

The Treasury

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Tax policy report: Approving the new revenue strategy and tax policy work programme

Date:	23 March 2018	Priority:	Medium
Security level:	Budget Sensitive	Report no:	T2018/746 IR2018/182

Action sought

	Action sought	Deadline
Minister of Finance	Approve the proposed new revenue strategy and tax policy work programme, and agree the timing for announcing the work programme	27 March 2018 – when you are due to discuss these documents at the Joint Ministers’ meeting
Minister of Revenue	Approve the proposed new revenue strategy and tax policy work programme, and agree the timing for announcing the work programme	27 March 2018 – when you are due to discuss these documents at the Joint Ministers’ meeting

Contact for telephone discussion (if required)

Name	Position		Telephone	
Mark Vink	Manager, Tax Strategy, The Treasury	[39]	(wk)	[23] (mob)
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David Carrigan	Acting Deputy Commissioner, Policy and Strategy, Inland Revenue	[39]	(wk)	[23] (mob)
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23 March 2018

Minister of Finance
Minister of Revenue

Approving the new revenue strategy and tax policy work programme

Executive summary

1. This report seeks your agreement to a new revenue strategy and tax policy work programme, following discussions with you on earlier drafts of these documents at the Joint Ministers meeting on 28 January.

2. Annex A provides a revised draft of a new revenue strategy. The strategy sets out the Government's objectives for the tax system and helps inform decisions on items to include on the work programme.

3. Annex B provides a revised draft of a new tax policy work programme. The prominent features of the new work programme are supporting the Tax Working Group and the Welfare Expert Advisory Group, and delivering the Government's priorities in the 100 day plan and the coalition and confidence and supply agreements.

4. The work programme includes a focus on introducing research and development tax credits and addressing base erosion and profit shifting (BEPS) concerns, and emerging concerns on the taxation of the digital economy.

5. The programme also includes the policy work that will help Inland Revenue's business transformation. The capability being built through business transformation may be needed if the Government implements significant policy changes in response to the Tax Working Group's recommendations.

6. Following earlier discussions with you, new items have been included on the work programme to address base maintenance and fairness concerns in the following areas:

- tax compliance of the self-employed;
- charities and not-for-profit organisations; and
- [41]

7. [33], [34]

8. A small number of discretionary projects have also been included on the work programme that address the integrity of the tax system. Several of these are important for stakeholders. If implemented, some of them would be revenue negative.

9. Throughout the delivery of the work programme there may be issues that come up that aren't listed on the programme that you require our advice on. We will regularly update you on the work programme, including on any items that arise in this manner. We have allowed capacity to maintain a watching brief on a number of issues and to update you when necessary.

10. We will review the work programme approximately halfway through the parliamentary term, once the Tax Working Group and the Welfare Expert Advisory Group have made their recommendations.

11. The work programme is usually noted by Cabinet before publication. If you approve the revenue strategy and tax policy work programme, we will draft a paper for you asking Cabinet to note both. The revenue strategy will form part of the Fiscal Strategy Report at Budget. You may wish to announce the work programme alongside the revenue strategy at Budget, or at a separate engagement.

Recommended action

12. We recommend that you:

(a) **Approve** the new revenue strategy.

Approved / Not Approved

Approved / Not Approved

(b) **Approve** the new tax policy work programme.

Approved / Not Approved

Approved / Not Approved

(c) **Note**, if you approve the revenue strategy and tax policy work programme, officials will draft a paper for you asking Cabinet to note both.

Noted

Noted

(d) **Agree** to the approved tax policy work programme being published by Inland Revenue alongside the revenue strategy at Budget.

Agreed / Not Agreed

Agreed / Not Agreed

(e) **Note** that we will report to you on a regular basis with updates on the tax policy work programme, progress made on current items and whether or not new issues have emerged, and we will publish any updates you agree are appropriate.

Noted

Noted

(f) **Note** that we will report to you on a refresh of the tax policy work programme approximately halfway through the parliamentary term.

Noted

Noted

Mark Vink
Manager
The Treasury

Nigel Mehta-Wilson
PAS Programme Manager
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2018

Hon Stuart Nash
Minister of Revenue
/ /2018

Background

13. The revenue strategy sets out the Government’s objectives for the tax system. It helps inform decisions on items to include in the tax policy work programme, which determines the work of the Treasury and Inland Revenue tax policy teams.

14. On 28 January we discussed draft versions of a new revenue strategy and tax policy work programme with you. Annex A provides a revised draft of a new revenue strategy, and Annex B provides a revised draft of a new tax policy work programme.

Tax policy work programme considerations

A balanced work programme

15. The factors listed below were considered in determining the make-up of the tax policy work programme:

- Identifying the Government’s highest priority issues which fit with the revenue strategy, your broader objectives and coalition and confidence and supply agreement commitments.
- Demands on officials’ resources and capacity to undertake the policy work and implement the policy changes, as well as stakeholder capacity to engage and give well-considered feedback on policy proposals.
- The need to undertake important maintenance work to ensure the coherence and integrity of the tax system.
- How the tax policy work programme needs to be sequenced with the work of the Tax Working Group.
- The timing of deployment of tax products through business transformation, especially when staff training and technology upgrades are being delivered.
- Fiscal impacts, including the need to fit within budget responsibility rules, only submitting manifesto commitment initiatives for Budget 2018, and maintaining the tax policy “scorecard”.

Fiscal impacts

16. To maintain integrity and fairness and to keep the tax system working as intended, there is an ongoing need to implement policies that may have positive or negative fiscal impacts – many of which are relatively small. To accommodate the many upwards and downwards fiscal changes, a tax policy “scorecard” was established by previous Ministers of Finance and Revenue.

17. The scorecard acts as a memorandum account to the Between Budget Contingency. It allows greater flexibility in tax policy, as revenue savings from tax policy changes may be retained in order to offset subsequent revenue costs arising. In this way, the scorecard helps ensure that the cumulative net revenue impacts of non-significant tax policy changes are considered in aggregate.

18. As a safeguard to ensure the flexibility provided by the scorecard would not be mismanaged, it was agreed by previous Ministers that the scorecard balance would be kept strictly positive over the forecast period. Also, the scorecard does not include significant tax initiatives, forecasting changes, departmental costs/savings or other appropriated expenditure.

19. The five-year forecast period currently extends to the 2021/22 fiscal year, and will include 2022/23 from October 2018.

20. The Treasury and Inland Revenue track the “spare capacity” in the scorecard and this can influence whether or not new projects are recommended that, if implemented, would be fiscally negative or positive.

[33]

[33]

23. In the longer term, we will provide you with regular updates on the balance of the scorecard, and of potential future claims against it as work on work programme items progresses. At some stage, if you wish to maintain the current practice of keeping the scorecard balance positive, you may need to decide either to:

- include some significant revenue positive items on the scorecard; or
- prioritise work on smaller revenue positive items over work on revenue negative items.

24. Officials will only forward what we consider to be high priority items to you for your consideration.

Proposed work programme

25. The proposed tax policy work programme is set out in the following streams:

- Government priorities, including the Tax Working Group, the Welfare Expert Advisory Group, coalition and confidence and supply agreement and other 100 day plan items;
- enhancing and maintaining the broad-base low-rate tax system, including ongoing work to improve the integrity of the tax system and to keep the system operating as intended;
- international tax and work to address BEPS;
- business transformation and information sharing, which includes items that support or enable Inland Revenue's business transformation; and
- social policy, which includes advice on other government agency proposals which may have an impact on Inland Revenue's administration of social policies.

26. Annex B sets out the individual items in each stream showing the source of the policy change, the status of work and the estimated fiscal impact.

27. The proposed tax policy work programme includes important projects for which the timing of delivery will need to be sequenced with the outputs of the Tax Working Group and Welfare Expert Advisory Groups, and with the availability of tax policy resources. For example, our support for the Welfare Expert Advisory Group may reduce our capacity to develop social policy enhancements being considered under business transformation. While it would be inefficient to make significant policy and administrative changes if these were soon to be superseded by recommendations from the Welfare Expert Advisory Group, there are some changes that can usefully continue now which are expected to support the direction of the work of the Welfare Expert Advisory Group. [33]

Enhancing and maintaining the broad-base, low-rate tax system

28. After a further discussion between the Minister of Revenue and Inland Revenue officials, we recommend including a small number of discretionary projects which we believe will become a high priority during the term of the work programme. The following are all a high priority for private sector stakeholders who have expressed concern that the work programme may not address some of the maintenance issues that are of greatest concern to them. We would plan to sequence work on these issues alongside any related considerations by the Tax Working Group and in line with future Budget considerations to fund fiscally negative changes. These issues relate to:

- feasibility and black hole expenditure – whether tax deductions for expenditure on feasibility studies and other forms of “blackhole” (non-deductible) business expenditure should be permitted;
- cross-border employment – reducing the compliance costs associated with businesses employing staff from overseas and with New Zealanders temporarily working offshore; and
- treatment of losses – carrying forward company losses when company ownership changes.

29. The following items are maintenance issues which are important to keep the tax system operating as intended:

- purchase price allocation – addressing the inconsistency in valuations used by vendors and purchasers for the same assets in a sale. Addressing this issue would improve the integrity of the tax system [33]

While we had not highlighted this issue in discussions to date we raise this now because it has emerged as a significant concern.

- removing the over-taxation of fringe benefits on loans made by banks to their employees at discounted interest rates. We reported to you on this earlier this month (T2018/537, IR2018/124 refers) and note that you agreed to seek Cabinet approval for this. Addressing this issue will have a \$3 million per year negative impact on the scorecard.
- GST discussion document – we will send you a report soon outlining a proposed discussion document on a number of GST issues.

Tax legislation

30. The work programme includes progressing the current bills:

- Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill – this will be enacted by 31 March.
- Taxation (Neutralising Base Erosion and Profit Shifting) Bill.
- [33]

- [33]
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Tax policy work programme renewal and updating processes

Ongoing prioritisation

31. After setting the work programme new issues will emerge. These may be a consequence of changes in taxpayer behaviour, changes in overseas jurisdictions, new technology or new interpretations of the law. As such these issues may be raised by stakeholders or from our internal processes of compliance activities, conducting litigation, or from public rulings and interpretations provided by the Commissioner of Inland Revenue.

32. From time to time officials will recommend adding projects of sufficiently high priority to the tax policy work programme taking into account:

- the priorities that you have established in the revenue strategy;
- fiscal implications and the ability to manage these through the Budget or the scorecard; and
- the capacity of Inland Revenue to implement change, and of stakeholders to engage with the policy development process.

Work programme updates

33. We will report to you on a regular basis on the tax policy work programme, progress made on current items and whether or not new issues have emerged that officials agree need to be included on the work programme and that are consistent with the revenue strategy. We propose publishing, as appropriate, these reports as a way of updating stakeholders on the work programme.

34. A full refresh of the work programme will be proposed after approximately 18 months as by this time it is likely that a number of key items will have been completed, significant new issues may have emerged, priorities may have changed and the Tax Working Group will have made its recommendations to you.

Next steps

Cabinet endorsement

35. Once you have approved the new revenue strategy and tax policy work programme, officials will provide you with a draft Cabinet paper for Cabinet to note both documents.

Announcement and publishing of the revenue strategy and tax policy work programme

36. Following Cabinet noting the revenue strategy and tax policy work programme, the revenue strategy will be included in a section of the Fiscal Strategy Report at Budget. You may wish to consider announcing the work programme alongside the revenue strategy at Budget, or at an separate function or engagement.

37. While Budget is still a few weeks away, there is no pressing need to release the work programme sooner. An advantage of releasing it at Budget is the clear alignment that would be established between the revenue strategy and the tax policy work programme.