinet report back

152 In the recent Cabinet paper "Future Direction of the Working for Families Review" it was noted that you would report back to Cabinet on the next steps of the Review by the end of the year [CAB-23-MIN-0178].

153 Depending on Government formation timelines following the election and other Government priorities during the post-election period, officials anticipate the most likely date for the Cabinet report back is December 2023.

Timing of subsequent advice

154 The decisions in the report on the preferred option/s for the WFF Review will enable a report back to Cabinet in December 2023. If Ministers would like to progress a WFF option for consideration in Budget 2024, timely decisions on the advice in this report will be required.

155 Through further work on the Review, officials have determined that there is insufficient time to develop a structural reform option for Budget 2024 (with an implementation date of 1 April 2025), though smaller-scale changes within the current system could still be considered. Options for structural reform could be considered in Budget 2025, with an implementation date of 1 April 2026.

156 If Ministers still would like to progress the in-work payment, officials will provide advice in late 2023 or early 2024 to enable decisions in Budget 2025 with an implementation date on or after 1 April 2026.

157 If the preferred outcome of the Review is to address the anticipated overlapping abatement of MFTC and WFF by one of the abatement threshold variations, then decisions related to this option could be progressed on standard timeframes. For implementation on 1 April 2025, funding could be sought through Budget 2024. However, as the overlap is not anticipated to occur until April 2026, this decision could be delayed and funding could be sought through Budget 2025 for implementation on 1 April 2026.

158 It would also be possible to implement the abatement threshold options that do not remove the MFTC (AT(a) and AT(b)) more quickly – by 1 April 2024. However, this would require urgent legislation passed by the end of 2023 and a pre-commitment against Budget 2024.

Public announcements related to the next steps of the Review

159 As part of the May 2023 Cabinet paper [CAB-23-MIN-0178 refers], Cabinet noted that any reactive communications about the next steps of the Review would indicate that a new in-work payment is a possible option being explored further, alongside consideration of changes to current settings.

160 Cabinet agreement would need to be sought again to make any further public announcements related to the options outlined in this report.

Next Steps

Inland Revenue advice on administrative improvements

161 In November 2022 (MSD REP/22/11/111) - IR2022/512), the Minister for Social Development and Employment and the Minister of Revenue agreed to some administrative improvements (providing a grace period on the death of a child, removing the historic Child Tax Credit, and improving information

sharing between MSD and IR) which would be $0.48 million over the forecast period and $0.156 million for outyears and which could be implemented as part of the reforms.

162 In March 2023 (MSD REP/23/3/169 - IR2023/018), we noted that we will provide further advice about minor administrative and remedial amendments. Inland Revenue officials are currently working through proposals including how they relate to the debt reduction work. Officials expect these to be in the range of $1 - 2 million a year. The changes identified so far could be implemented in time for an April 2025 start date if decisions are made in Budget 2024. We will provide further advice when we report to you on the broader package.

Ministerial discussion of this advice

163 Officials recommend you forward a copy of this advice to the Prime Minister, Minister for Children, Minister of Finance, Minister for Child Poverty Reduction and the Minister of Revenue and that a Ministerial meeting is set up to consider this advice and the next steps for the Review.

Appendices

- **Appendix One** – Previous options considered
- **Appendix Two** – Illustrative diagram of WFF tax credits – structural reform
- **Appendix Three** – Summary of option impacts and key trade-offs
- **Appendix Four** – Parameters of in-work payment options
- **Appendix Five** - Flow on impacts of the new in-work payment

Report numbers: REP/23/7/669; IR2023/216

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Appendix One – Previous options considered (figures from July 2022)

	Child poverty reduction	Household gains and losses	Annual fiscal cost
Improvements to the structure and design of in-work tax credits in order to make work pay			
Option 1: A single in work payment* proposes a significant structural change by introducing a single and more targeted in-work payment that combines the Minimum Family Tax Credit (MFTC) and In-Work Tax Credit (IWTC).	9,000 (BHC50) 28,000 (AHC50)	170,000 HHs gain by $81 per week. 24,000 HHs lose by $34 per week.	$675m
Option 2: An alternative MFTC proposes a smaller-scale change that largely keeps existing settings but replaces the MFTC with a similar, more flexible, payment for sole parents that abates gradually.	2,000 (BHC50) 2,000 (AHC50)	134,000 HHs gain by $5 per week. No HHs lose.	$35m
Option 3: IWTC phase-in removes the MFTC and phases in the IWTC more gradually as incomes increase and allows beneficiaries to receive the payment while on benefit (i.e., removes 'off benefit' rule).	1,000 (BHC) 1,000 (AHC50)	41,000 HHs gain by $33 per week. 20,000 HHs lose by $30 per week.	$38m
Option 4: Change benefit abatement settings removes the MFTC, retains the off-benefit rule for the IWTC and increases benefit abatement thresholds to better support families in part-time work.	1,000 (BHC50) 2,000 (AHC50)	225,000 HHs gain by $8 per week. No HHs lose.	$83m
Option 5: A single family tax credit with variations including: • removes the MFTC and IWTC, but increases the eldest child rate of FTC by $50pw, and subsequent child rate by $15pw • increases the FTC abatement threshold to $50,000 and reduces the abatement rate to 25% to help make work pay • introduces a two-tiered abatement regime to target increases more to lower-income working families and to reduce fiscal costs • options for phased implementation.	24,000 (BHC50) 27,000 (AHC50)	235,000 HHs gain by $46 per week. 24,000 HHs lose by $23 per week.	$540m
Improvements in the early years to assist with the costs of children and support choices around work and childcare			
Extending targeted Best Start payment to eligible families with children up to age five ($40pw).	5,000 (BHC50) 5,000 (AHC50)	49,000 HHs gain by $41 per week. No HHs lose.	$104m
Increasing Best Start by $40pw for eligible families up to age three.	5,000 (BHC50) 8,000 (AHC50)	68,000 HHs gain by $44 per week. No HHs lose.	$156m
Complementary changes that could further reduce child poverty alongside changes to in-work payments			
Increase FTC by $25pw per child.	32,000 (BHC50) 35,000 (AHC50)	267,000 HHs gain by $49 per week. 5,000 HHs lose by $3 per week.	$680m
Increase IWTC by $25pw.	6,000 (BHC50) 8,000 (AHC50)	161,000 HHs gain by $23 per week. No HHs lose.	$192m

** A version of this option is being proposed in the current advice*

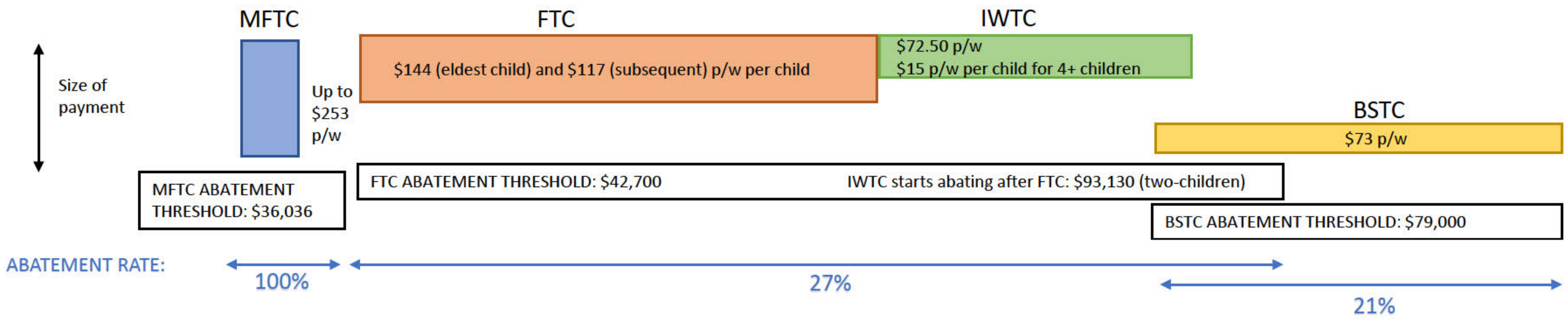
Appendix Two - Illustrative diagram of WFF tax credits – structural reform

Appendix Three – Summary of impacts and key trade-offs

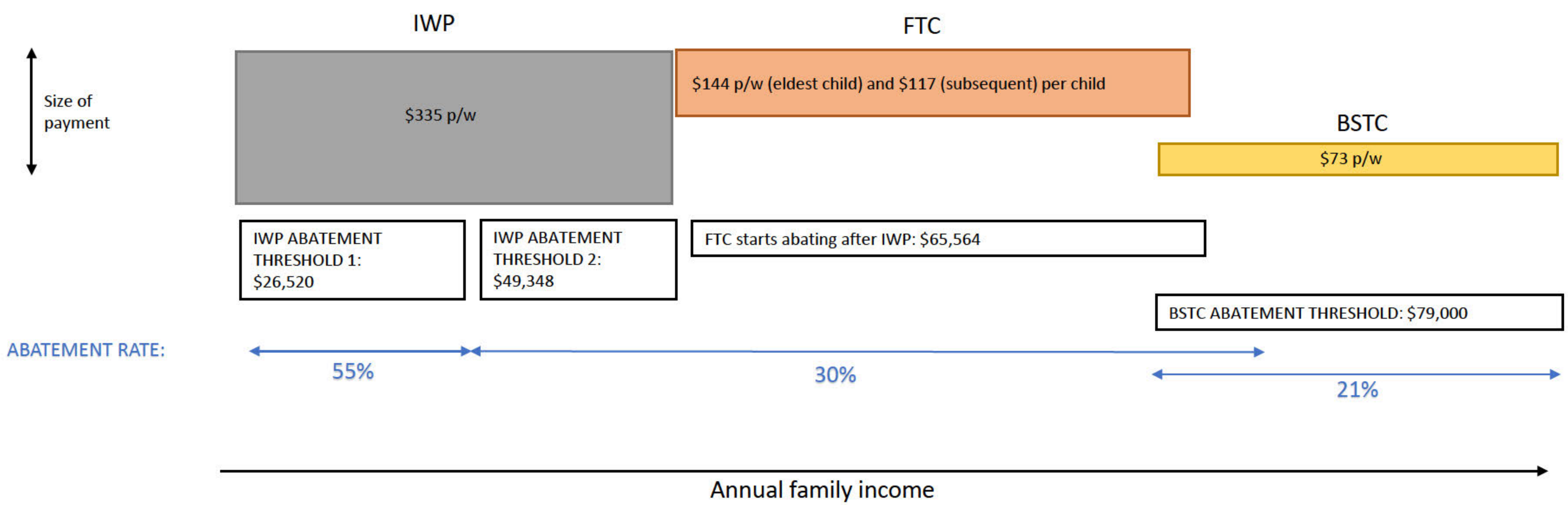
Appendix Four – Parameters of new in-work payments

Appendix Two – Illustrative diagram of WFF tax cre structural reform

Current WFF tax credits (as at 1 April 2025)



New in-work payment (IWP) replaces MFTC & IWTC – IWP (a)



Summary of impacts

Option	New, more generous, in-work payment (costings for 2025/26)					Abatement threshold increase + complementary changes (costings for 2024/25)			
	IWP(base)	IWP(a)	IWP(b)	IWP(c)	IWP(d)	AT(a)	AT(b)	AT(c)	AT(d)
Costs*	$690m	$343m	$221m	$617m	$240m	$238m	$309m	$406m	$291m
Child poverty	21,000 (BHC50) 26,000 (AHC50)	14,000 (BHC50) 14,000 (AHC50)	8,000 (BHC50) 7,000 (AHC50)	19,000 (BHC50) 23,000 (AHC50)	9,000 (BHC50) 10,000 (AHC50)	4,000 (BHC50) 11,000 (AHC50)	6,000 (BHC50) 17,000 (AHC50)	8,000 (BHC50) 19,000 (AHC50)	5,000 (BHC50) 16,000 (AHC50)
Gainers / losers	170,000 HHs gain $78pw	148,000 HHs gain $45pw 5,000 HHs lose $20pw	136,000 HHs gain $33pw 11,000 HHs lose $18pw	173,000 HHs gain $68pw	142,000 HHs gain $34pw 11,000 HHs lose $20pw	152,000 HHs gain $30pw	173,000 HHs gain $34pw	173,000 HHs gain $46pw 6,000 HHs lose $35pw	167,000 HHs gain $35pw 7,000 HHs lose $36pw
Benefit/work interface	Having a large weekly payment with no hours test creates tensions with the benefit system in relation to work obligations and sanctions for a near-equivalent rate of payment in the benefit system.				Mitigates tension with benefit system and provides greater incentives to work more by retaining hours test for full amount of payment.	Status quo.		A small number of low-income working families will receive benefits for longer – and benefit system changes required.	
Administration	Moderate simplification due to removal of MFTC with hours test. No need to notify IR of changes to work hours (similar to IWTC currently).				Higher compliance costs for clients with variable working hours and is significantly more complex to administer than the current system.	Minor administrative impact. These options could be implemented from 1 April 2024 if urgent legislation is passed before the end of 2023.		Moderate simplification through removal of MFTC. These changes could not be implemented before 1 April 2025 due to the removal of the MFTC.	
Incentives to work / make work pay	Improves the returns from working full-time for sole parents and primary earners in couples, reduces financial incentives for second earners in couples.	Same as IWP(base) for increased financial incentives for sole parents and reduced financial incentives for secondary earners. The lower payment rate perpetuates an existing issue that means couples are not necessarily better off off-benefit at 30 hours on the minimum wage. Benefit system changes could be considered to enable couples to receive a benefit for longer to avoid being worse off.				Generally slightly improves the returns from working more hours (particularly for those with earnings above the minimum wage), reduces financial incentives for second earners in couples.			
EMTRs	Increases abatement rate slightly resulting in higher EMTRs compared to the status quo. Also: Eliminates overlapping abatement of main benefits and FTC. Increases overlapping abatement of FTC with BSTC.	Same as IWP(base)		Maintains EMTRs at or below current levels. Also: Eliminates overlapping abatement of main benefits and FTC. Increases overlapping abatement of FTC with BSTC similar to IWP(base).	Same as IWP(base)	Ensures people don't face overlapping abatement or EMTRs over 100% due to MFTC/FTC. Reduces overlapping abatement of FTC with main benefits. Increases overlapping abatement of IWTC with BSTC.			

* The fiscal costs will continue to be refined as officials work through the detailed policy parameters, include operational/IT costs, and use more up-to-date forecasts (PREFU).

Appendix Three – Summary of impacts and key trad

High-cost options for an in work payment – IWP(base) / IWP(c)

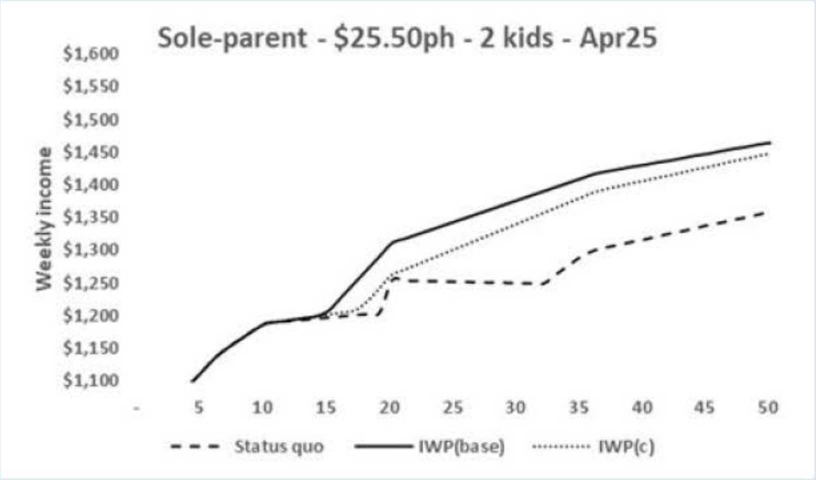
Choice between IWP(base) and IWP(c) is between:

- **A high payment rate, or**
- **A lower abatement rates/EMTRs.**

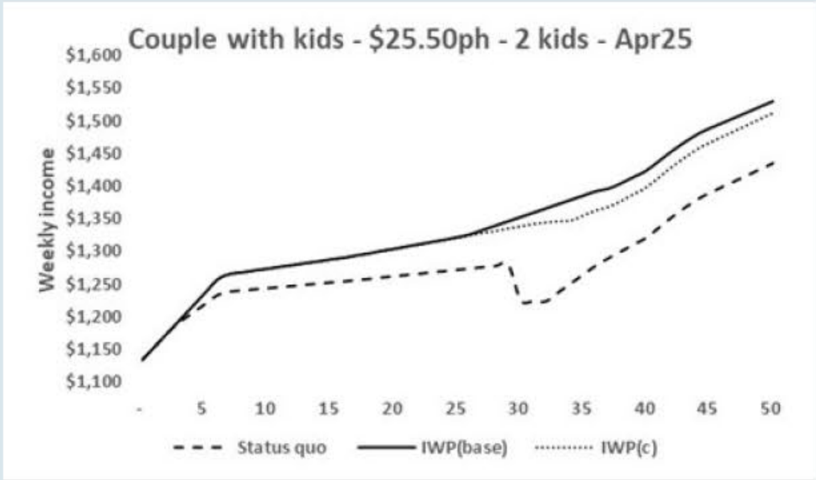
The **high payment rate** ensures that couples as well as sole parents are better off off-benefit at 30 hours of work a week on the minimum wage. However, couples are a small proportion of the target population and higher payments to couples tend to reduce the labour supply of secondary earners overall. The trade-off for the high payment rate requires higher abatement settings than IWP(c) and results in higher EMTRs/reduced financial incentives to work.

A **lower abatement rate** maintains EMTRs at or below current levels, but trade-offs a reducing to a medium payment rate than means couples may not be better off off-benefit.

Sole parent income by hours worked (no WEP)



Couple income by hours worked (no WEP)



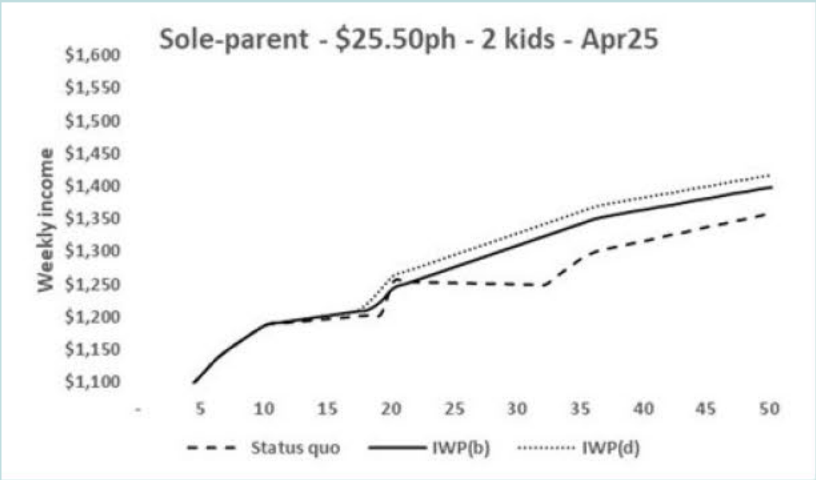
Lower-cost options for an in work payment – IWP(a) / IWP(b) / IWP(d)

Choices between IWP(a) / IWP(b) and IWP(d) are:

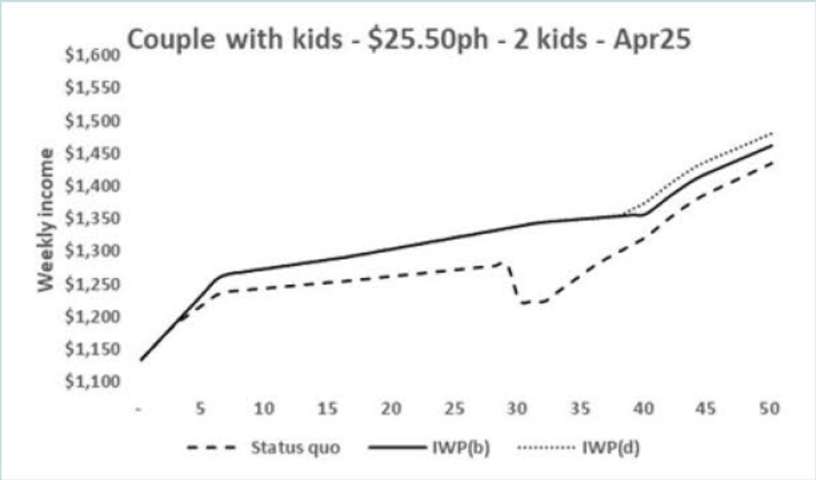
- **The payment rate** – A low payment rate provides a lower amount than the current system on 1 April 2025, but sole parents are still better off overall off-benefit at 20 hours of work if there are increases to the minimum wage. A medium payment rate provides an equivalent amount to the current system and means families retain more of the gains from an increase to the minimum wage.

- Whether to introduce **an hours test** to mitigate the tension with benefit system created by a person being able to receive a similar amount of support from the in-work payment as the benefit system, but with minimal work obligations and no sanctions. However, hours test creates significant administrative complexity for clients and agencies.

Sole parent income by hours worked (no WEP)



Couple income by hours worked (no WEP)



Abatement threshold increase + complementary changes – AT(a)-(d)

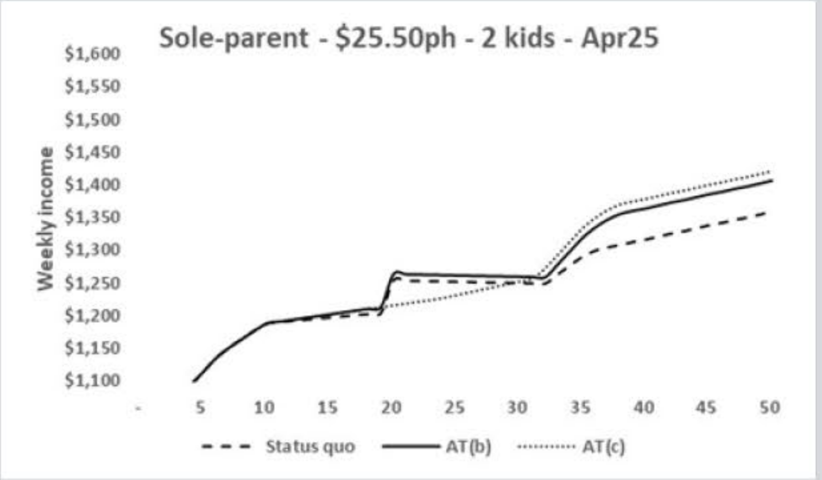
Choices between AT(a)-(c) are:

- Whether to **remove or retain the MFTC**, and
- The **size of the IWTC increase.**

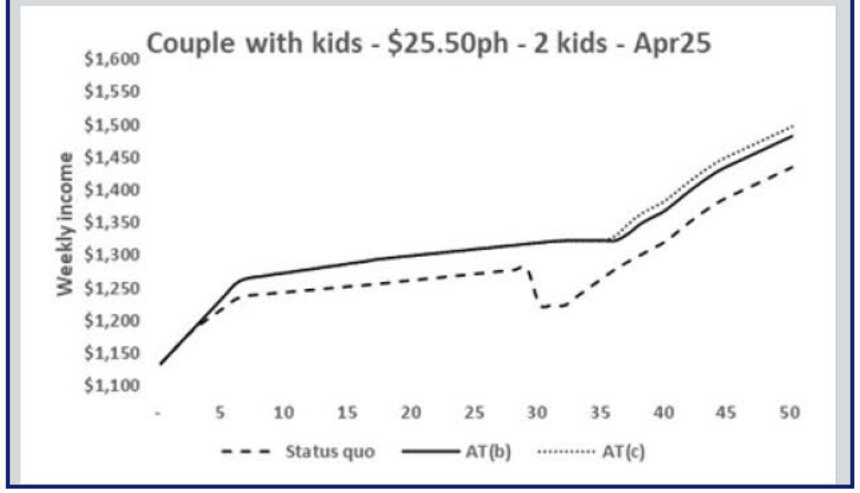
Options that **retain the MFTC** do not address the key issues with this payment (high EMTRs, administrative complexity, debt). Options that remove the MFTC would mean more working families receiving benefits.

Larger **IWTC increases** cost more but have greater reductions in child poverty.

Sole parent income by hours worked (no WEP)



Couple income by hours worked (no WEP)



Appendix Four – Parameters of in-work payment op

Parameters

	Status quo	New, more generous, in-work payment (2025/26)					Abatement threshold increase + complementary changes (2024/25)			
		IWP (base)	IWP(a)	IWP(b)	IWP(c)	IWP(d)	AT (a)	AT(b)	AT(c)	AT(d)
In work payment (annual)	N/A	$19,968	$17,420	$16,432	$17,420	$17,420	N/A			
In work payment (weekly)	N/A	$384pw	$335pw	$316pw	$335pw	$335pw	N/A			
Payment rate based on sole parent or couple	Sole parent	Couple	Sole parent	Sole parent	Sole parent	Sole parent	N/A			
Amount for being 'off-benefit'	$72.50pw	$384pw	$335pw	$316pw	$335pw	$100pw	$72.50pw	$82.50pw	$97.50pw	$82.50pw
Amount for being 'off benefit' and meeting hours test	$72.50pw +MFTC (up to $253pw for min wage earner)	N/A – same as above				Hours test - $335pw	$72.50pw +MFTC (up to $253pw for min wage earner)	$82.50pw +MFTC (up to $253pw for min wage earner)	$97.50pw (MFTC removed)	$82.50pw (MFTC removed)
Abatement threshold(s)	Abates after FTC	$26,520 $49,348	$26,520 $49,348	$26,520 $49,348	$26,520 $49,348	$26,520 $49,348	Abates after FTC			
Abatement rate(s)	27%	55% 30%	55% 30%	55% 30%	50% 27%	55% 30%	27%			
FTC abatement threshold / rate	$42,700 27%	$74,057 30%	$65,564 30%	$62,270 30%	$71,593 27%	$65,564 30%	$50,000 27%			

[

Appendix Five: Flow on impacts of the new in-work payment

- **Eligibility for the self-employed** – Officials are likely to recommend that the new in-work payment would include self-employed people, but further work would need to be undertaken to confirm this and examine its specific implications. For example, a higher payment may result in more incentives to game. Under the status quo, self-employed people are eligible for the IWTC only and not the MFTC, for reasons that are partly historical in nature, and because of an increased incentive to game for self-employed people.
- **Shared care –** Currently the full amount of IWTC is available for each parent with shared care of a child, whereas the FTC is apportioned between parents depending on the level of care. Modelling for this report has assumed the same rules as the IWTC. There is a question as to how the shared care rules would apply to the new in-work payment, and whether the same rules apply as for the IWTC. The Minister for Social Development and Employment recently received initial advice on options to address split and shared care within the welfare system [REP/23/6/583].
- **OB/UCB/FCA –** Caregivers cannot currently receive OB/UCB/FCA and the FTC for the same child, as these payments are considered analogous. However, caregivers can receive both the IWTC and the OB/UCB/FCA, if they qualify. Decisions would be required on whether the same settings should apply to the new in-work payment.
- **4+ IWTC rate –** The current IWTC includes a per-child rate of $15 pw for the 4th and subsequent children, which did not feature in the original design of Option 1B included in previous advice. There is a policy question as to whether to retain the rate or remove it - removing it would potentially disadvantage some larger working families.
- **Detailed abatement and ring-fencing rules** – The shift from IWTC/MFTC to the new in-work payment may have implications for rules about how income and abatement settings are operationalised in practice. Detailed policy settings are yet to be confirmed. There may be some families who are financially disadvantaged from these changes.

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Briefing note

Reference:	BN2023/301
Date:	20 December 2023
To:	Revenue Advisor, Minister of Revenue – Lonnie Liu Private Secretary, Minister of Revenue – Helen Kuy
From:	Richard McLaughlan
Subject:	Minimum family tax credit consequential amendment

Purpose

1. This briefing note provides information on a consequential amendment to the Minimum Family Tax Credit (MFTC) threshold resulting changes to the indexation method for main benefit rates. It also identifies future areas of work in relation to the tax and transfer system.

Background

Main benefit indexation

2. The Government has agreed to index the rate of main benefits to inflation (upwards movement in the Consumers Price Index (CPI)) from 1 April 2024 [CAB-23-MIN-0490 refers]. This will replace the current legislative requirement, which has been in force since 2019, to adjust main benefits by net average wage growth at the Annual General Adjustment (AGA).[1]

3. We understand that a part of the Government's rationale for indexing main benefits to inflation is to ensure cost effectiveness in annual adjustments to main benefit rates.

Minimum family tax credit threshold

4. The MFTC, which is part of the Working for Families scheme, seeks to provide a financial incentive to work by ensuring that low income working families remain financially better off in full time work then they would be on a main benefit. The current MFTC calculation ensures sole parents are better off working and receiving the MFTC than they would be receiving a benefit on an annual basis [CAB-21-MIN-0116.33 refers].

5. The MFTC threshold is tied to main benefit rates. That is, as main benefit rates are proposed to increase with upwards movement in the CPI from 1 April 2024, the MFTC threshold will also need to be increased to maintain the policy intent of the payment. Therefore, the Government has agreed that the annual amount of the

[1] This is the annual process undertaken by MSD to adjust benefit and payment rates to account for either the Consumers Price Index or net average wage changes.

MFTC increase from $34,217 to $35,360 (after tax) for the tax year beginning 1 April 2024 [CAB-23-MIN-0490 refers].

Fiscal savings

6. The MFTC threshold increase is already included in the budget forecasts created in the Half-yearly Economic and Fiscal Update 2023. However, this was based on main benefits being adjusted by changes in net average wage growth.

7. Indexing main benefits to upwards movement in the CPI from 1 April 2024 will result in smaller increases to the MFTC threshold over time. This will save approximately $7 million over the forecast period.

Legislation

8. Depending on other legislative priorities and available House time, it is proposed that an omnibus bill is introduced into the house early next year on approximately 12 February 2024. This bill would contain Social Security Act 2018 amendments for benefit indexation, as well as Income Tax Act 2007 consequential amendments for the MFTC threshold.

9. The Ministry of Social Development (MSD) will be the lead agency responsible for progressing the omnibus bill. Inland Revenue will be consulted where appropriate in relation to the MFTC threshold.

10. The bill will need to be enacted prior to 20 February 2024. This is so Inland Revenue can notify affected customers of this change in their new notices of entitlement.

11. The timing of issuing these notices gives customers four weeks to review their details and notify Inland Revenue of any required changes prior to 1 April. This timing also ensures customers know what their entitlements are going to be, can plan their household budget, and get paid the right entitlement, avoiding debt. Customers who receive the MFTC require high levels of reassurance from Inland Revenue during this time and are a particularly vulnerable customer group, so certainty of entitlements, and early notification of changes, is highly desirable.

Future work

12. s 9(2)(g)(i) [redacted]

13. Inland Revenue is also undertaking a stewardship project on Working for Families and will provide advice in 2024 on how this work relates to the Government's priorities.

Consultation

14. The Treasury was not informed about this briefing note.

15. The Ministry of Social Development was consulted on this briefing note.

Richard McLaughlan
Senior Policy Advisor
s 9(2)(a) [redacted]

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Memo

10-01-2023

To: s 9(2)(a)

From: Richard McLaughlan

Omnibus bill query – MFTC threshold

This memo seeks preliminary advice on whether a threshold adjustment to the Minimum Family Tax Credit (MFTC) can be included in an omnibus bill alongside changes to the indexation method for main benefit rates. This would require there to be a single broad policy linking the two changes.

Social security indexation changes

The Government has agreed to index the rate of main benefits to inflation (upwards movement in the Consumers Price Index (CPI)) from 1 April 2024 [CAB-23-MIN-0490 refers]. This will replace the current legislative requirement, which has been in force since 2020, to adjust main benefits by net average wage growth at the Annual General Adjustment (AGA).

To facilitate this change, amendments are required to the Social Security Act 2018. This will allow the indexation of main benefits to be tied to changes in the CPI and will affect the payment rate of MFTC from 1 April 2024 onwards.

Minimum family tax credit threshold

The MFTC, which is part of the Working for Families scheme, seeks to provide a financial incentive to work by ensuring that low income working families remain financially better off in full time work then they would be on a main benefit. The current MFTC calculation ensures sole parents are better off working and receiving the MFTC than they would be receiving a benefit on an annual basis [CAB-21-MIN-0116.33 refers].

The MFTC threshold is tied to main benefit rates. That is, as main benefit rates are proposed to increase with upwards movement in the CPI from 1 April 2024, the MFTC threshold will also need to be increased to maintain the policy intent of the payment. Therefore, the Government has also agreed that the annual amount of the MFTC increase from $34,217 to $35,360 (after tax) for the tax year beginning 1 April 2024 [CAB-23-MIN-0490 refers].

To facilitate an increase to the MFTC threshold an amendment is required to the Income Tax Act 2007.

Single broad policy

Under Standing Order 267 an omnibus bill that amends more than one Act may be introduced if the amendments deal with an interrelated topic that can be regarded as implementing a single broad policy. The indexation of main benefits is included in the Social Security Act 2018, however, Working for Families tax credits including the MFTC are included in the Income Tax Act 2007.

There is a strong connection between the MFTC and main benefits. These payments both address income adequacy and are a part of the government's income support scheme.

The single broad policy is to provide for a benefit system that responds to increases in the cost of living without creating perverse work incentives. The policy would allow for upwards adjustments of main benefit rates, based on movements in the consumers price index. However, it would also ensure that low-income working families remain better off in full time work then they would be on a main benefit.

This policy protects the real incomes of benefit recipients as well as financial incentive to work. For the tax credit system to work as intended, the lower limit of the MFTC must increase according to the increase in main benefits. This maintains rate relativities and work incentives.

The increase to the MFTC threshold occurs alongside any changes made to main benefit rates. The AGA, and the beginning of a tax year, both take effect on 1 April of any given year. Usually, the prescribed amount of the MFTC is increased by an Order in Council, once either wage growth or CPI indexation information that will be used for the indexation of benefits is made available.

Richard McLaughlan
Senior Policy Advisor

Appendix A
Document 8

MINISTRY OF SOCIAL DEVELOPMENT
TE MANATŪ WHAKAHIATO ORA

DEPARTMENT OF THE PRIME MINISTER AND CABINET
TE TARI O TE PIRIMIA ME TE KOMITI MATUA

Inland Revenue
Te Tari Taake

TE TAI ŌHANGA
THE TREASURY

Tax policy report: **Working for Families Review: CPI indexation of Family Tax Credit/Best Start Tax Credit and adjustment of Minimum Family Tax Credit threshold**

Date:	27 September 2022	**Priority:**	High
Security level:		**Report number:**	IR2022/440, REP/22/9/900 T2022/2142, DPMC-2022/23-300

Action sought

	Action sought	Deadline
Prime Minister Minister for Child Poverty Reduction	**Discuss** report at the Income Support Ministers Meeting on 5 October **Agree** to recommendations	7 October 2022
Minister of Finance	**Discuss** report at the Income Support Ministers Meeting on 5 October **Agree** to recommendations	7 October 2022
Minister for Children	**Discuss** report at the Income Support Ministers Meeting on 5 October **Agree** to recommendations	7 October 2022
Minister for Social Development and Employment	**Discuss** report at the Income Support Ministers Meeting on 5 October **Agree** to recommendations	7 October 2022
Minister of Revenue	**Discuss** report at the Income Support Ministers Meeting on 5 October **Agree** to recommendations	7 October 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Eina Wong	Principal Policy Advisor, Policy and Regulatory Stewardship, Inland Revenue	s 9(2)(a) s 9(2)(a)
Polly Vowles	Policy Manager, Welfare System and Income Support, Ministry of Social Development	s 9(2)(a) s 9(2)(a)
Laura Browne	Senior Analyst, Welfare and Oranga Tamariki, The Treasury	s 9(2)(a)
Deborah Tucker	Principal Analyst, Child Wellbeing and Poverty Reduction, Department of the Prime Minister and Cabinet	s 9(2)(a) s 9(2)(a)

27 September 2022

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

Working for Families Review: CPI indexation of Family Tax Credit/Best Start Tax Credit and adjustment of Minimum Family Tax Credit threshold

Executive summary

1. Under current Working for Families (WFF) legislation, the Family Tax Credit (FTC) and Best Start Tax Credit (BSTC) payment rates must be increased to match inflation at specified times. The rates are increased once the cumulative value of quarterly increases in the Consumers Price Index (CPI) reaches 5% since the payment rates for these credits were last adjusted (which in this case last occurred on 1 October 2021). Any change to credit payment rates takes effect at the start of the following tax year.

2. Because of the higher rate of inflation this year, we anticipate the 5% cumulative CPI threshold will be exceeded at the end of the September 2022 quarter. This means higher payments would be required from 1 April 2023.

3. Current Cabinet policy also requires the Minimum Family Tax Credit (MFTC) threshold to be adjusted to ensure MFTC recipients continue to be better off financially in work than they would be on a main benefit. As main benefits will increase with wage growth, the MFTC threshold will also need to be increased from 1 April 2023.

4. The FTC and BSTC rates and the MFTC threshold can be adjusted by Order in Council. This will need to occur by **1 December 2022** to apply from 1 April 2023.

5. Officials are preparing advice on policy options as part of the WFF Review for Income Support Ministers for November. While the options being considered could impact on FTC, BSTC, and MFTC, they would not be implemented until 1 April 2024 at the earliest. The indexation adjustments would maintain the value of the tax credits in the interim.

6. If Ministers wish to increase the FTC or BSTC beyond the indexation adjustments for the income year beginning 1 April 2023, officials will provide you with urgent advice on the implications for timeframes and any interactions with the wider WFF Review. This may also affect our ability to provide the full WFF Review advice requested for the November Income Support Ministers' meeting.

Recommended action

We recommend that you:

1. **Note** the legislative requirement to CPI index FTC and BSTC rates, regardless of other decisions Ministers may make in relation to the WFF Review.

Noted

2. **Note** that the exact CPI increases for FTC and BSTC rates will be confirmed in mid-October with officials reporting to Ministers shortly after with updated rates for final approval, and the rates would need to be enacted in legislation by 1 December 2022.

Noted

3. **Note** that Cabinet agreed to increase the MFTC threshold in line with increases to main benefit rates, which increase by wage growth every year.

Noted

4. **Note** that, until decisions under the WFF Review have been made, Cabinet agreed the calculation for the MFTC threshold beginning in the 2021-22 tax year would ensure that only sole parents working 20 hours per week are better off when averaging the Winter Energy Payment over the year.

Noted

5. **Note** that policy options under consideration as part of the WFF Review that may increase or otherwise impact on FTC, BSTC, or MFTC could be implemented from 1 April 2024 at the earliest, and the CPI indexation adjustments would be required to maintain the value of these tax credits in the interim.

Noted

6. **Agree** to make CPI-indexation increases to FTC and BSTC rates applying from 1 April 2023. **[Recommended]**

Agreed / Not agreed

7. **Note** that it is possible to further increase the FTC and BSTC payments beyond the indexation adjustment for 1 April 2023; however, doing so would require:

   7.1 a pre-commitment to Budget 2023 and may affect the fiscal costs of future changes in the WFF Review, and

   7.2 Cabinet policy decisions by 28 November 2022 to enable urgent primary legislation to be enacted by 1 December 2022.

Noted

8. **Direct** officials to provide additional policy advice on increasing the FTC and/or BSTC rates beyond the indexation adjusted amounts.

Directed / Not directed

9. **Agree** to increase the MFTC threshold from 1 April 2023, reflecting the forecast wage indexation of main benefits, in line with the current agreed approach. **[Recommended]**

Agreed / Not agreed

10. **Note** that if Ministers agree, the following timeline will apply:

18 October 2022	**Stats NZ release Sept quarter CPI figures**
Late-October	Final decisions from Ministers Officials prepare Cabinet paper Begin drafting Orders in Council (or primary legislation if recommendation 8, above, is selected).
16 November	Cabinet paper to be lodged
24 November	Cabinet paper considered by LEG
28 November	Decisions confirmed by Cabinet and incorporated legislatively
December	Public announcement
1 April 2023	Rate changes come into effect

s 9(2)(a) [redacted]

Clare Ward
Executive Director
Child Wellbeing and Poverty Reduction
Department of the Prime Minister
and Cabinet
27/09/2022

s 9(2)(a) [redacted]

Keiran Kennedy
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27/09/2022

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Rt Hon Jacinda Ardern
Prime Minister
Minister for Child Poverty Reduction
/ /2022

Hon Grant Robertson
Minister of Finance

/ /2022

Hon Kelvin Davis
Minister for Children

/ /2022

Hon Carmel Sepuloni
Minister for Social Development and Employment
/ /2022

Hon David Parker
Minister for Revenue
/ /2022

Background

CPI inflation adjustment of FTC and BSTC required by legislation

11. Under the Income Tax Act 2007, the Family Tax Credit (FTC) and Best Start Tax Credit (BSTC) payment rates must be adjusted for inflation once the cumulative value of quarterly increases in the CPI reaches 5% since the payment rates were last adjusted. These inflation-indexed increases in payment rates ensure FTC and BSTC maintain their real value over time. The process for setting and authorising rates through Orders in Council is set out in the Income Tax Act 2007.

12. The payment rates for the FTC and BSTC were last set by legislative amendment incorporating inflation up to the end of September 2021. This means the cumulative count of inflation began from 1 October 2021. Due to the current high rates of inflation, it is anticipated that the 5% cumulative threshold will be exceeded by the end of the September 2022 quarter. Once this is confirmed by StatsNZ, increases to FTC and BSTC rates will need to be made by Order in Council no later than 1 December 2022. The new, adjusted FTC and BSTC payment rates will apply from 1 April 2023.

13. Final CPI figures will be available on 18 October 2022. The relevant percentage increases and new rates will be confirmed in a subsequent report and the Cabinet paper.

MFTC annual adjustment

14. Unlike the CPI indexation of FTC and BSTC, the adjustment of the Minimum Family Tax Credit (MFTC) threshold is required under current Cabinet policy rather than by legislation. The intention is to ensure low income working families remain better off financially in full time work than they would be on a main benefit. This helps support people in moving from a main benefit to full-time work.[1] Because benefit rates are expected to increase from 1 April 2023 to reflect wage growth, the MFTC threshold needs to be adjusted to ensure this policy intention is achieved.

15. The way the MFTC threshold is calculated has changed over the last few years. Because the Winter Energy Payment is paid for part of the year, the MFTC threshold calculation was adjusted to take this into account beginning 1 July 2021. Cabinet changed the calculation as part of a series of changes to benefit settings and WFF rates to balance fiscal cost, financial incentives to work and the cost of options being considered through the WFF Review. The current method ensures sole parents are better off working and receiving the MFTC than they would be receiving a benefit on an annual basis [CAB-21-MIN-0116.33 refers]. This calculation change was intended for the duration of the WFF Review.

16. Officials have calculated the threshold adjustment using the same approach as agreed by Ministers last year, using current forecasts of wage growth that adjust benefit rates.[2] The current MFTC rate is $32,864 net of tax and the current forecasted increase in benefits is 3.4% based on the June 2022 quarter.

17. The MFTC threshold for 1 April 2023 has been calculated as $33,852 net of tax, equivalent to a gross income of $39,828. This is based on estimates of MSD's sole-parent benefit rates for 2023, and five months of Winter Energy Payments spread over 12 months (flat-rate WEP option).

[1] Full-time is defined as working 20 hours or more per week for sole parents and 30 hours or more per week for couples, as defined in s MA 7 of the Income Tax Act 2007.
[2] in REP/21/3/318; T2021/814; IR2021/144 of 30 March 2021, and CAB-21-MIN-0116.33 refers.

Discussion

Timing of legislation and potential impacts of further increases beyond indexation adjustments

18. Officials are currently preparing further advice on two options for structural changes to WFF and will provide an update to Ministers in late September and further detailed advice in November.

19. Both the FTC and BSTC rates and the MFTC threshold can be adjusted by Order in Council by 1 December 2022. On occasion, these rates have been increased by legislative amendment (e.g., 2021 when the rates were increased by more than the CPI adjustment).

20. If Ministers agree to make the CPI-indexation increases with no additional rate increases, then this will be done via Order in Council. We will report in mid- to late-October once the final CPI figures are confirmed and seek final agreement to the rates, threshold adjustments and next steps.

21. If, on the other hand, Ministers prefer to consider further measures (in addition to the indexation of the FTC and BSTC) alongside the indexation round, officials will provide urgent advice on changes that could be implemented in these timeframes. In our view, any further measures should be confined to changes to the FTC and BSTC payment rates, rather than further changes such as abatement rate increases. Either way, there would be trade-offs with an additional increase in advance of the more significant reform options in terms of de-prioritising the review and increasing the costs of implementation of the reform options.

22. If Ministers want to make additional changes, this would require urgent amendments to primary legislation to be passed by 1 December at the latest. This may affect our ability to provide the full WFF Review advice requested for the November Income Support Ministers' meeting. The cost of the decision would need to be pre-committed against the Budget 2023 allowance. However, the choice would have to be made without detailed advice on alternative options to advance the Government's priorities through the Budget process or final advice on the economic and fiscal context. Generally, there is a high bar for taking such decisions.

23. Related to a potential additional increase, caregivers who receive the Orphan's Benefit (OB), Unsupported Child's Benefit (UCB) and Foster Care Allowance (FCA) do not qualify for FTC for the same child. However, increases to FTC rates have resulted in commensurate increases to the base rates of the OB, UCB, and FCA in 2005, 2007, 2018 and 2022. This is because the FTC makes a partial contribution towards the costs of raising children. The OB, UCB and FCA are indexed to the CPI and are adjusted each year on 1 April. If Ministers progress additional increases to FTC beyond indexation, these will not automatically flow on to increases to OB, UCB and FCA. Officials will include options to pass the increases on if subsequent advice is requested.

Child poverty targets

24. The 2022 Child Poverty Budget Report shows child poverty rates on the primary income poverty measures are estimated to be above the target rate for the current three-year targets, which are due to be achieved in the 2023/24 financial year.

25. The modelling shows that rates are expected to be about 2.9ppt (31,000 children) above the second intermediate BHC50[3] target rate and 1.4ppt (15,000 children)

[3] The before-housing-costs moving-line measure – second intermediate target rate is 10%.

above the AHC50[4] target rate. We cannot model material hardship rates, but there is a risk that the downward trajectory in material hardship rates in recent years may not continue.

26. An additional increase in Budget 2023 would have a positive impact on the second intermediate targets; however, because rates in a given year are based on a two-year rolling average, only about half of the impact of any change implemented in mid-2023 would be reflected in the measured rates in the 2023/24 target year.

27. More significant WFF review changes implemented in Budget 2024 would have a partial impact in the first year of the third round of intermediate targets, but then a full impact in the subsequent two years that lead up to the 10-year targets, which are due to be achieved in 2027/28.

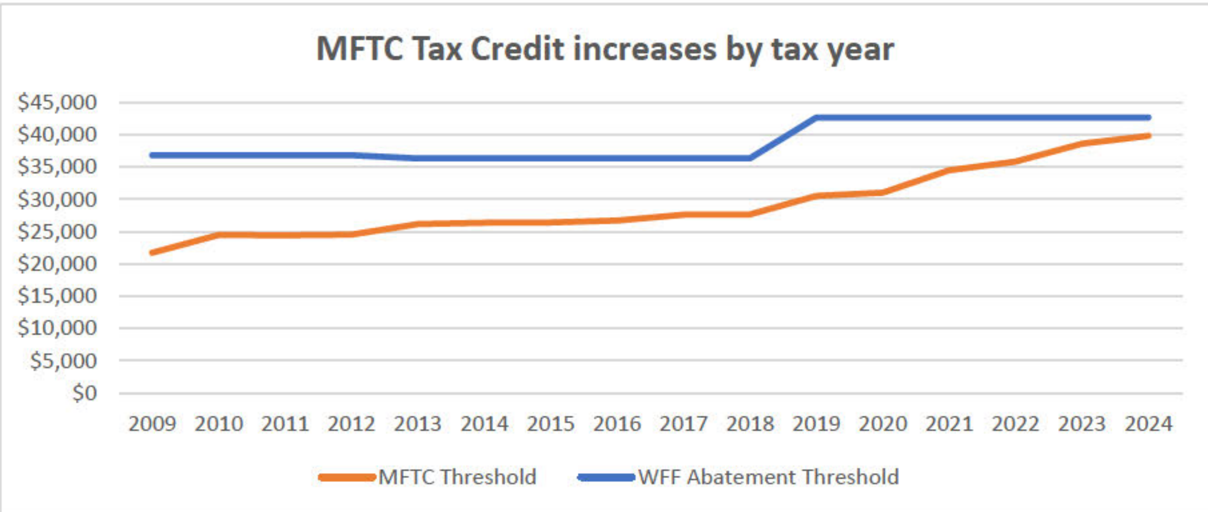
Risk of MFTC threshold and WFF abatement threshold overlapping

28. The gross income threshold rate of MFTC is estimated to be $39,828 from 1 April 2023 and the WFF abatement threshold is $42,700. As noted in the recent WFF advice, there is the risk that the MFTC and WFF abatement thresholds will soon overlap.

29. Although Treasury's forecast suggests this overlap could occur in the 2026 income tax year, it could occur sooner if benefit payments increase by more than wage growth (such as with one-off increases to main benefit rates). In that event, a small group of low-middle income households will face effective marginal tax rates of more than 100%. This means these households will lose more in financial support than they receive in additional wages from pay rises or extra hours.[5]

30. Both the options being considered as part of the WFF Review remove the MFTC threshold and increase the FTC abatement threshold. If Ministers decide to delay the implementation of the options being considered in the WFF review, officials will monitor the risk of overlapping abatement and provide advice on options to address this issue.

Figure 1: increases to gross MFTC thresholds relative to the WFF abatement threshold



Source: IRD.

[4] The after-housing-costs fixed-line measure – second intermediate target rate is 15%.
[5] Currently, around 4,450 families receive the MFTC.

Anticipated Fiscal Costs of Indexation

31. The anticipated rate increases are set out in the table below. These are based on forecast CPI data. The table also provides the estimated fiscal costs (as compared to not changing the entitlements at all).

32. The Budget 2022 Fiscal Forecasts have assumed that this indexation occurs and the above fiscal costs are already included in the fiscal forecasts. Any fiscal costs will occur to the extent that the change in the rates differs from the Budget 2022 Fiscal Forecasts.

Tax credit payment: (annualised)	**From ($)**	**To ($)**	**Change ($)**	**Fiscal cost ($m)**
Family Tax Credit				
Eldest child rate	6,642	7,072	430	223
Subsequent child rate	5,412	5,762	350	
Best Start Tax Credit	3,388	3,607	219	21
Minimum Family Tax Credit threshold	32,864	33,852	988	4
In-work Tax Credit*	3,770	3,770	0	17

* The fiscal cost of the IWTC is a flow-on consequence of increasing the FTC.

Next steps

33. Officials will provide final numbers once the September quarter CPI figures are released, in mid-October. Following decisions by joint Ministers, officials will seek your direction to prepare a draft Cabinet paper and issue drafting instructions. Officials recommend that the Minister of Revenue be invited to submit a paper for LEG.

34. The Cabinet paper will need to be lodged by 16 November 2022 at the latest to ensure Cabinet decisions are made before 1 December.

35. Officials will work with your Offices on the details for any announcement.

Table 1: Timeline for rate increase

Timeline	**Deliverable**
18 October 2022	Stats NZ release Sept quarter CPI figures
Late-October	Final decisions from Ministers Officials prepare Cabinet paper Begin drafting Orders in Council (or primary legislation if further increases are selected)
16 November	Cabinet paper to be lodged

24 November	Cabinet paper considered by LEG
28 November	Decisions confirmed by Cabinet and incorporated legislatively
December	Public announcement
1 April 2023	Rate changes come into effect

Update on Working for Families – October Income Support Ministers meeting

Appendix A
Document 9

1. Purpose of this update

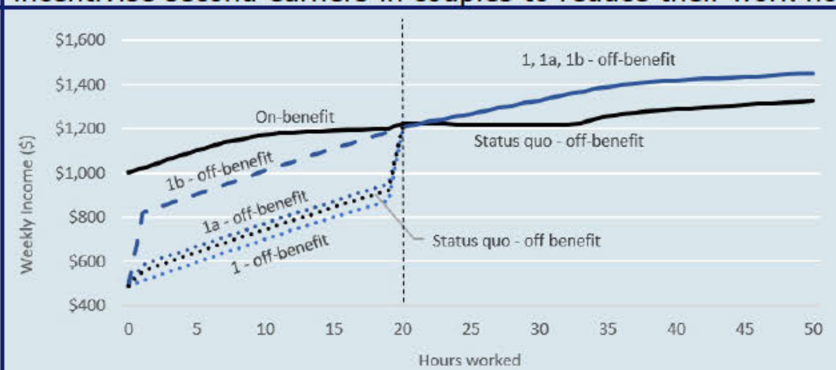
- Provide a high-level overview of the detailed advice and modelling that will be included in the substantive advice in November.
- Present initial modelling to show how the variations of options address specific concerns raised, and highlight the different choices for Ministers on the design of WFF and the benefit/tax credit interface.
- Seek feedback on the direction of travel, or whether there are any particular areas of interest for further work, to help inform the November advice.

2. An updated options set is being developed for Ministers to consider in the substantive November advice

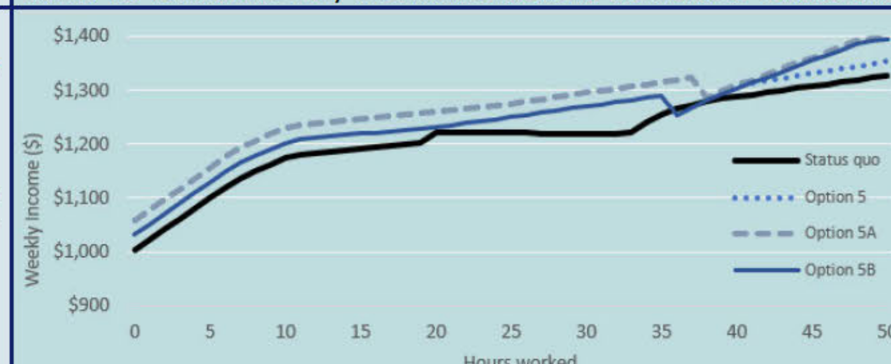
	1. Maintaining an in-work payment			**5. A single tax credit**		
Context and options	**Option Summary:** Maintains an in-work payment and has a strong focus on making work pay by also increasing the generosity of this payment. **Request for more advice:** how can this option (a) better support families who don't meet the hours test and (b) improve its BHC50 outcomes. **Variations of options:** The new in-work payment would only be available to families off-benefit who regularly meet the hours test (to support off-benefit outcomes). Alternative variations will consider allowing families who are off-benefit to receive some, or all, of the payment before the hours test is met to reduce the number of families worse off and improve BHC50 outcomes.			**Option summary:** Removes the in-work payments and enhances the FTC. It improves income adequacy and makes work pay through more generous FTC payment rates and abatement settings. **Request for more advice:** how can this option (a) better support 'making work pay', (b) reduce the number of families worse off and (c) mitigate the impacts from any increased reliance on the benefit system. **Variations of options:** Options that better make work pay, either through more generous FTC settings or through changes to the benefit system. Additional structural changes could also be made to reduce the number of families being made worse off.		
	Option 1: Not entitled to payment unless hours test is met (option presented in previous advice)	**Option 1a:** Entitled to a portion of payment before hours test is met	**Option 1b:** Entitled to entire payment regardless of hours worked	**Option 5:** Remove IWTC and make FTC payment rates and abatement settings more generous	**Option 5a:** Further changes to WFF abatement settings to help make work pay	**Option 5b:** 5a but also rebalancing some of main benefits into FTC to further make work pay
Child poverty	9,000 (BHC50) 28,000 (AHC50)	10,000 (BHC50) 29,000 (AHC50)	14,000 (BHC50) 31,000 (AHC50)	24,000 (BHC50) 27,000 (AHC50)	27,000 (BHC50) 41,000 (AHC50)	20,000 (BHC50) 29,000 (AHC50)
Costs (p.a)	$675m	$716m	$800m	$540m	$882m	$686m
Gainers / losers	170,000 HHs gain by $81pw. 24,000 HHs lose by $34pw*.	178,000 HHs gain by $80pw. 16,000 HHs lose by $32pw*.	181,000 HHs gain by $87pw. 13,000 HHs lose by $32pw*.	235,000 HHs gain by $46pw. 24,000 HHs lose by $23pw^.	265,000 HHs gain by $65pw. 18,000 HHs lose by $27pw^.	262,000 HHs gain by $53pw. 34,000 HHs lose by $23pw^.
	*Around 12,000 of these HHs are estimated to be worse off due to the modelling applying different ringfencing rules for the current IWTC and the proposed new in-work payment. Further modelling for the November advice will determine whether these losses reflect desired policy or are due to the modelling assumptions used.			^These families are worse off due to the removal of the IWTC and flow-ons to AS. For many of these families it may become financially advantageous to move onto benefit to prevent being worse off. Further advice and options will be provided.		
Make work pay / incentives to work	Option 1 and its variations increase the incomes of employed HHs by between $80pw - $87pw on average (depending on the option), while the incomes for non-working HHs remain the same. It will increase the returns from working compared to the status quo and option 5. For example, it increases the gap between benefit and 40 hours work by $131pw for a sole parent with two children earning the minimum wage. The average gains are lower for families with relatively higher earnings. However, similar to the WFF changes in 2005/06, option 1 and its variations may incentivise second earners in couples to reduce their work hours.			Option 5 provides larger gains for non-working HHs ($66pw) compared to working HHs ($39pw).	Option 5a provides similar gains for non-working and working HHs ($67pw and $65pw respectively).	Option 5b provides smaller gains for non-working HHs ($41pw) compared to working HHs ($57pw).
				Option 5 reduces the returns from working more for many low to middle-income workers compared to the status quo; option 5a has more mixed impacts; and option 5b generally increases the returns from working (particularly for couples and those with earnings above the minimum wage). Like option 1, but to a lesser extent, option 5 and its variations may incentivise second earners to reduce their work hours.		

Income by hours worked

For sole parent with two children earning minimum wage



Notes: The variations of option 1 provide different levels of income for those off-benefit working less than 20 hours a week, but the same income for 20 or more hours of work. It will be financially advantageous to be on benefit when working less than 20 hours, however some families remain off benefit instead. This could be for various reasons, such as personal choice or lack of awareness of supports available.



Notes: Incomes drop slightly around 35-40 hours worked as this is when families would move off benefit and lose WEP (families without children face this drop currently). During summer months, there won't be a drop in income under this option and the returns from working would be stronger.

Incomes under Option 5 is the same as option 5a for lower levels of hours worked.

3. There are trade-offs within options…

Option	1. Maintaining an in-work payment			5. A single tax credit		
	Option 1: Not entitled to payment unless hours test is met	**Option 1a:** Entitled to a portion of payment before hours test is met	**Option 1b:** Entitled to entire payment regardless of hours worked	**Option 5:** Remove IWTC and make FTC payment rates and abatement settings more generous	**Option 5a:** Further changes to WFF abatement settings to help make work pay	**Option 5b:** 5a but also rebalancing some of main benefits into FTC to further make work pay
Pros and cons	Has the strongest incentives to work the desired number of hours. However, non-beneficiary sole parents working less than 20 hours (or 30 hours for couples) are financially disadvantaged.	More closely reflects current system, where all low-income non-beneficiaries are eligible to receive the IWTC and receive a top-up at 20 or 30 hours worked (through the MFTC). Compared to option 1, this option reduces the number of families worse off, has slightly greater child poverty impacts, but is slightly more costly.	This variation of option 1 further reduces child poverty and the number of families worse off, is the easiest to administer and reduces debt. However, this option is the most costly and has weaker incentives to work full-time. For those off-benefit, it also provides relatively generous levels of assistance with minimal work requirements.	Provides larger income gains for non-working households (HHs) ($66pw) compared to working HHs ($39pw). Of all the variations of option 5, it reduces the gap between benefit and work the most.	Provides similar income gains for non-working and working HHs ($67pw and $65pw respectively). Is less targeted than option 5 and has higher costs. It will only 'get you so far' with improving incentives as it provides greater benefits to relatively higher income families and may encourage second earners to reduce their work hours.	Provides smaller gains for non-working HHs ($41pw) compared to working HHs ($57pw). Increasing FTC, and reducing benefits by a smaller amount, is better for work incentives. Benefit and FTC rates would be more similar to, but higher than, what WEAG recommended. Improves incentives more cost effectively than option 5a, however, has lower child poverty reductions.

…as well as trade-offs across options

	1. Maintaining an in-work payment		5. A single tax credit	
Trade-offs across options	This option only **benefits working families** (around half of families in poverty), so has lower BHC50 impacts compared to option 5 in the short-term. It also increases the depth of poverty on this measure because it increases median incomes. →	You could complement this option with a modest increase to other adequacy payments for beneficiary families – progressed at the same time or at a later stage.	Some **families will be worse off** from rebalancing IWTC into FTC given the two payments have different apportionment rules, eligibility settings and flow-on impacts to AS and TAS. →	This could be addressed by changing the FTC rate structure to a 'per family' amount, plus a 'per child' amount. In practice, this is a structural change that doesn't affect entitlement for many families, but could help families disadvantaged from multiple complex interactions (such as shared care).
	This option is likely to have **higher longer-term costs** if payment settings are indexed to ensure families remain 'better off' off-benefit over time, especially if main benefits are increased in the future. →	Officials will provide advice on different options for indexing – including advice on the trade-offs between regular indexation and ad-hoc adjustments.	Depending on the design, this option is **likely to reduce the financial incentives to work** for some families. →	Changing benefit abatement settings is another relatively targeted way to incentivise part-time work. However more families will then be eligible for a benefit under option 5. Officials can provide further advice on additional options to make work pay, including interactions with options being considered through the review of Childcare Assistance.

4. Important considerations

Benefit interface	Although highly uncertain, it is estimated that up to 20,000 additional working families would financially benefit from receiving a benefit under option 5, but this would reduce slightly under option 5b. We expect actual take-up to be lower in practice. Option 5 would likely require a legislative change to allow JS recipients to work full-time (30 hours or more) and receive a benefit until it abates to zero (like Sole Parent Support currently). These working families would interact with the higher compliance benefit system, including declaring income weekly. MSD are exploring ways to improve the client experience for this group to help mitigate any negative impacts, and advice will be provided in November.
Overseas tax credits	Overseas tax credits differ in design, with Australia (and the UK once it moves to Universal Credit) having a tax credit system that is more consistent with option 5. On the other hand, the US and Canada both have in-work payments like option 1, but these are set at much more modest levels.

5. Buffer tax credit vs increased automatic debt write-off threshold

	Buffer Tax Credit	Increased debt write-off threshold
Description	Essentially a refundable tax credit made available at the end of the income year. It would be first applied against any WFF debt a customer may have accrued due to over-payments. Where a customer has not accrued any WFF debt, the balance of the buffer tax credit could be paid as a one-off lump sum at the end of the tax year.	Increasing the threshold for automatic write-offs for WFF debt (currently $50) would clear low-value WFF debt. An increased write-off threshold could either apply to all customers or could be targeted to smaller groups with greater need (e.g. customers with income under a certain amount).
Initial advice on trade-offs	• Benefits customers with and without debt, so less targeted towards families with debt. However, is more equitable than an increased debt write-off threshold because customers who have kept IR informed of changes receive the same dollar amount as other customers who have been overpaid during the year and have debt written off. This also means it doesn't create perverse incentives. • More costly than increasing the debt write-off threshold by the equivalent dollar amount. • More complicated to administer due to the requirement to pay out unused portion of the tax credit if the customer has no debt or their debt is less than the amount of the credit.	• Targeted as it is only available to customers with debt, but may create perverse incentives and would be less equitable than the buffer tax credit. • Likely to be lower cost than the buffer tax credit. • Less complicated to administer because no further steps are required after the debt write-off has been applied.

6. Next Steps

Next steps

If Ministers have any feedback on this update we can reflect this in the substantive November advice. If Ministers are generally comfortable with the direction of the advice, officials will provide two reports on Working for Families for the November Income Support Ministers meeting. The two reports will cover detailed advice on:

- **Paper One: Further advice on options 1 and 5**, expanding on the content covered in this brief update
- **Paper Two: Administrative and operational improvements**, including more detailed advice on the buffer tax credit and increased debt write-off threshold.

At the November Ministers meeting, officials recommend Ministers choose a preferred option for redesign – this would allow officials and Ministers to focus on more detailed policy parameters that comes with significant redesign.

November advice content

Paper One: Further advice on options 1 and 5	Paper Two: Administrative and operational improvements
In addition to more detail on the options included in this update, Paper One will also respond to the following questions and feedback. **Option One:** • What impact the removal of the IWTC hours test has had, and advice on how to soften any reintroduction of this test. • Expected increased employment effects of this option. **Option Five:** • What is the impact of this option on sole parent households relative to other households? • How can this option reduce the reliance on some families moving onto a main benefit, and/or be more customer friendly for people on benefit? • Would lower income tax rates at the bottom help to improve work incentives for this option? **Across options:** • How do the options align with OB, UCB, and FCA? • Analysis of any potential savings, including any reduced supplementary/hardship payments. **Officials will also consider more detailed advice on:** • Child poverty, financial incentives / making work pay, and fiscal costs (including longer-term costs). • Behavioural impacts / labour supply. • Indexation and longer-term settings. • Phasing-in or sequencing of options (including using existing CPI adjustments). • Interactions of options with NZ Income Insurance Scheme.	In addition to more detailed advice on the buffer tax credit and increased debt write-off threshold, Paper Two will respond to the following requests for further advice: • giving WFF recipients a longer period of time in which to inform Inland Revenue of a change in circumstances ('grace periods') • improving information exchange between Inland Revenue and the Ministry of Social Development for people moving on and off benefit • other miscellaneous administrative changes to improve customer experience, as set out in the WFF advice provided in July 2022. This paper will also respond to the question on how widespread overpayments are resulting from the complexity of WFF.