

Tax improvements for business 1



Less taxing tax

A Government discussion document

Hon Bill English
Treasurer

Rt Hon Sir William Birch
Minister of Finance
Minister of Revenue

Less taxing tax; a Government discussion document
(Tax improvements for business 1)

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PREFACE

This discussion document looks at ways of helping businesses to put more time and energy into their business and less into meeting, and worrying about, their tax obligations. The goal is to help New Zealand's businesses expand and prosper.

The Government's objective is major simplification of the tax system – the small business equivalent of the recent measures removing the need for wage and salary earners to file a tax return. This document represents the start of that process.

Although the Government is committed to simplification, significant improvement will not be easy. The variety of businesses, their approaches to tax compliance and changing technology makes for a complex exercise. The consultation by the Government, outlined in the discussion document, highlights this. It also makes clear the need for reforms, especially in the area of provisional tax.

Compliance costs are a burden imposed on all business taxpayers. To reduce this burden, in the best way possible, we need the contribution of businesses and their advisers. We look forward to receiving submissions.

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CHAPTER 1

INTRODUCTION

- 1.1 The Government's objective is to make it much easier for individuals and businesses, especially small businesses, to meet their tax obligations. This discussion document presents for public consideration a series of simplification measures that constitute a further step towards this objective.
- 1.2 The Government is aware of the concerns of small businesses regarding tax requirements. These concerns include potential exposure to penalties that are perceived to be harsh, the complexity of calculating tax liabilities and return filing requirements.
- 1.3 The 1999 income year is the last year that salary and wage earners need to file IR 5 income tax returns. This is a significant simplification step with widespread effect. The Government has been exploring ideas that could lead to a similar reform for small businesses. The objectives include reducing exposure to interest and penalties, reducing the complexity of information required, streamlining tax filing and payments and reducing the need for taxpayers to contact Inland Revenue.
- 1.4 Such simplification, if it is achievable, will be a complex task requiring careful rethinking of how we can collect tax and appropriate information more efficiently. There are likely to be trade-offs between certainty, simplicity, fairness, revenue and accuracy that have to be considered.
- 1.5 Further, although salary and wage earners are a relatively homogeneous group, small businesses are a very diverse group. They have many different legal structures (for example, company, trust, partnership, sole trader), are involved in a vast range of different activities and can therefore be subject to different tax rules.
- 1.6 The focus of this discussion document is the enhancement of aspects of the existing tax system. Its scope, therefore, is modest. It aims to achieve worthwhile reductions in the complexity of the current tax payment system and reduce the costs associated with payment, while ensuring the integrity of the tax system and its administration.
- 1.7 The Government will continue to work on ideas for a simpler method of calculating and paying tax, particularly for small business. We welcome the views of taxpayers, their advisers and other interested parties on how we can achieve this.

Benefits of tax improvement

1.8 The specific benefits expected to arise from the measures outlined in this discussion document include:

- a fairer application of late payment penalties;
- reduced compliance costs through narrowing the application of use-of-money interest in cases where the benefits are considered to be outweighed by the costs;
- increased consistency and certainty in payment processes; and
- simpler and more streamlined payment processes.

Operational issues raised by Institute of Chartered Accountants

1.9 As part of the Government's continuing consultation, the Institute of Chartered Accountants of New Zealand raised a number of operational issues that impose significant compliance costs, which it is discussing with Inland Revenue. Examples of the issues raised include:

- Inland Revenue's issuing of a statement relating to a period with no details other than a notation that the period has not yet been finalised;
- the fact that no notification is provided to taxpayers or their agents when refunds are being held in Inland Revenue's account review system for more than 30 days; and
- problems with the calculation of use-of-money interest.

1.10 Inland Revenue acknowledges that the issues raised are important and is working urgently to address them. Inland Revenue and the Institute have undertaken work to document these problems and identify and schedule solutions.

Summary of reforms

1.11 A summary of the reforms proposed in this discussion document follows:

Obligation to pay tax on time (chapter 4)

- Reduce the incremental penalty for late payment of tax from 2 percent a month to 1 percent a month.
- Apply the initial late payment penalty either seven days after the due date or at the rate of 1 percent on the due date and 4 percent seven days later.

- Extend to one month the 15-day use-of-money interest ‘grace period’ following issue of a statement.

Fairness and clarity of treatment for those with overdue tax (chapter 5)

- Extend the existing serious hardship and financial difficulty relief provisions to all taxes.
- Extend the existing instalment arrangement provisions to all taxes and provide for remission of incremental penalties each month as taxpayers comply with their arrangement.
- Increase the threshold above which approval from the Minister of Finance is required for an instalment arrangement or hardship remission from \$50,000 to \$100,000.

Aligning tax payment dates (chapter 6)

- Streamline payment of taxes so that most payments will be paid on one day each month, on either the 5th, 20th or the last working day of each month.
- Tax payments due on a non-working day become payable on the next working day.

Simplification of fringe benefit tax (chapter 7)

- Remove the requirement to pay small amounts of fringe benefit tax by applying the current \$75 per quarter per employee threshold to all classes of fringe benefit. (The maximum exemption would remain limited to \$450.)
- Remove use-of-money interest charged on FBT paid annually. This is likely to increase the use of the option to pay FBT once a year.
- Include the payment of GST on the value of fringe benefits in the FBT return.

Simplification of provisional tax (chapter 8)

- Raise the individual threshold for the ‘safe harbour’ from use-of-money interest from \$30,000 residual income tax to \$35,000, thus reducing the number of individuals liable for use-of-money interest.
- Remove the ‘reasonable care’ standard, leaving the ‘gross carelessness’ standard for all taxpayers who estimate provisional tax and have less than \$35,000 residual income tax. (It would stay at \$30,000 if the proposal above is not adopted.)
- Allow taxpayers to elect into the withholding payment regulations.

Review of information required in tax returns (chapter 9)

- A review will be undertaken of information provided to Inland Revenue, to remove duplication and ensure that unnecessary information does not have to be provided.

Application date of proposals

- 1.12 Inland Revenue has major administrative commitments over the next 12 months, including the implementation of the tax simplification changes applying to salary and wage earners, the Parental Tax Credit, changes to Family Assistance, and operational improvements. Many of the initiatives outlined here will also require a major departmental commitment, and that cannot begin until legislation arising from this discussion document is enacted.
- 1.13 Given these factors, and the need to align new tax policy initiatives with the start of a tax year, the Government considers the earliest application date for most of these measures would be 1 April 2001.

Key questions

- 1.14 Before making final decisions on whether to proceed with the various tax improvement measures discussed here, the Government wishes to seek the views of interested people. Key areas in which the Government seeks feedback are:
- whether the areas of concern outlined here are the most significant as regards tax compliance costs; and
 - whether the tax improvement measures considered in this discussion document should be adopted.

SUBMISSIONS

Submissions should be addressed to:

The General Manager
Policy Advice Division
Inland Revenue Department
P O Box 2198
WELLINGTON

Submissions should be made by 26 November 1999. They should include a brief summary of their major points and recommendations. They should also indicate whether it would be acceptable for officials from Inland Revenue to contact those making the submission to discuss their submission if required.

CHAPTER 2

CONTEXT OF THESE REFORMS

- 2.1 The last decade has seen extensive reforms of both tax policy and tax administration in New Zealand. These reforms include a broadening of the tax base, the implementation of various social policy measures through the tax system, modernisation of the tax administration, and an increasing obligation on taxpayers to assess their own tax liability and comply with the law voluntarily.
- 2.2 Although the reforms have provided significant benefits by way of a more efficient and equitable tax system, they have also created problems. They have increased the number of payments taxpayers must make, the complexity associated with calculating those payments, and the extent to which these obligations are effectively enforced.
- 2.3 The Government is seeking to reduce the 'costs' of these reforms for individuals and businesses. These costs may take the form of monetary and non-monetary costs. Monetary costs comprise the value of the time involved, the fees paid to professional tax advisers, and incidental costs incurred. Non-monetary costs include psychological costs such as stress.
- 2.4 It is inevitable that any tax system will impose these compliance costs. The challenge is to have an efficient tax system that keeps to an absolute minimum the total costs it imposes.
- 2.5 The desire to minimise the costs imposed by the tax system has resulted in a number of inquiries over the last year. In particular, concerns about the current payment rules have been raised in numerous forums. For example, both the Commerce Committee, in its Inquiry into Compliance Costs for Business, and the Committee of Experts on Tax Compliance discussed the issue of aligning tax payments to reduce compliance costs. Taxpayers and tax practitioners have also raised concerns about the existing tax payment system.

Recent reviews of the tax system

Commerce Committee Inquiry into Compliance Costs for Business

- 2.6 Parliament's Commerce Committee conducted an inquiry into compliance costs imposed on business. Amongst the recommendations in its November 1998 report was for Inland Revenue to undertake:

...detailed analysis and consultation with the objective of streamlining payment dates and payment forms for small to medium sized enterprises.

- 2.7 The Government undertook to consider issues relating to aligning payment dates as part of its response to the Committee's report. This discussion document represents the response to the Committee's concerns in relation to payment streamlining and the provision of duplicated or unnecessary information to Inland Revenue.

Committee of Experts on Tax Compliance

- 2.8 The Government announced the establishment of the Committee of Experts on Tax Compliance in March 1998. The Committee's terms of reference broadly required it to consider and make recommendations on tax compliance costs and the robustness of the tax system against avoidance and evasion. The Committee reported to the Treasurer and the Minister of Revenue in December 1998.

- 2.9 This discussion document includes a number of the Committee's recommendations for tax simplification. They were to:

- consider the amalgamation of the due dates for payment of tax;
- standardise the treatment of payments that fall due on a non-working day;
- remove use-of-money interest from those who choose to pay FBT annually;
- reduce the incremental penalty for late payment of tax from 2 percent a month to 1 percent;
- apply the initial late payment penalty incrementally; and
- include GST on fringe benefits in the FBT return rather than the GST return.

- 2.10 The Committee made a number of other simplification recommendations which the Government is still considering.

Finance and Expenditure Committee Inquiry into the Powers and Operations of the Inland Revenue Department

- 2.11 Parliament's Finance and Expenditure Committee received over 180 public submissions and over 50 hours of oral presentations. The Government presented to the Committee a submission addressing the policy and administrative issues raised with it.

2.12 In relation to the matters raised in the submissions, the Government considered two categories of policy response were appropriate:

- changing some areas of compliance and penalty policy through the normal generic tax policy process, as announced in the ‘5 Steps Ahead’ package; and
- specifically including a number of minor policy issues in the forthcoming review of the compliance and penalties legislation, which also will follow the normal policy development process.

Recent tax simplification measures

2.13 Until this year about 1.2 million New Zealanders filled in an IR 5 income tax return showing the income they received during the year and the rebates they were claiming. This took each of them an average of one hour. About 50 percent of them needed some help to complete their form – half an hour’s worth, on average. That added up to 1.5 million hours each year devoted to filling in the nation’s IR 5 tax returns.

2.14 The Government has adopted measures which eliminate the IR 5 tax return by using information provided to Inland Revenue by third parties, such as employers and banks, and improvements in the way that information is provided.

2.15 The measures outlined in this discussion document represent a step towards similar simplifications that will be of benefit to small businesses.

The Government’s ‘5 Steps Ahead’ package

2.16 A number of changes to the compliance and penalties rules in the Tax Administration Act 1994 are being considered as part of the Government’s ‘5 Steps Ahead’ package. The aim is to make the rules more flexible, reduce the penalties imposed on taxpayers who pay just a few days late, and ensure that essentially honest taxpayers are not excessively penalised. The changes are to:

- Explicitly extend the serious hardship, financial difficulty and instalment arrangement provisions to all types of tax.
- Increase the threshold requiring approval from the Minister of Finance for hardship remissions and instalment arrangements from \$50,000 to \$100,000.
- Reduce the incremental penalty for late payment of tax from 2 percent a month to 1 percent a month (an idea initially raised by the Committee of Experts on Tax Compliance).

- Apply the initial late payment penalty incrementally (also first raised by the Committee of Experts on Tax Compliance).
- Cancel incremental penalties before completion of an instalment arrangement if the taxpayer involved is complying with that arrangement. Taxpayers who enter instalment arrangements should be given certainty with regard to these arrangements, and a partial failure to comply with an instalment arrangement should not result in a disproportionate penalty.

2.17 These possible changes should be considered through the usual process of consultation, to ensure they are well-designed. For this reason they have been included in this discussion document.

Technology

2.18 The Government is also concerned that the processes specified by the tax system might be a barrier to the development of new ways for businesses to meet their tax obligations, perhaps by way of improvements in technology. The Government welcomes submissions on whether there are legislative changes that would remove such barriers.

CHAPTER 3

CONSULTATION

- 3.1 As part of its continuing commitment to tax simplification, the Government has been consulting with taxpayers and their representative bodies about the problems taxpayers face in complying with the law and how compliance costs can be reduced.
- 3.2 This consultation raises more issues than can be addressed in this discussion document. The purpose of this chapter is to confirm that the consultation that has already taken place has correctly identified the key issues the Government needs to address.
- 3.3 The Government will be continuing this consultation process and working to identify ways to address the concerns raised. The remainder of this chapter discusses the key issues that have been raised so far.

General themes from consultation

- 3.4 Three key themes have emerged from the consultation undertaken by the Government.
- 3.5 First, simplification for business taxpayers is unlikely to come from eliminating the forms businesses have to complete. The major problems for business taxpayers do not lie in filling in the forms, but in the amount of work required to obtain the necessary information to calculate tax liabilities.
- 3.6 The second theme is that, for tax purposes, businesses are not a homogenous group like salary and wage earners. Any consideration of tax-related problems of businesses must span a variety of different entities with vastly different processes and systems. All businesses can have problems with the same tax or tax process, but the perspective of larger businesses is generally very different from that of the self-employed contractor. It is critical to consider the different perspectives when identifying potential solutions to the problems. A single solution is likely to have markedly different impacts on different types and sizes of business.
- 3.7 One of the key differences between businesses is their degree of tax knowledge. There are two extremes. At one end of the spectrum are the businesses whose operators are able to manage the tax requirements of the business. This may only involve having a cash-book that is kept up to date and engaging an accountant to complete annual tax returns. Nevertheless, their affairs are 'tax organised'. At the other end of the spectrum are those whose tax affairs are 'disorganised' and who consequently have difficulty meeting their tax obligations.

- 3.8 The degree of tax organisation is not a comment on non-tax aspects of the business. For example, a business may be very profitable but be 'disorganised' in its tax affairs.
- 3.9 The final theme is the high psychological costs some specific taxes and elements of the tax system impose on taxpayers. Many of the issues businesses feel strongest about concern tax rules which they neither like nor perhaps understand, such as the depreciation rules, which in fact impose relatively low compliance costs. In other words, there is a strong link between a taxpayer's view of an aspect of the tax system and the perception of the burden that aspect places on the business.

Specific concerns

Provisional tax

- 3.10 Taxpayers have raised a range of issues that relate to the way in which provisional tax is calculated and interest is applied. The critical issues are:
- the lack of accuracy when paying on the basis of last year's tax plus 5 percent;
 - the complexity involved in applying the estimation option;
 - the potential interest costs if the estimation is incorrect; and
 - the fact that provisional tax does not take account of seasonal income patterns.
- 3.11 Most individuals who pay provisional tax do not have to pay use-of-money interest. Their payments are based on the previous year's tax liability plus 5 percent and they are within the \$30,000 residual income tax 'safe harbour'. A concern is that these payments do not reflect the current year's income. Business activity can be highly volatile, and financial performance can vary significantly from year to year. This can result in provisional tax payments being at variance with the individual's actual tax liability.
- 3.12 Individuals who know that their provisional tax payments will not accurately reflect their income tax liability may choose to estimate their liability. This enables them to make provisional tax payments they believe more accurately reflect their income tax liability for that year. Two problems arise, however, when they use the estimation option:
- It does not provide a general 'safe harbour', so use-of-money interest will be applied to any difference (greater than \$100) between the provisional tax paid and residual tax liability for the year.

- The estimation of future income is complex, particularly for businesses that have no routine income source (such as contractors) or when fluctuating economic conditions have a significant impact on revenue.

- 3.13 A consistent message from businesses is that it is extremely difficult to estimate profit up to a year ahead. The penalties and use-of-money interest that could apply when provisional tax liability is incorrectly estimated add to the psychological burden this process places on businesses. Although the estimation can be changed up until the final provisional tax payment date, interest on any variance is calculated and applied back to the first provisional tax payment date. Therefore a business may receive higher than expected income in the final period but any variance, of provisional tax payments to income tax liability, is applied back to the first provisional tax payment date. A number of individuals commented that they considered the application of use-of-money interest in this case to be a significant ‘penalty’.
- 3.14 Although estimating income may give a business the opportunity to align provisional tax liability with anticipated profits, the provisional tax rules assume that this profit will be earned evenly across the year, so the three payments are of equal value. In many instances income and expenditure patterns are not even across the year. This, again, reflects concerns that the payments required under the provisional tax system do not match the income-earning process, therefore causing cash flow problems in some cases.

Income tax year-end requirements

- 3.15 Determining taxable profit can be an onerous activity for businesses, particularly those with little accounting knowledge, poor accounting systems or limited resources to apply to the task. Whereas many businesses keep reasonable cash records, preparing end-of-year accrual accounts can be difficult to understand and to do. Adjustments for small businesses usually include at least capital purchases and sales, depreciation, trading stock valuation, private use adjustments, and adjustments for creditors and debtors.
- 3.16 The adjustments are usually the issues that require small businesses to hire an accountant. Small businesses have indicated a preference for a simplified system that they could understand and undertake themselves with a reasonable degree of certainty that they had calculated their liability accurately.
- 3.17 The annual income tax process requires a business to complete full accrual-based financial accounts. For some of these businesses, particularly self-employed people and partnerships, financial management is achieved through cash flow records, and financial statements are produced only for tax purposes. Other institutions, such as banks, are placing less emphasis on the requirement to produce annual financial statements of performance and position.

Goods and services tax

- 3.18 The responses from businesses during consultation indicated that they believed they had few problems with GST and considered it relatively easy to comply with. This was particularly evident from those whose affairs are 'tax organised'.
- 3.19 Many businesses indicated that the requirement to calculate and file GST returns regularly assisted with their understanding of the process. Problems they did face with GST related to making minor errors, such as arithmetical mistakes, or one-off transactions that increase the complexity of the return for that particular period. Calculating and remembering to pay GST on fringe benefits is also a frequent problem.

Fringe benefit tax

- 3.20 Taxpayers' lack of understanding of the purpose of fringe benefit tax (FBT), together with their perception that it is pervasive, significantly affect their perceptions of the compliance costs associated with it. Nevertheless, some of the requirements for complying with FBT are complex. Many of these complexities again require smaller businesses to make use of an agent to meet their obligations.

Payments

- 3.21 Problems associated with the timing of payment of tax elicit opposing views from different groups of taxpayers. One group is concerned about the number of payments that have to be made in a month. That group would prefer just one payment date for all taxes due in that month, even though this would mean a larger payment. Another group would rather make a series of smaller, more frequent payments. A problem for this group is that tax payments often do not align with the receipt of income, thereby causing cash flow problems.
- 3.22 Some business taxpayers are interested in paying tax on a more commercial basis. For example, many businesses are interested in more technology-based solutions for payments, but others do not use the electronic options already available. This may be because they prefer the cash flow benefits that arise from sending a cheque that will take three days to get through the mail and be processed.

Compliance and penalties rules

- 3.23 The businesses spoken to all had problems with the compliance and penalties legislation. Although many of them had never had to pay penalties, the possibility of incurring the penalties and interest has generated increased compliance costs. Many businesses, particularly medium-sized to large businesses, have complained about the amount of effort and cost involved in putting in place effective control procedures to ensure mistakes are not made.
- 3.24 The feedback received on the compliance and penalty rules is that they are inflexible. Many of those consulted considered the interest rates inappropriate. A number of comments related to the lack of consideration of compliance history when considering penalties.

SUBMISSIONS

The Government seeks submissions on:

- whether the Government has correctly identified the principal compliance costs faced by businesses; and
- other compliance cost concerns not identified above.

CHAPTER 4

OBLIGATION TO PAY TAX ON TIME

- 4.1 In a tax system based on self-assessment, taxpayers have three key obligations: to assess their own tax liability, to file their tax returns on time, and to pay the tax on time. Late payment penalties are intended to enforce a fundamental obligation – the payment of taxes by their due date.
- 4.2 Setting penalties too low would probably cause significant delays in the Crown's receipt of tax payments. This would reduce the fairness of the tax system and place a greater burden on complying taxpayers to the extent they would have to cover any shortfall in payment.
- 4.3 However, late payment penalties that are too high also cause problems. They unduly punish failure to comply, increase debt problems and discourage voluntary compliance by reducing the fairness of the tax system. Excessive penalties also place pressure on processes used to mitigate imposition of the penalty, such as disputes procedures and remission requests, thus increasing both compliance and administrative costs.
- 4.4 As part of its '5 Steps Ahead' programme the Government announced there was scope to make the payment rules more flexible and reduce the penalties imposed on taxpayers who pay just a few days late.

Background

- 4.5 The obligation to pay tax on time is supported by:
- a 5 percent penalty if the due date for the payment of the tax is missed;
 - incremental penalties of 2 percent of the tax outstanding each following month.
- 4.6 These penalties have generally applied from 1 April 1997. They are not deductible for tax purposes.
- 4.7 The initial late payment penalty is to enforce the due date given that failure to pay on time imposes costs both on the Government through delay in the receipt of revenue, and the tax administration in having to undertake action to encourage payment.
- 4.8 The incremental late payment penalty is the principal method by which the Government ensures a continuing incentive for taxpayers to pay overdue tax. The incremental penalty also ensures that complying taxpayers can see that non-compliance is punished.

- 4.9 These penalties are supported by the application of use-of-money interest on outstanding debts. The rate is currently 10.59 percent on unpaid tax. The interest charged is to compensate the Crown for the deferral of the payment of the tax. Any interest charged may be deductible for tax purposes provided the general deductibility provisions are met.
- 4.10 Because these penalties, together with use-of-money interest, are the principal method by which the Government ensures payment of tax, the result must provide a significant incentive to pay. As a start, the combined penalty and interest must exceed the borrowing cost faced by taxpayers; otherwise some may decide to defer payment. It must also contain a culpability component so that complying taxpayers can see that non-compliance is punished.
- 4.11 Administrative alternatives to imposing penalties for late payment, such as managing extended instalment arrangements, court action and bankruptcy action, are more expensive, both for the tax administration and the judiciary. Moreover, the delays inherent in these approaches reduce the equity and integrity of the tax system by rewarding non-compliance.
- 4.12 The Committee of Experts on Tax Compliance endorsed the reasons for the late payment penalty, and considered it inappropriate to depart from giving taxpayers incentives to pay their tax on time. The Committee considered, however, that:
- The penalty should have less of an impact and the 5 percent penalty should not apply to taxpayers who fail to pay on time if they correct that error within a few days of the due date.
 - The Government should consider reducing the incremental late payment penalty from 2 percent to 1 percent per month.

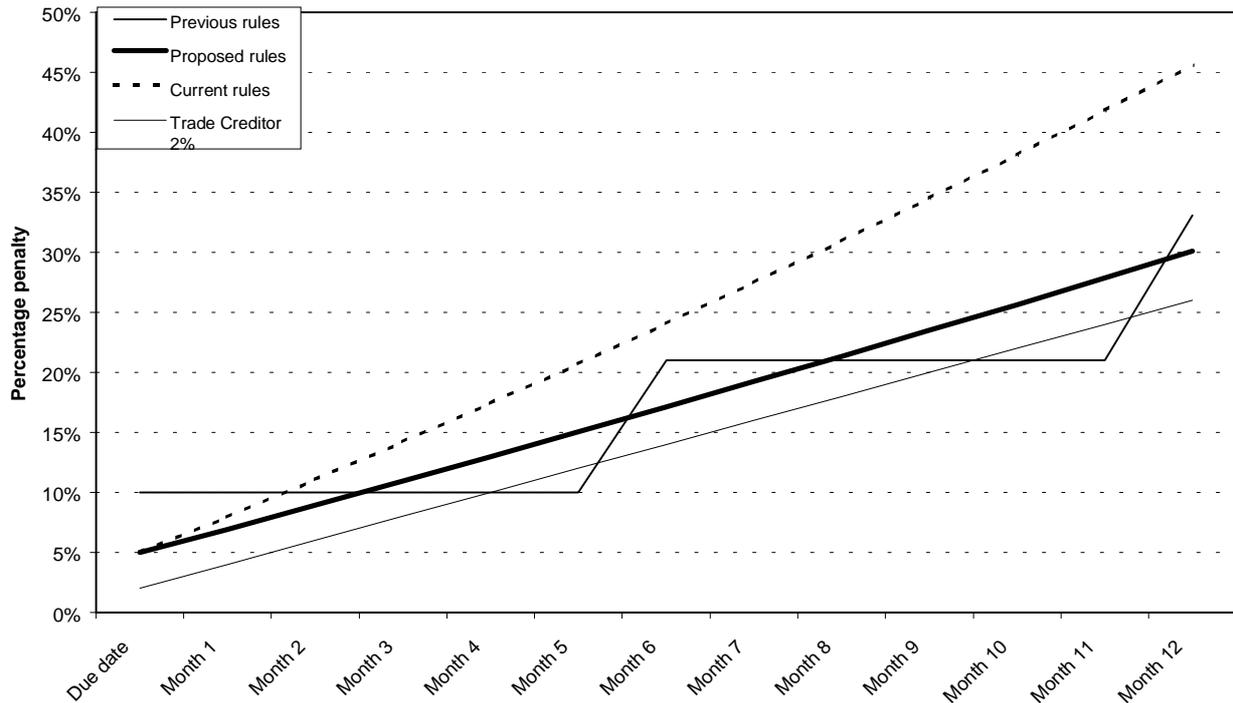
Appropriate enforcement of due dates for payment of tax

- 4.13 The Government proposes:
- reducing the incremental penalty for late payment of tax from 2 percent to 1 percent a month;
 - applying the initial late payment penalty incrementally; and
 - extending to one month the 15-day use-of-money interest ‘grace period’ following the issue of a statement.

Reducing the incremental penalty for late payment of tax from 2 percent to 1 percent a month

- 4.14 The objective of the incremental late payment penalty is to provide a clear, continuing incentive to comply.
- 4.15 Of concern to the Government is whether the incremental penalty is higher than that necessary to ensure the fairness and integrity of the tax system. In other words, can the penalty be lowered while still ensuring voluntary compliance by taxpayers?
- 4.16 Comparison with the private sector treatment of trade creditors shows Inland Revenue charges more, in total, including use-of-money interest, than the private sector. A trade creditor who fails to pay is usually charged 1.5 percent to 2 percent a month, depending on the specific arrangement. This equates to between 18 percent and 24 percent a year. This expense would be deductible to a business.
- 4.17 The level of interest charged by trade creditors provides a useful basis of comparison because there is generally no intention in the ordinary course of business to extend credit without additional security being provided. Thus when a taxpayer does not pay on time, the Crown is in a similar position to a trader.
- 4.18 A reduction in the incremental penalty from 2 percent to 1 percent a month would mean the annualised charge for non-payment of tax due, including use-of-money interest, would be approximately 30 percent a year. The Government considers a rate a few percent higher than that of trade creditors appropriate because:
- Non-paying taxpayers would be inclined to pay trade creditors over Inland Revenue if the rates were identical.
 - It ensures there is a penal element, recognising that the penalty is imposed on taxpayers who fail to meet one of their fundamental tax obligations.
 - The Government has limited control over those who choose to ‘borrow’ from the Crown by not paying their tax.
- 4.19 On these grounds the Government has concluded that the incremental late payment penalty should be reduced from 2 percent to 1 percent a month.

Late payment penalties under different rules



Applying the initial late payment penalty incrementally

4.20 An initial 5 percent penalty applies when the due date for payment passes. The concern expressed to the Finance and Expenditure Committee's Inquiry into the Powers and Operation of the Inland Revenue Department was that this penalty is substantial and excessive when applied to basically honest taxpayers who have failed to comply by only a few days. A number of submissions to that Committee raised the idea of delaying the imposition of the late payment penalty for, say, 30 days. The issue was also considered by the Committee of Experts on Tax Compliance, which recommended a delay of a 'few days' before imposing the 5 percent penalty.

4.21 The Government has identified two approaches to a more phased application of the initial late payment penalty. When considering these options it should be borne in mind that:

- The objective is still to enforce the due date for payment of the tax. A result that merely sees tax deferred by all taxpayers for a period does not address the issue of providing flexibility. The effective payment date is likely to become the 'norm', with taxpayers considering themselves unfairly penalised if they missed that 'norm' by one day.

- Any option which results in significant deferral of payment imposes costs on the Government which eventually have to be borne by all taxpayers in some form.
- The current remission provisions will be retained.

4.22 One approach is simply to defer the application of the initial late payment penalty for seven days. In other words, the late payment penalty would apply seven days after the due date for the payment of the tax. Seven days would give taxpayers time to correct their mistake or approach Inland Revenue if they faced difficulties.

4.23 Advantages of this approach are that it provides a period during which taxpayers who miss the due date can correct that failure at low compliance and administrative cost. The obvious risk with this approach is the concern expressed above, that lack of enforcement of the due date might mean that the 'norm' becomes paying taxes on the day before the late payment penalty applies.

4.24 The benefit to taxpayers is that they would gain a short tax deferral, rather than a lenient treatment of small errors. If a late payment penalty were imposed, the case for remission would be more difficult than at present because the taxpayer would have to establish why payment was a full seven days late, even though the taxpayer had missed the 'norm' date by only one day.

4.25 Another option would be to apply the initial 5 percent late payment penalty, but incrementally. Under this option the due date would be supported by a 1 percent penalty, with a further 4 percent penalty imposed seven days later.

4.26 The advantage is that there would still be an incentive to pay on the due date. Because the initial penalty would be reduced from 5 percent to 1 percent, however, the penalty on a taxpayer who missed that date would not be large. But if the taxpayer did not pay within the seven days, a further 4 percent penalty would apply. After seven days the taxpayer would be in nearly the same position as arises under the current rules.

4.27 It is anticipated that by providing some relief to the application of the initial late payment penalty, there should be fewer applications for remission. A disadvantage of this latter approach, however, is that the 1 percent penalty might still cause taxpayers to believe they have been unfairly treated for failing to pay on the due date. Therefore they would still incur compliance costs to get this penalty remitted, and Inland Revenue would incur administrative costs considering the merits of remission. The Government would welcome submissions on this point.

Extending the 15-day use-of-money interest ‘grace period’ to one month

- 4.28 A ‘grace period’ applies to use-of-money interest when Inland Revenue has issued a statement for taxes due and the amount due is paid within 15 days of the date of the statement. This grace period allows taxpayers to use the interest calculation on the statement and means they do not have to recalculate it.
- 4.29 It is proposed to extend the interest ‘grace period’ to one month. This will reduce the compliance costs associated with a payment that is paid late, but within a reasonable time, because taxpayers will not have to calculate their interest liability on a daily basis. There will be associated administration savings by Inland Revenue.

SUBMISSIONS

The Government seeks submissions on:

- whether reducing the incremental penalty from 2 percent to 1 percent would adversely affect voluntary compliance;
- the approaches to providing flexibility around the tax payment dates discussed in this chapter;
- extending to one month the 15-day use-of-money interest ‘grace period’ following the issue of a statement; and
- other approaches to enforcing the payment dates that might also provide some flexibility.

CHAPTER 5

FAIRNESS AND CLARITY OF TREATMENT FOR THOSE WITH OVERDUE TAX

- 5.1 One of the Government's objectives is to achieve clear, simple and certain tax legislation. This objective is of special relevance to taxpayers facing financial difficulties or serious hardship. A treatment perceived by taxpayers to be understandable and predictable would reduce anxiety and stress and might, in some cases, ensure the survival of businesses in difficulties.

Background

Serious hardship – section 176

- 5.2 Section 176 of the Tax Administration Act 1994 allows Inland Revenue to release taxpayers from their liability to pay income tax and to alter their assessment as necessary for that purpose. This provision applies to amounts of income tax and fringe benefit tax only.
- 5.3 Inland Revenue must be satisfied that serious hardship exists or, in the case of a deceased taxpayer, that the recovery of the income tax owing would cause serious hardship to the beneficiaries of an estate. The discretion is exercised in such a manner '...as to maximise the net present value of any recovery or likely recovery from the taxpayer of any current and future tax amounts.'

Financial hardship – section 177

- 5.4 Under section 177 of the Tax Administration Act 1994 Inland Revenue has discretion to remit income tax or fringe benefit tax if a taxpayer is in financial difficulties. The net present value calculation used for section 176 also applies to this provision. A taxpayer's application for relief must be in writing. Any relief granted may be cancelled if misleading information or further information renders the original grant of relief inappropriate.

Instalment arrangements – section 177

- 5.5 An instalment arrangement is an agreement between a taxpayer and Inland Revenue about the period within which the taxpayer will pay tax owing.

- 5.6 The current position under section 177 is that Inland Revenue may enter into an instalment arrangement if a taxpayer is in financial difficulties and if doing so would maximise the net present value of revenue collection. The provision is restricted to income tax and fringe benefit tax. However, Inland Revenue's authority to collect revenue in section 156 of the Tax Administration Act 1994, in conjunction with the 'care and management' provisions, allows instalment arrangements to be accepted for other types of taxes.

Increased certainty of treatment

- 5.7 The Government has been concerned for some time about possible deficiencies in these provisions. The serious hardship provision has remained largely unchanged since its inception back in the 1930s. The financial hardship provision, introduced in the late 1980s, was intended to address debt forgiveness issues arising from the accrual rules.
- 5.8 Neither set of hardship provisions was reviewed when the current compliance and penalties legislation was introduced.
- 5.9 The Government considers the following amendments may be appropriate:
- *Serious hardship and financial difficulty provisions.* The existing provisions, which apply only to income tax and fringe benefit tax, should be explicitly extended to all taxes, including GST and PAYE. At present, an administrative write-off mechanism is used to achieve a similar result.
 - *Instalment arrangements.* Taxpayers who enter into instalment arrangements should be given certainty with regard to these arrangements, and a partial failure to comply with an instalment arrangement should not result in a disproportionate penalty. Further, these provisions should explicitly apply to all types of tax.
 - *Approval threshold.* The threshold above which approval from the Minister of Finance is required for an instalment arrangement or hardship remission should be raised from \$50,000 to \$100,000.
- 5.10 Consideration of the submissions to the Finance and Expenditure Committee's Inquiry into the Powers and Operation of the Inland Revenue Department identified a number of minor but complex amendments and improvements that could be made in this area. These issues will be considered as part of the post-implementation review of the compliance and penalties legislation, scheduled to begin later this year.

Extension of hardship and financial difficulty provisions to all tax types

- 5.11 At present, the serious hardship and financial difficulty provisions can be applied only to a taxpayer's income tax or fringe benefit tax liabilities.
- 5.12 The policy rationale for this is that income tax and fringe benefit tax are the taxpayer's personal liabilities, whereas taxes such as PAYE are held in trust by the taxpayer for the Crown. It is the taxpayer's duty to withhold these taxes and then forward them on to Inland Revenue. In theory, therefore, withheld taxes should not fall into arrears and thus should not require remission or relief.
- 5.13 In practice, however, taxpayers also face serious hardship and financial difficulties in meeting their tax obligations for taxes other than income tax and fringe benefit tax. In these cases Inland Revenue uses an administrative write-off mechanism to provide a measure of relief.
- 5.14 The current application of the hardship provisions and the write-off rules can lead to inconsistency of treatment and increased compliance and administrative costs associated with the lack of clarity.
- 5.15 The Government considers that a general application of the serious hardship and financial difficulty provisions has merit.

Instalment arrangements

- 5.16 The Government proposes two amendments to the current instalment arrangement provisions.
- 5.17 The first is extending instalment arrangements to all types of tax, as proposed for the hardship remission provisions discussed earlier.
- 5.18 The second is adopting a more flexible instalment arrangement policy. Currently, only on successful completion of an instalment arrangement can incremental late payment penalties be cancelled. In other words, the current incremental penalty of 2 percent each month continues to accrue on the tax owed, with those penalties remitted only at the end of the instalment arrangement.
- 5.19 If a taxpayer defaults in any way on payments during the term of an arrangement, the whole arrangement is cancelled and all accumulated incremental penalties that would otherwise have been cancelled on full compliance are reinstated. The effect is that a partial, possibly small, failure to comply with the provisions of an instalment arrangement results in a disproportionate penalty. This becomes more obvious when a taxpayer fails to comply in some way near the end of an instalment arrangement, leading to a significant accumulation of incremental penalties.

5.20 The Government considers this position inequitable and proposes that each month that a taxpayer complies with an instalment arrangement the incremental penalties in relation to that month be remitted. This approach:

- actively rewards taxpayers for their compliance;
- prevents undue penalties if taxpayers fail to comply, and although they may be penalised for that failure, the penalty should not be excessive; and
- is easier for taxpayers to understand than the current approach.

Ministerial approval threshold in cases of serious or financial hardship

5.21 The hardship provisions require Inland Revenue to seek the approval of the Minister of Finance to remit, refund or enter instalment arrangements for amounts of more than \$50,000. The only time this is not necessary is when a ‘class of case’ (an exemption for classes of taxpayers who meet rules set by the Minister) has been approved.

5.22 The Minister’s role is designed to provide an assurance that Inland Revenue is appropriately applying the hardship provisions in the most significant cases. The requirement to seek approval has a number of disadvantages, however:

- The process can be a time-consuming procedure that causes stress and anxiety for taxpayers who are waiting for approval.
- Delays often affect a taxpayer’s economic circumstances and may act to reduce revenue collection.
- This approach blurs the separation of Inland Revenue’s statutory role of day-to-day tax administration from the Minister’s role of political oversight.

5.23 Balancing these factors, the Government considers it appropriate to increase the threshold from \$50,000 to \$100,000. This has the advantage of maintaining the current check on Inland Revenue’s application of these provisions, in the most significant cases, while allowing most cases to be dealt with expeditiously.

5.24 This proposal also reflects the fact that the discussed extension of these provisions to all tax types may increase the number of requests the Minister of Finance may receive.

SUBMISSIONS

The Government seeks submissions on:

- extending the existing serious hardship and financial difficulty provisions to all types of tax, thus increasing the certainty of treatment of taxpayers;
- extending the existing instalment arrangement provisions to all types of tax and providing for remission of incremental penalties each month as a taxpayer complies with the arrangement;
- increasing the threshold above which approval from the Minister of Finance is required for an instalment arrangement or hardship remission from \$50,000 to \$100,000; and
- other changes that might be considered as part of the reform of the remission and instalment arrangements.

CHAPTER 6

ALIGNING TAX PAYMENT DATES

- 6.1 The Government is concerned that numerous due dates for returns and payment of taxes cause unnecessary compliance costs for businesses. In line with the recommendations of both the Commerce Committee and the Committee of Experts on Tax Compliance, the Government is reviewing payment and return dates and encourages public discussion and submissions on these topics.
- 6.2 This chapter outlines a number of different options for aligning payment dates, setting out the main advantages and disadvantages of these options, and discusses their relative merits. It also discusses the advantages and disadvantages of separating returns and payments.

Background

- 6.3 Returns and payments are generally due together (with the exception of income tax payments and returns). However, different types of taxes are due on different days:
- PAYE is paid either monthly on the 20th of the month following the PAYE deduction or, if the aggregate of PAYE and specified superannuation contribution withholding tax deductions exceeds \$100,000, on the 20th of the month and the 5th of the following month.
 - GST is paid either monthly, two-monthly or six-monthly and is due on the last working day of the month following the end of the taxable period.
 - FBT is paid either quarterly on the 20th of the month following the end of the quarter, annually on 31 May following the end of the income year, or is aligned with the taxpayer's balance date and due on the taxpayer's terminal tax date.
 - Provisional tax is paid on the 7th of the fourth, eighth and twelfth months of an income year, and terminal tax is due, for March balance date taxpayers, on the 7th of the eleventh or thirteenth month after balance date.

- 6.4 Taxpayers who pay PAYE, FBT, GST, provisional tax and terminal tax generally make 19 to 44 tax payments and 16 to 41 returns of information each year.¹

Compliance costs

- 6.5 Both the Committee of Experts on Tax Compliance and the Commerce Committee explained that the compliance cost benefits of amalgamating payment dates are uncertain and cannot be determined without consultation. What are advantages for some taxpayers will be disadvantages for others, and positive and negative compliance cost impacts will need to be balanced.
- 6.6 Efficiencies may be gained if taxpayers address all their tax obligations at one time, make one payment to cover all liabilities, and have fewer contacts with Inland Revenue. Moreover, one constant payment date would reduce the likelihood of a taxpayer forgetting to pay tax and having a late payment penalty imposed. It might also be possible to offset refunds that arise in relation to one type of tax against a liability from another type of tax.
- 6.7 The main disadvantage of aligning payments is that it has significant potential to create cash flow difficulties for businesses with inadequate financial management or accounting systems. The schedule for payments would change from frequent small payments to fewer but larger payments. Although the alignment options discussed in this chapter would have a net overall effect of delaying tax payments, the time-value use of that money to taxpayers might well be outweighed by the effect of large payments on their cash flow.
- 6.8 The Government is also concerned that the extent of any simplification from aligning payments might be limited because many tax calculations are necessary regardless of the due dates for payment of the tax. For example, as illustrated by the Committee of Experts on Tax Compliance, employers must deduct PAYE each pay-day from wage and salary payments, irrespective of the date on which it is paid to Inland Revenue.
- 6.9 If one person has the responsibility for managing all the affairs of the taxpayer, aligning payment dates should result in savings as documents and files would only need to be accessed once. However, if different people handle different types of tax (for example, a payroll officer, the person responsible for GST and perhaps the accountant) there may be less advantage from aligning payment dates.

¹ Either 12 or 24 PAYE returns and payments; between 2 and 12 GST returns and payments; either 1 or 4 FBT returns and payments; three provisional tax payments, one terminal tax payment and one income tax return.

- 6.10 Finally, completing and filing returns together for more than one type of tax and making a single amalgamated payment would require additional calculations to ensure that the total tax liability equalled the tax payment. Furthermore, the work of preparing these cumulative returns is peaked rather than spread.
- 6.11 Choices in payment due dates would result in significant compliance costs for taxpayers. Resources continually expended in working out and implementing the most effective current tax payment strategy would more appropriately be spent on taxpayers' business activity. Therefore the Government considers that any change to payment dates should be applied to all taxpayers or none at all.
- 6.12 Overall, the Government considers the degree of reduction in compliance costs that would be achieved by aligning payment dates is uncertain and would differ from taxpayer to taxpayer. Compliance cost savings would most likely occur for small to medium-sized businesses that rely heavily on external tax accounting support, although they would face greater cash flow risks. Taxpayers with effective accounting and budgeting systems would be able to minimise the cash flow risks identified and take advantage of deferred due dates.

Options for reform

- 6.13 The Government has considered the options of aligning payment dates so that all payments due in a given month would become due on either the 5th, the 20th or the last working day of each month. Given the importance of the collection of PAYE to the management of the Crown's cash flow, large employers would still be required to make two PAYE payments each month.
- 6.14 The appendix contains an illustration of the effect on cash flow of amalgamating tax payments for a taxpayer who pays PAYE, GST, FBT, provisional tax and terminal tax.

Option 1: Payments due on 5th of the month

- 6.15 All payments (other than the second PAYE payment each month from large employers) would be aligned to the closest 5th of each month. PAYE and FBT payments by small employers would be moved from the 20th of the month to the 5th of the following month. Provisional tax and terminal tax payments would be moved two days earlier, from the 7th of the month to the 5th of the same month. GST payments would be delayed from the last working day following the end of the GST period to the 5th of the following month.

6.16 The significant changes from adopting this option are that PAYE and FBT payments by small employers and all GST payments would be delayed. This option creates the least variation from the current schedule of payments and corresponds to one of the current PAYE due dates for larger employers. Moreover, given that most businesses pay expenses near the end of each month, aligning payments to a date near the beginning of the month has the potential to cause the least fluctuation in cash flow. If it is decided to align payment dates, this is the Government's preferred option.

Option 2: Payments due on 20th of the month

6.17 Payments (other than the first PAYE payment each month from large employers) would be aligned to the closest 20th of each month.

6.18 The significant changes from adopting this option are that GST payments would be delayed by about 20 days, from the last working day of the month following the end of the GST period to the 20th of the month following that month. Provisional tax and terminal tax payments would be delayed from the 7th to the 20th of the month. This option has the advantage of being aligned with 12 current due dates for PAYE.

Option 3: Payments due on the last working day of the month

6.19 Under this option all payments would be due on the last working day of the month (except the first PAYE payment for large employers, which would be due on the 15th of the month).

6.20 Significant changes under this option would be that:

- All PAYE payments and quarterly FBT payments would be delayed by approximately 10 days.
- Provisional tax, terminal tax and FBT calculated on an income year basis would be payable sooner, moving from the 7th of the relevant month to the last day of the previous month.

6.21 Although this option aligns payments with current due dates for GST, it does not align payments with either of the two current PAYE payment due dates. It creates the greatest change from the current payments schedule and has the further disadvantage that it creates a varying due date. Because Inland Revenue cannot process all returns received by the end of the day payments are due, uncertainty for the Government's estimates of revenue also arise to the extent of those unprocessed returns.

Returns and other administrative matters

- 6.22 Returns for individual tax types would still need to be completed and filed for the appropriate period. The only change that would ensue from aligning payment dates is that the separate returns would be filed together on the same day. In the future it may be possible to replace individual single-page returns with a multi-page return that includes information required for each type of tax due in the return period. Because of the work already done to streamline GST, FBT and PAYE returns there may not be significant scope to eliminate the amount of information requested, although some opportunities may arise.
- 6.23 Collecting revenue and processing returns is a major component of Inland Revenue's duties. Any change to the payment system would significantly affect the way Inland Revenue functions. Processing cumulative returns and amalgamated payments would cause significant work peaks. It is also likely that Inland Revenue's work in auditing and answering inquiries would peak to a greater extent than it does now. Inland Revenue currently receives amalgamated payments of PAYE, student loan repayments, child support contributions, ACC and specified superannuation contribution withholding tax. Separating and prioritising a greater number of amalgamated payments into their individual tax types would also increase Inland Revenue's workload.

Separating returns and payments

- 6.24 At present, payments and returns for PAYE, GST and FBT are due together. Provisional tax and terminal tax are due separately from the income tax return. The Committee of Experts on Tax Compliance recommended considering separating the flow of information from the payment of tax.
- 6.25 The principal merit of separating returns from the payment of tax is that it may be possible to reduce the number of returns that have to be filed. For example, one possibility could be that a taxpayer registered for GST might pay GST on a two-monthly basis but make an annual GST return.
- 6.26 In the Government's view, separating returns and payments would not enable returns to be filed earlier than they are at present.
- 6.27 The main disadvantage of separating payment of tax from returns is that if information were provided to Inland Revenue less frequently it might delay the identification of differences between assessments by taxpayers and Inland Revenue's audit. This delay could result in an accumulation of penalties and use-of-money interest. Another disadvantage of separating returns from payments is the lack of certainty for the Government in determining the amount of revenue due in a taxable period.

- 6.28 The Government is also concerned that separating returns from payments may increase compliance costs. Given that the underlying calculations have to be carried out to determine the amount payable at the time payments are due, deferring the return but not the payment would cause double handling and therefore increased compliance costs.
- 6.29 On balance, the Government considers that the disadvantages to be gained from separating returns from payments for GST, PAYE and FBT seem to outweigh the advantages of doing so. However, the Government encourages consideration of the matter and, in particular, whether there would be other benefits in separating payments and returns.

Payments due on a non-working day

- 6.30 Payments that are due on a non-working day are accepted as being paid on time if they are received by the next working day. The Government agrees with the recommendation of the Committee of Experts on Tax Compliance that legislating for this administrative practice would reduce uncertainty in payment processes, thereby reducing compliance costs.
- 6.31 Including GST payments in either option 1 or option 2, discussed earlier in this chapter, would mean that if GST became due on a non-working day, like all other payments of tax it would be payable on the next working day. At present, GST is always due on the last working day of the relevant month.

SUBMISSIONS

The Government seeks submissions on:

- what other benefits and costs would arise from separating returns and payment of tax;
- which factors are the most significant in determining whether compliance costs will be reduced by aligning payment dates;
- which of the three options for aligning payment dates offers the greatest net benefit; and
- other changes that could be considered as part of the review of payments.

CHAPTER 7

SIMPLIFICATION OF FRINGE BENEFIT TAX

- 7.1 Fringe benefit tax (FBT) is levied on non-cash benefits provided to employees to ensure that an appropriate level of tax is paid on what is effectively income to an employee. Although this tax is necessary on equity grounds, as well as to protect the tax base from employees receiving their income in kind rather than in cash, the Government wishes to minimise the compliance costs associated with it.
- 7.2 The measures proposed in this section are intended to make the payment of fringe benefit tax both more flexible and certain, especially for smaller employers.

Background

- 7.3 FBT is payable at a rate of 49 percent on the value of fringe benefits provided to employees and shareholder-employees by an employer. This rate was set so employers face the same tax cost in providing fringe benefits that they would in making an equivalent taxable payment to employees on the top 33 percent marginal tax rate. Expenditure incurred in providing fringe benefits is generally deductible in determining the employer's taxable income, as is the fringe benefit tax itself. The main categories of fringe benefits are:
- subsidised or free motor vehicles;
 - low or nil interest loans;
 - employer contributions to sick, accident or death benefit funds, some superannuation funds, and specified insurance policies; and
 - other unclassified benefits, such as subsidised or free goods or services.
- 7.4 An exemption from fringe benefit tax is provided to a limit of \$75 per employee per quarter. This exemption is capped at six employees, meaning a maximum quarterly exemption of \$450. If the threshold is exceeded, FBT is payable on the full value of the benefit. The exemption applies only to unclassified fringe benefits, not other types of benefits such as use of a motor vehicle.
- 7.5 When the annual level of gross PAYE deductions and specified superannuation contribution withholding tax deductions does not exceed \$100,000 for all employees in the business, an employer may elect to pay FBT annually.

- 7.6 Use-of-money interest is charged to offset any payment deferral advantage associated with annual payment. This ensures that this annual payment option is chosen for compliance cost reasons rather than simply to defer tax payment.

Simplification of FBT

- 7.7 The Government is considering the following improvements to FBT:
- removing the requirement to pay small amounts of FBT;
 - removing the use-of-money interest charged on FBT paid annually; and
 - including the payment of GST on the value of fringe benefits in the FBT return.

Removing FBT from small value fringe benefits

- 7.8 Approximately 3,500 employers pay FBT on small-value fringe benefits, as shown in the table.

EMPLOYERS PROVIDING QUARTERLY TAXABLE FRINGE BENEFITS BETWEEN \$1 AND \$450

	<i>June 1997</i>	<i>September 1997</i>	<i>December 1997</i>	<i>March 1998</i>
All categories	3,472	3,640	3,573	3,624

- 7.9 There may be scope to extend the current exemption to all classes of fringe benefits. Extending this exemption would mean that employers who provide fringe benefits (other than unclassified benefits) whose total value is less than \$450 a quarter would no longer be required to account for FBT.
- 7.10 Employers who currently provide only unclassified benefits not exceeding \$450 a quarter would not have their position changed.
- 7.11 The advantage of this measure is that it would reduce compliance costs by allowing the threshold to apply to all classes of fringe benefits. This would mean that employers paying small-value fringe benefits outside the unclassified benefit category would no longer be liable for fringe benefit tax.

- 7.12 The disadvantage of this measure is that employers unable to provide unclassified fringe benefits could begin paying small-value fringe benefits simply as a way to pay employees tax-free rather than for genuine business reasons. The Government does not consider this risk significant because of the limit of \$75 of benefits per quarter per employee and the overall cap of \$450 per quarter.
- 7.13 The Government concludes that this measure would act to reduce the compliance costs imposed on employers in relation to small-value fringe benefits.

Removal of use-of-money interest charged on FBT paid annually

- 7.14 The Government is compensated for the deferral associated with employers choosing to pay FBT annually by imposing a use-of-money interest on the deferred payments.
- 7.15 This ensures that the decision to file and pay annually is not made simply to defer payments. Research undertaken by Inland Revenue, however, shows that taxpayers see the use-of-money interest provisions as complex and a disincentive to file annual returns. Currently, only 500 out of 12,000 eligible taxpayers pay FBT on an annual basis.
- 7.16 This low number could be caused by:
- The use-of-money interest system itself imposing compliance costs.
 - Taxpayers being uncomfortable having an unquantified (at least until after year end) liability accumulating interest.
- 7.17 The combination of these factors appears to discourage the use of an option which has the potential to reduce compliance costs for small businesses. This in turn means a potentially useful simplification option measure is not used to its full potential. Therefore the Government proposes to remove the use-of-money interest charge from those who choose to pay fringe benefit tax annually.

Including the payment of GST on the value of fringe benefits in the FBT return

- 7.18 Employers are required to account for GST as appropriate on the fringe benefits they provide. This is because the provision of the benefit is regarded as a supply for GST purposes. This adjustment for the GST due is carried out on the GST return. In other words, to complete a GST return employers must refer to the value of benefits provided in their FBT return and determine the value of output credits associated with the fringe benefits.

- 7.19 There may be potential to move the payment of the GST from the GST return to the FBT return, thus reducing the risk that this adjustment is overlooked. It would also reduce the need for employers to keep records to ensure that they correctly account for GST on fringe benefits they provide. It may also simplify accounting procedures, because, like fringe benefit tax itself, GST on fringe benefits is an expense.
- 7.20 This change was recommended by the Committee of Experts on Tax Compliance, who noted that it is common for taxpayers to omit the GST on fringe benefits from their GST returns. They suggested that although it may be the taxpayer's fault, the tax system should be designed to minimise the possibility of this type of omission. The Committee supported a legislative correction to this problem.
- 7.21 To place the extent of this problem in context, although a small matter, this omission is the seventh most common discrepancy identified by GST audits.
- 7.22 Incorporating the associated GST into the FBT return would result in small compliance cost savings for the approximately 25,000 taxpayers currently required to account for GST on the fringe benefits they provide. More importantly, it removes the risk of an employer forgetting to include the payment in a GST return and incurring penalties for that oversight.

SUBMISSIONS

The Government seeks submissions on:

- removal of the requirement to pay small amounts of fringe benefit tax by applying the current \$75 per quarter per employee FBT threshold to all classes of fringe benefit;
- removal of use-of-money interest charged on FBT paid annually;
- including the payment of GST on the value of fringe benefits in the FBT return; and
- any other simplification measures which could apply to fringe benefit tax.

CHAPTER 8

SIMPLIFICATION OF PROVISIONAL TAX

- 8.1 The purpose of the provisional tax system is to ensure that taxpayers make regular payments of tax on income that is not subject to some form of withholding tax, such as PAYE.
- 8.2 In the Government's view, it should be possible to make a number of changes to the provisional tax system that will act to mitigate, but not completely resolve, the concerns raised by those consulted. The intention of these changes is to reduce the impact of use-of-money interest and the compliance and penalties rules.

Background

- 8.3 About 250,000 taxpayers pay provisional tax. They range from taxpayers with a single rental property to multi-national companies.
- 8.4 Provisional taxpayers can choose between two methods of calculating their provisional tax: the estimation method, or the standard method of using last year's residual income tax² plus an 'uplift factor', currently 5 percent. In both cases a final terminal payment may be required once the taxpayer completes the end-of-year return and the tax liability is determined.
- 8.5 Individual taxpayers whose residual income tax is less than \$30,000 and who use the standard method of calculating provisional tax are generally excluded from use-of-money interest on provisional tax payments. This is known as the 'safe harbour' from use-of-money interest.
- 8.6 Other taxpayers are subject to use-of-money interest on underpayments and overpayments.

Simplifying provisional tax

- 8.7 The Government is considering three possible provisional tax simplification measures:
- raising the 'safe harbour' threshold for individuals from \$30,000 to \$35,000 of residual income tax;

² Tax liability less any tax credits, such as for PAYE or RWT deducted.

- removing the ‘reasonable care’ standard for all provisional taxpayers whose residual income tax is less than \$35,000 (or \$30,000 if the change discussed above is not made); and
- allowing taxpayers to choose to have tax deducted under the withholding payment regulations.

Raising the safe harbour use-of-money threshold

- 8.8 Consultation has identified that many taxpayers, especially smaller business taxpayers, consider the provisional tax system hard to understand, inequitable in its application and difficult to comply with. To mitigate this the Government proposes to raise the residual income tax threshold over which use-of-money interest applies.
- 8.9 The compliance cost advantage of raising the threshold is that it would reduce the need for taxpayers to estimate income, so would provide greater certainty in calculating provisional tax.
- 8.10 The disadvantage of this measure is its fiscal cost, although the Government considers the compliance cost benefits outweigh the fiscal cost.

Removal of ‘reasonable care’ standard in case of estimation of provisional tax

- 8.11 Consultation shows that many smaller taxpayers do not like the provisional tax estimation option because:
- Use-of-money interest applies.
 - They fear the possible penalties. At present, taxpayers can attract a penalty for ‘lack of reasonable care’ in making an estimate, possibly ‘gross carelessness’ and, if intent to underestimate is proven, evasion. The imposition of these penalties is considered as part of an Inland Revenue audit.
- 8.12 The automatic penalty that used to apply to underestimates of provisional tax was repealed two years ago. This alone considerably simplified estimating provisional tax.
- 8.13 It may be possible to further reduce the concerns of small businesses by reducing the risk associated with estimation. This could be done by setting a threshold under which taxpayers would be liable for penalties on an estimate only if they were grossly careless in making the estimate.

- 8.14 The benefits of this measure are that:
- It would reduce the concern taxpayers face when estimating their income.
 - More taxpayers might estimate their liability, making their provisional tax payments during the year more accurate. Apart from the direct benefit of more accurate payment, many taxpayers would have freed-up funds to invest in their business during the year.
- 8.15 An appropriate threshold requires balancing the potential impact on Government revenue through deferred payments and increased certainty of treatment for taxpayers. Bearing these factors in mind, the Government concludes that a reasonable care penalty threshold should cover the bulk of taxpayers while ensuring that the tax paid by larger taxpayers was still covered by a requirement to estimate reasonably. Thus if the measure to raise the individuals' safe harbour threshold is supported by submissions, all taxpayers with less than \$35,000 residual income tax liability (or \$30,000 if the 'safe harbour' threshold is not extended) would have to be at least grossly careless in estimating before attracting a shortfall penalty.

Voluntary election into withholding payment regulations

- 8.16 The Income Tax (Withholding Payments) Regulations 1979 specify levels of withholding which apply to various types of income. If a payment for a service is not covered by these regulations, no withholding tax applies. Such income is subject to the usual provisional and terminal tax rules.
- 8.17 These regulations could be amended to allow taxpayers to:
- elect into the regulations (should both the payer and the payee agree);
 - choose which withholding rate to apply should they elect into the regulations.
- 8.18 The advantage of this measure is that it would provide an option for taxpayers not currently covered by the withholding rules to gain the benefits of having their tax deducted at source. These benefits include not having to pay provisional tax and paying tax on income as it is earned.
- 8.19 The Government is concerned that the number of taxpayers who may use this option may be small, thus not justifying the compliance and administrative costs associated with establishing it. The Government would welcome submissions on this point.

- 8.20 Although the measure would reduce the compliance costs faced by those currently paying provisional tax, there would be an increase in costs for those required to withhold the tax and pay it to Inland Revenue. The Government considers this cost is outweighed by the benefits to the payee. The payer would be compensated by the benefit of holding the money deducted until it has to be paid to Inland Revenue. Finally, if the payer were already in the PAYE or withholding payment systems, the marginal cost involved in withholding tax in these further cases would probably be small.
- 8.21 When using this option the payee would be required to ensure that a reasonable withholding rate applied.
- 8.22 The Government is concerned that this option could be used to manipulate provisional tax payments. This could be done, for example, by electing an accurate withholding rate one year and then leaving the scheme the next year and returning to the provisional tax system, which would result in artificially low payments of provisional tax for that year.
- 8.23 To address this concern it seems appropriate that taxpayers using this option would be subject to use-of-money interest if they become liable to pay provisional tax. Alternatively, there could be a limit on the lowest withholding rate that could be elected, such as 20 percent. The Government requests submissions on this issue.

SUBMISSIONS

The Government seeks submissions on:

- increasing the threshold for the individuals' safe harbour from use-of-money interest from \$30,000 residual income tax to \$35,000;
- removing the reasonable care standard for all taxpayers with less than \$35,000 (or \$30,000) residual income tax;
- allowing taxpayers to elect into the withholding payment regulations;
- whether those who use this option should be liable for use-of-money interest if they become a provisional taxpayer and whether there should be limitations on the appropriate withholding rate; and
- any other simplification measures which could apply to provisional tax.

CHAPTER 9

REVIEW OF INFORMATION ON TAX RETURNS

9.1 The Government wants to ensure that taxpayers need provide only necessary information on tax returns, and that they provide it only once. This should also apply to associated forms such as disclosure and election forms.

9.2 The Committee of Experts on Tax Compliance discussed the issue of information provision and recommended that:

...the department should consider reviewing each of the purposes of the tax return to decide whether the return remains the most appropriate vehicle for these functions. It may be that the tax return could simply be a pay-in slip, with the other purposes of a tax return being dealt with independently.

9.3 The law now requires taxpayers to provide Inland Revenue with information necessary for it to assess taxpayers' tax liability. Except in the case of wage and salary earners, who now receive income statements when appropriate, this means that taxpayers are required to provide not only a statement of their tax liability, but also the underlying accounting summaries, such as IR 10s. For example, small companies may provide the same information, such as interest income, twice, once in the return and a second time on the IR 10 form. Likewise, trustees are sometimes required to provide information that is unnecessary or duplicated elsewhere.

9.4 Although under self-assessment taxpayers have the obligation to calculate their own tax liability, tax returns are still required for a number of other reasons. These include for forecasting Government revenue, costing policy proposals, and audit and other enforcement purposes. Statistics New Zealand and other government agencies may also use the information. Information provided for these purposes would still be required.

9.5 For these reasons the Government considers a review of information requirements may only lead to small reductions in compliance and administrative costs.

SUBMISSIONS

The Government seeks submissions on:

- information provided to Inland Revenue which taxpayers consider may be duplicated or in some way unnecessary;
- comments on potential simplifications that could be made to disclosure and election forms.

APPENDIX

APPENDIX

ALIGNING TAX PAYMENTS

The effect on cash flow of aligning tax payments will vary from taxpayer to taxpayer according to:

- what taxes they pay;
- seasonal fluctuations in income and expenditure;
- how large their individual payments are;
- whether they are a small employer or a large employer; and
- whether they are eligible for extensions of time to make payments.

Cash flow example

Figures 1, 2 and 3 illustrate the cash flow effect on a hypothetical 'average' small business taxpayer of the three payment date options discussed in chapter 6. This taxpayer is a small employer who pays GST, FBT, provisional tax and terminal tax. The taxpayer has to make payments during the year of \$79,000, made up of:

- \$28,000 for GST;
- \$20,000 for provisional tax (current year);
- \$9,000 of terminal tax (from previous year's income);
- \$19,000 for PAYE (paid monthly); and
- \$3,000 for FBT.

The taxpayer's PAYE, GST and FBT liability is spread evenly during the year. GST is paid two-monthly on a category A basis, and the taxpayer has an extension of time to pay terminal tax. The taxpayer currently makes six payments of \$4,666.66 for GST, three payments of \$6,666.66 for provisional tax, twelve payments of \$1,583.33 for PAYE, four payments of \$750 for FBT and one payment of \$9,000 for terminal tax.

The figures show the due dates and payment size of current payments compared with the amalgamated payments resulting from each of the alignment option. The position of the payments on the vertical axis show when payments are due each month. The size of the bar of each payment is proportional to the amount of tax that would be paid.

Figure 1

Option 1: Payments aligned to the 5th of the Month

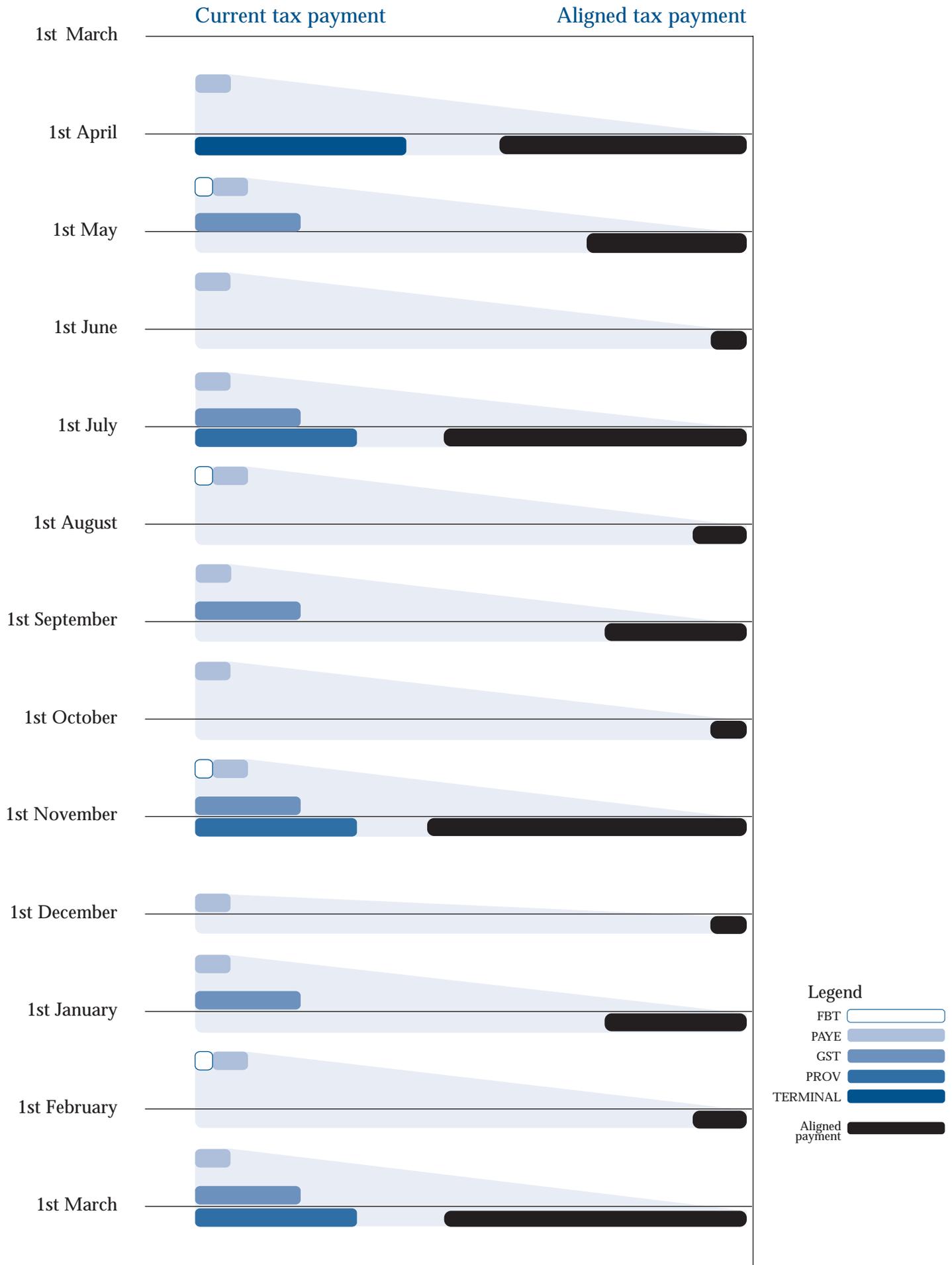


Figure 2

Option 2: Payments aligned to the 20th of the Month

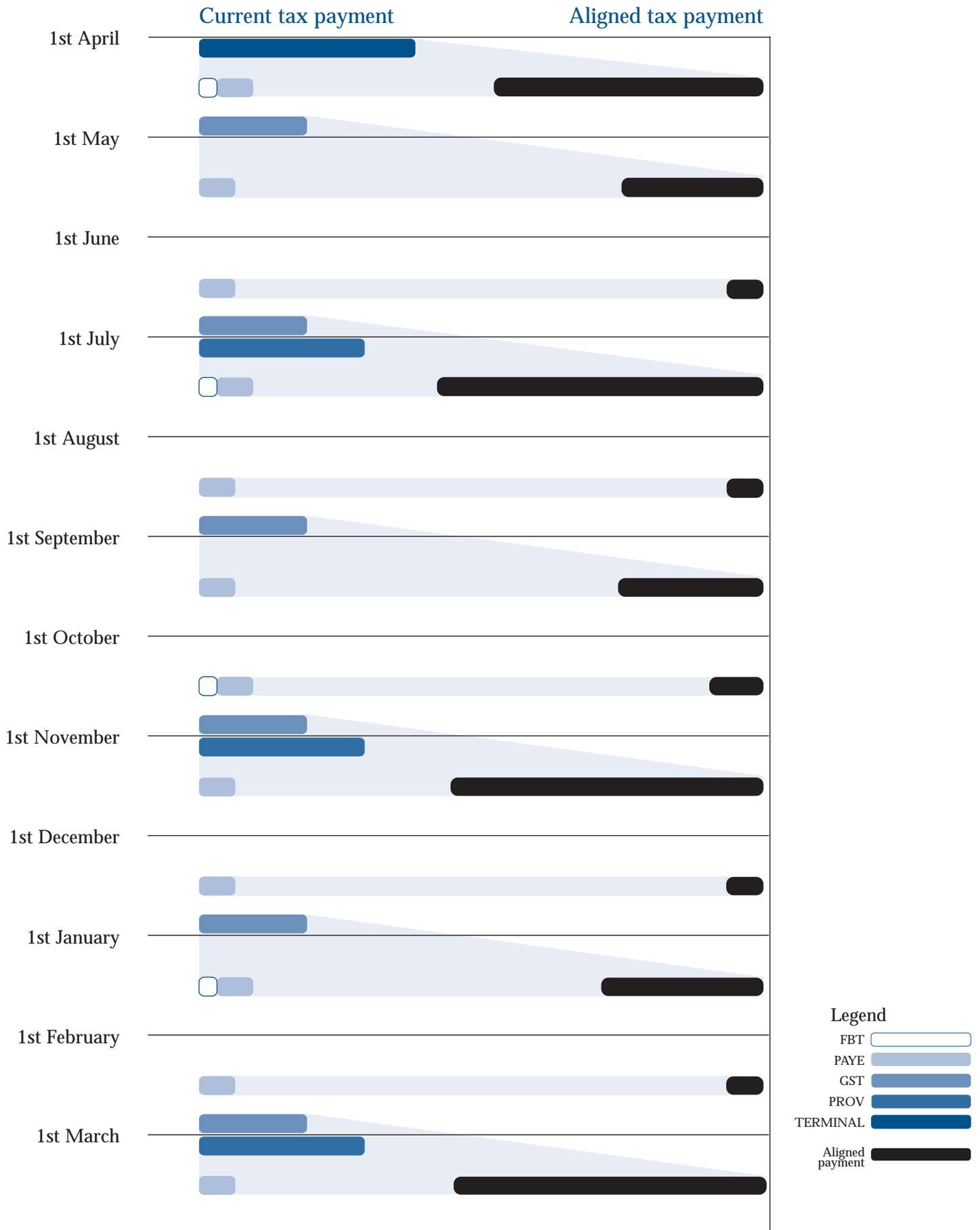


Figure 3

Option 3: Payments aligned to the last day of the Month

